A framework for mergers and acquisitions due diligence: Lessons from selected REITs in South Africa.

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ABSTRACT

In April 2013, the South African listed property sector converted from Property Unit Trust and Property Loan Stock investment structures into a Real Estate Investment Trust (REIT) structure that is understood globally. This conversion spurred consolidations in the property market in the form of mergers and acquisitions. Research shows that mergers and acquisitions tend to have high failure rates as growth strategies.

It remains unknown how sufficient traditional due diligence is and how it can be improved to enhance the chances of successful corporate marriages within the South African REIT market. This paper reviews the aspects of the traditional due diligence scope which generally comprises of financial, legal and commercial due diligence in order to determine its adequacy as a decision making tool that helps reduce the risk of failure in REIT merger and acquisition transactions in South Africa.

There is consensus in the literature that due diligence is a means to reduce the risk of merger and acquisition failure, some studies suggest that failure occurs when due diligence is not done well. This paper uses interviews conducted with due diligence professionals from seven REIT companies listed on the Johannesburg Stock Exchange who were involved in large merger and acquisition transactions in the preceding four years. The interviews were used to ascertain how the professionals perform due diligence, whether or not they think that traditional due diligence is sufficient for REIT mergers and acquisitions and to solicit their views on how the due diligence scope can be expanded. Transcribed data from each of the interviews was analysed based on three concurrent sub-processes adapted from the works of Miles and Huberman (1994) which consist of data reduction, data display and drawing and verifying conclusions.

The results show that the traditional due diligence scope is not sufficient for REIT merger and acquisition transactions, a majority of the respondents agree with this observation. Encouragingly the professionals within the South African REIT market have a due diligence scope which is already much wider than the

traditional scope, be that as it may, there is still a high failure rate of 59% observed in the sample analysed.

Due diligence professionals have a low regard for understanding and resolving the different companies cultural issues, this is cited in the literature as one of the contributing factors for merger and acquisition failure. This is an area that can possibly augment the due diligence cycle and professionals should focus on it in order to improve the chances of success. The research proposes expanding the due diligence scope by incorporating strategic due diligence which is forward looking and it overcomes the challenges of traditional due diligence of relying on historic information. Strategic due diligence assists the acquirers understand the target’s future prospects, and it allows the acquirers to determine if the target prospects fit with their own strategic objectives. This together with a higher focus on understanding and resolving cultural issues of the merging companies should augment the traditional scope and ultimately lead to transactions that yield higher shareholder value.

DECLARATION

I, Yongama Mabece, declare that this research report is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Building Science in Property Development and Management in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Yongama Mabece

Signed at Pretoria

On the 09th day of February 2018

DEDICATION

Firstly, I dedicate this work to my grandmother, Mrs. I.T Ngaleka, my source of inspiration and motivation in seeing this research project through to the end. Khulu, you may have not lived to see me graduate but I take comfort in knowing how proud you would have been of me. Lala ngoxolo.

Secondly, I dedicate this work to my parents who saw it fit to sacrifice so much so that I could get the best education that they could afford, more so my mother Ntombizodidi Mabece who instilled in me at an early age the importance of education.

I also dedicate this to my younger sister Yonela Mabece; I hope I inspire you to go even further in your studies; we need a PhD graduate in the family.

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I would like to thank my research supervisor Mrs Prisca Simbanegavi whom without her guidance this research may have never been completed.

I thank my friends, girlfriend Masego Sibiya and family who supported me through this journey, thank you for understanding when I missed all those social events and family gatherings, now you will have my undivided attention.

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CHAPTER 1. INTRODUCTION TO THE RESEARCH

1.1 Chapter Introduction

This chapter introduces the research report with a presentation of the purpose of the study, the context in which the study is undertaken, the problem statement, the significance of the study, the main research questions, delimitations of the study, the assumptions made as well as the research proposition.

1.2 Purpose of the study

A good due diligence framework is necessary to improve the prospects of superior investment performance and mitigate the loss exposure. As mergers and acquisitions (M&A) become increasingly more complex, the activities of due diligence become more important (Perry & Herd 2004). By understanding the due diligence processes, decision makers and investors in Real Estate Investment Trusts (REITs) will have more reliable information on which to base their decisions on whether to transact or walk away from a deal.

The purpose of this research firstly is to understand how effective the traditional due diligence process is and secondly whether the expansion of the scope is necessary in order to reduce failures in South African REIT merger and acquisition transactions. The outcome of this will be the recommendation of an improved merger and acquisition due diligence framework informed by the literature review drawn from various studies focusing on different backgrounds and the views of due diligence professionals within the South African REIT market. It is necessary to embark on this process for better merger and acquisition transaction outcomes.

1.3 Context of the study

REITs are globally recognised and accepted property investment vehicles used in more than 25 countries including South Africa (SA REIT Association 2016). A

REIT allows investors the ability to invest in property assets through vehicles that provide for tax transparent treatment (Miller 2015). In South Africa, the recently amended Income Tax Act 58 of 1962 through section 25BB essentially aims to provide certainty to investors in REITs with respect to the tax position of the REITs and to make it uniform with the rest of the world.

Prior to the current REIT legislation, there were two forms of publicly traded property investment entities in the country. There were Property-Loan Stock (PLS) companies and Property-Unit Trust (PUT) companies, these fulfilled the function of REITs but they were subject to different tax treatments and regulated under different Acts. The PLS stocks were regulated in terms of the Companies Act 71 of 2008 whilst the PUT were regulated in terms of the Collective Investment Schemes Control Act 45 of 2002 (Miller 2015). The current legislations aligns the South African investment structures with international ones in that it clears up the conflicting tax interpretations. Having a REIT structure not only aligns the South African listed property sector with the rest of the world but it also opens it up to a broader market.

The definition of a REIT in the amended Income Tax Act is a South African tax resident company with shares listed as a REIT on the JSE. Miller (2015) explains that in order to list as a REIT, companies need to comply with the JSE Listings Requirements that state a REIT must:

- Own property with a value in excess of R300 million
- Maintain its debt below 60% of its gross asset value
- Earn 75% of its income from rental or from property owned or investment income from indirect property ownership
- Have a committee in place to monitor risk
- Must not enter into derivative instruments that are not in the ordinary course of business, and
- It must distribute at least 75 per cent of its taxable earnings available for distribution to its investors each year.

With four years having passed since the REIT structure was introduced in South Africa; after it came into effect on 01 April 2013; many companies which previously operated either as a PLS or a PUT have converted to a REIT structure which has aligned the local listed property sector with other property sectors in the world. As at June 2014, the South African REIT market was valued at approximately R250 billion and it was ranked eighth in the world by size (Anderson 2014), by December 2016 this figure had increased to approximately R380 billion, a 52% increase in a period of two and a half years (SA REIT Association 2016).

Figure 1: SA REIT Market Capitalisation

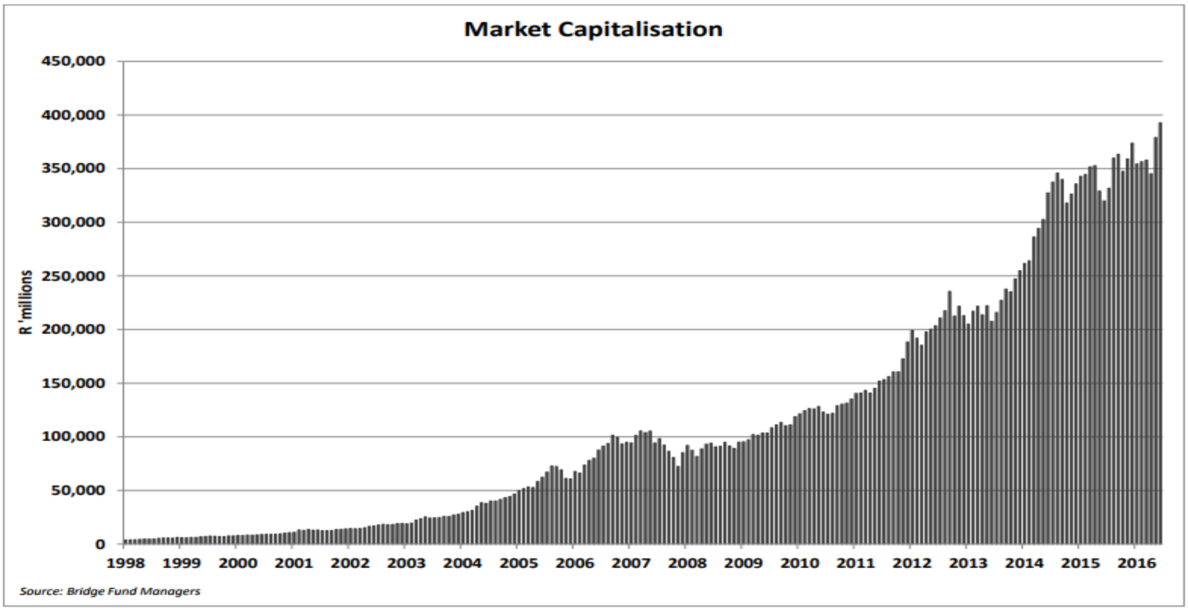
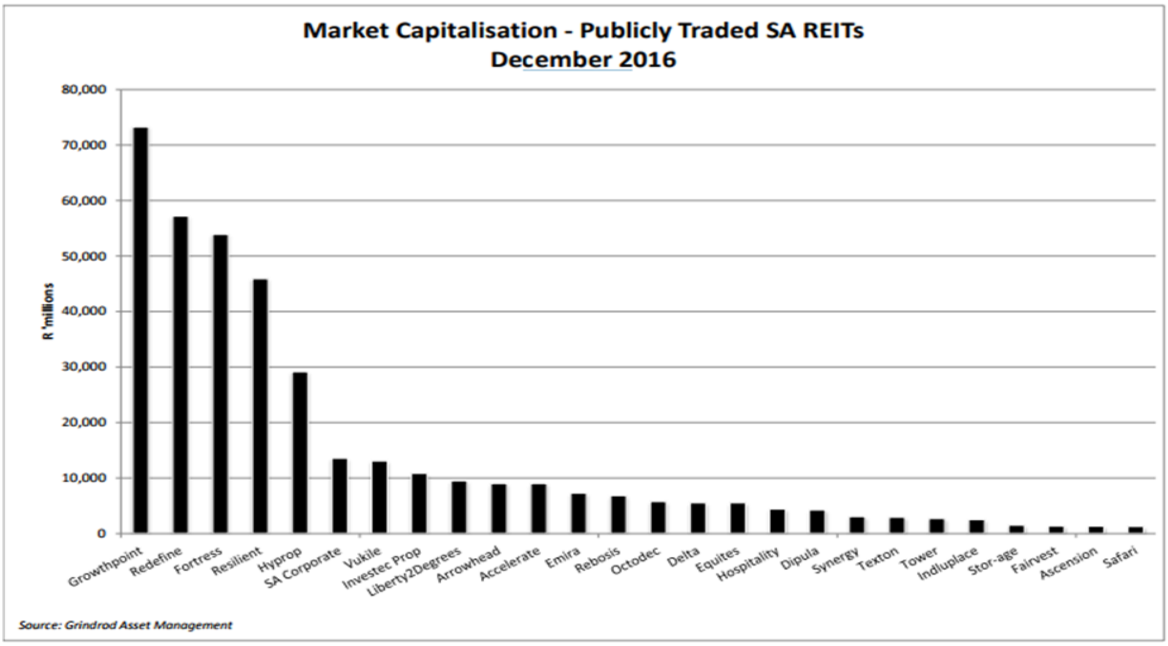


Figure 2: Market Capitalisation – Publicly Traded SA REITs



Source: SA REIT Association Monthly Chart Book, (SA REIT Association, 2016)

Since the introduction of the REIT structure in South Africa, foreign investors have shown interest in the local listed property market (Mhlanga 2013); foreign investors are familiar and comfortable with REIT structures, and that makes South Africa a more attractive listed property investment destination in the global sense.

The introduction of the REIT structure in South Africa and the interest shown by foreign investors has spurred consolidations in the sector (Odendaal 2014). Odendaal (2014) notes that most REITs pursued consolidations as a growth strategy in order to gain scale to compete in the sector. Such consolidations usually take the form of either mergers and/or acquisitions. Aluko and Amidu (2005) explain the difference between a merger and an acquisition as follows:

- A merger is an amalgamation of the undertakings or interests or any part of the undertakings of one or more companies and one or more bodies. They emphasise that a merger contemplates a transfer of properties and liabilities of one or more companies to another; however, it excludes non-transferable rights such as contracts of personal service. A fundamental characteristic of a merger according to them is that the acquiring company takes over the ownership of the other company and combines their operations with its own operations.

- An acquisition on the other hand is an act of acquiring effective control by one company over assets or ownership and management of another company or companies without necessarily combining the companies. The difference is that in an acquisition, two or more companies may remain independent separate legal entities but there will be a change in control of the companies.

Mergers and acquisitions are accepted growth strategies that can achieve increased shareholder wealth; however, there are many examples of failed merger and acquisition transactions for various reasons involving large corporations (Bertoncelj & Kovac 2007). Harvey and Lusch (1995) argued that many prominent deals of the 1980s were done with cursory due diligence resulting in some mergers and acquisitions failing to increase shareholder wealth. A cursory due diligence suggests that the due diligence process may not have been thoroughly conducted and that only what was deemed important for a particular transaction was considered for the due diligence. Due diligence done in this manner does not sufficiently reveal the inherent risks in a transaction. In a later study also by Harvey and Lusch (1998), it was noted that some of the failures may also have been due to inadequate integration where the due diligence process ended too soon after the merger or acquisition. Merger and acquisition failure is attributable to a myriad of other factors such as off strategy decision making, poor synergy, bad timing, and incompatible cultures. A way to address these is to apply due diligence best practice, which reduces the risk and improves the chances of success in merger and acquisition transactions (Perry & Herd 2004).

As seen above there are many reasons for merger and acquisition failure. With more consolidations expected in the South African REIT market due to smaller companies trying to gain scale and compete in the sector (Odendaal 2014), it is important to understand due diligence practices that can mitigate risk and improve the chances of success. Naschescu (2010) who states that the planning of the merger and acquisition activities and the use of due diligence reviews leads to the success or failure of the operation supports this view. Therefore, a well understood due diligence process within the South African REIT perspective is necessary for the success of future mergers and acquisitions in the listed real estate market.

This study aims to outline the broad due diligence processes needed to reduce the risk of diminishing shareholder wealth in merger and acquisition transactions involving South African REITs.

1.4 Problem statement

There are numerous cases of failed merger and acquisition transactions cited in literature (McDonald, Coulthard & de Lange 2005, Bertoncelj & Kovac 2007, Morrison, Kinley & Kistin 2008, Hao & Guoqiang, 2013). With the recent REIT structure, there is a lot of corporate action where real estate companies look to grow their portfolios through M&A in order compete in the market; shareholder value is at risk if due diligence processes are not understood and done properly in the pre and post deal phase of a merger and acquisition transaction. Although due diligence has been studied extensively in M&A across various industries and countries, there is still limited research focusing on listed real estate mergers and acquisitions in South Africa and the applicable processes to help preserve shareholder value in the newly embraced REIT market. Yet the function of due diligence is central to effective functioning of the real estate capital market and shareholder wealth preservation (Roulac 2000). Mergers and acquisitions are relied on as growth strategies even though historically there has been a high failure rate. A study conducted by KPMG using a sample frame from the top 700 cross border deals by value between 1996 and 1998 found that only 17% of those deals had added value to the combined company, 30% produced no discernible difference and 53% destroyed value. This translates to an 83% failure rate where M&A were used as a growth strategy (Kelly, Cook & Spitzer 1999).

The literature also shows that there is a high failure rate with various scholars estimating it to range between 50% and 80% in more recent studies (McDonald et al. 2005, Bertoncelj & Kovac 2007, Morrison et al. 2008 and Hao & Guoqiang 2013). According to Cron (2015), there are additional hurdles that are specific to the South African market that could affect the success or failure of mergers and acquisitions; these include the requirements to meet Black Economic Empowerment (BEE) objectives and the stringent labour laws. BEE requirements compel the transacting parties to structure any deal and the merged business in such a way that necessary elements of the BEE scorecards are achieved, labour laws require that a purchaser of a business takes over the existing labour force on existing terms and conditions. This places an extra burden on the transacting parties to make sure that these considerations are taken into account. These factors fall outside of the scope of the present research but they are important to note as they could potentially place the failure rate in South African mergers and acquisitions even higher than the ones quoted from the literature.

With more consolidations expected in the listed property sector (Grindrod Asset Management 2014), it is prudent to ask – is the traditional due diligence scope sufficient and how can it be improved to reduce the high failure rate in M&A and should a different kind of due diligence approach be adopted? It remains unknown how this process can be improved to enhance the chances of successful corporate marriages within the South African REIT market. In South Africa, there is a limited framework guiding the due diligence process into successful M&A especially for REIT transactions given the short period since the REIT dispensation has been in existence. The consequences of a lack of understanding of the due diligence processes are that the same mistakes could be repeated where decision makers enter into merger and acquisition transactions without having sufficiently reviewed the inherent risks in the transaction, they may enter into agreements that are not value enhancing. This would present the South African REIT market as being too risky to shareholders and therefore deter future investments in REITs listed on the JSE

This study is an attempt to resolve this problem by providing an improved due diligence framework for the South African REIT market.

1.5 Significance of the study

Mergers and acquisitions are one of the favoured methods of achieving growth targets, appeasing stakeholders and increasing shareholder value (McDonald et al. 2005). They are central techniques for overall organisational growth; likewise, the South African listed property sector has seen aggressive merger and acquisition activity since the conversion to a REIT structure, this is in pursuit for growth and increased shareholder value (Grindrod Asset Management 2014). Given the high failure rates associated with a merger and acquisition growth strategy, the results of this research can add to the body of knowledge on how future due diligence assessments should be conducted in order to reduce the failure rate and to preserve shareholder value, particularly in South African REIT mergers and acquisitions.

1.6 Research Contribution

The contribution of this study is to resolve principles of the due diligent process within REITs and provide an improved due diligence framework for the South African REIT market. The study hopes to provide guidance on how a proper due diligence should be done within the new REIT structure as failure to do so would have huge impact on shareholder value. Due diligence that is done well will reduce the risk of acquiring assets that are not value enhancing.

1.7 Research Questions

In order to guide the scope of this study and answer the main research question of "how can the traditional due diligence processes be improved to reduce the high failure rate in mergers and acquisitions?" there needs to be sub questions. The sub-questions need to be posed to thoroughly investigate whether or not improved due diligence assessments can reduce merger and acquisition failures in REIT transactions. These are:

1. What are mergers and acquisitions within a South African real estate context?
2. Is there a basis for the continued use of mergers and acquisitions as growth strategies?
3. Why do a high number of merger and acquisition transactions fail to meet shareholder expectations?

4. Is the traditional due diligence process sufficient for REIT merger and acquisition transactions within the South African listed property sector?
5. How should due diligence analyses be performed and what are the critical success factors for real estate merger and acquisition projects?

1.8 Delimitations of the study

The study focuses on the due diligence processes as applied in the South African commercial real estate market. Specific attention is placed on merger and acquisition transactions between property funds listed on the JSE. It reviews the due diligence process in order to identify where changes can be made that can improve the chances of success in REIT merger and acquisition transactions. The review will inform the framework of an improved due diligence assessment.

In terms of mergers and acquisitions, success does not only mean that the new formed entity generates more wealth for the shareholders. It could also mean that the primary objectives of the transaction are fulfilled, as they would have initially be determined. These objectives could be that the managers were looking for higher incomes, better market share or entering markets where an organisation is underrepresented (Naschescu 2010). For the purpose of this study, success will be limited to an increase in shareholder value as measured by the movement in the share price 1 year post the announcement of the conclusion of a deal, the inverse will apply for defining failure in mergers and acquisitions. A similar approach was adopted by Kelly et al. (1999) in a KPMG study where M&A success was measured using a benchmark based on an increase or decrease in share price.

1.9 Assumptions

The following three assumptions guide this study.

1. The outcomes of due diligence studies inform the decisions taken by dealmakers in real estate merger and acquisition transactions.
2. Largely, the success or failure of a merger and acquisition transaction is dependent on the quality of the pre-acquisition due diligence.

3. If the quality of the due diligence assessments is improved, there will be a higher probability of success for mergers and acquisitions and shareholder value will be preserved rather than destroyed.

1.10 Research Gap and Proposition

Due diligence is listed by both professionals and scholars as one of the key success factors in mergers and acquisitions (Kelly et al. 1999, Schuler & Jackson 2001, Epstein 2005). Its role is to assist acquirers understand and evaluate potential merger and acquisition targets, identify risks and strengthen their bargaining position. It should help identify, prevent and manage material risks that threaten the long-term prospects of post-acquisition success. The reported high failure rates in mergers and acquisitions therefore means that due diligence assessments are not achieving their objectives. Critical reasons put forward for this range from weak or inadequate due diligence assessments (Harvey & Lusch 1998) to downsizing or delegating important due diligence work (Hao & Guoqiang 2013). Seemingly, the problem is not that due diligence assessments are not done but they are not done well (Perry & Herd 2004).

Should some of the reasons for failed mergers and acquisitions that specifically relate to due diligence investigations be understood and addressed, there will be a higher probability of successful transactions that ultimately increase shareholder value. Wangerin (2010) agrees, stating that obtaining better quality information through the process of due diligence may lead to improved identification and valuation of assets and liabilities intended to be acquired; this reduces the risk of acquiring assets that are not value enhancing.

1.11 Organisation of the research report

The arrangement of the research report is as follows: Chapter 1 is an introduction of the study; Chapter 2 presents the literature review of previous empirical evidence. Chapter 3 then deals with the description of the data collection techniques and the methodology adopted in this study. Chapter 4 follows with the presentation of the summaries of research results; Chapter 5 presents the interpretation and discussion around the results. Lastly, Chapter 6 presents the conclusions made and recommendations on areas of further study.

CHAPTER 2. LITERATURE REVIEW

2.1 Chapter Introduction

This chapter answers the first, second and third questions of what mergers and acquisitions are within the South African context. It is broken down into three sections, the first section contains a literature review on mergers and acquisitions and a presentation of the key empirical findings from the literature on the performance of mergers and acquisitions. There is also literature review of the traditional due diligence and suggestions of newer and improved due diligence practices. The chapter closes with conclusions of the literature review.

The chapter starts with a background to mergers and acquisitions as defined and understood within the South African context followed by a study of the motives behind acquirers' decisions to merge with or acquire other companies. An analysis of whether or not there is a basis for using mergers and acquisitions as growth strategies follows; the research questions why there is such a high failure rate in M&As if there is a basis for this approach and what can be done to reduce it.

The second section of the literature review includes an introduction to due diligence which serves as a background to the history of due diligence and how it is defined by the various scholars in different disciplines as well as how the term is defined within mergers and acquisitions. There is then a discussion on the place of due diligence in the merger and acquisition process, this is to give a holistic view of the merger and acquisition process and to show the importance of due diligence in achieving the acquiring company's strategic objectives.

There is then a presentation of the types of due diligence and a discussion on the adequacy and issues of the traditional due diligence in mergers and acquisitions. This is required to develop a more comprehensive understanding of the processes involved. The research then explores the need for an expanded due diligence framework looking at the various suggestions put forward in literature. The last section focuses on strategic due diligence, what it offers in terms of reducing merger and acquisition failure. Finally, the chapter concludes on the literature review.

2.2 Mergers and Acquisitions (M&A)

Broadly speaking the term mergers and acquisitions refers to the principle of one company buying another one or more companies to create shareholder value that is over and above the sum of the individual companies. It is a strategy used by companies hoping to gain a greater market share or to achieve greater efficiency (McClure 2016).

2.2.1 *Concept and Definitions of M&A*

In literature the term mergers and acquisitions is defined as the combination of two or more companies into one new company with the main difference between the two being the manner in which the combination of the companies is brought about (Roberts, Wallace & Moles 2010, Gaughan 2011). Despite the manner of combination the main purpose of M&As is to create shareholder value that is over and above the sum of the individual companies (Gupta 2012).

In a merger, ussualy there are two companies involved which must relatively be comparable in stature. These companies come together and drawing from the best attributes of the two individual companies; they form a completely new organization (Epstein 2005). An aqcuisition on the other hand involves the fitting of a smaller company into the existing structures of a larger company (Epstein 2005). This gives credence to Aluko and Amidu’s (2005) definition, therefore a broad outline of what mergers and acquisitions are has been established. What remains however is to consider what mergers and acquisitions mean within the South African context to have a working definition for the present research.

The cornerstone of the South African legislative framework for mergers and acquisitions is the Companies Act 71 of 2008 (Davids & Hale 2011), the Act regulates fundamental transactions which include mergers and disposals of all or the greater part of the assets or undertakings of a company (Davids & Hale 2011). Another key piece of legislation according to Davids and Hale (2011) is the

Competition Act 89 of 1998 and the listing requirements of the JSE for transactions involving companies listed on the exchange. A brief discussion of the definitions set out in these two pieces of legislation and the JSE requirements is presented below.

2.2.2 *Companies Act no. 71 of 2008 Definition*

Section 1 of the Companies Act uses the term “amalgamation or merger” which means a transaction, or series of transactions pursuant to an agreement between two or more companies, resulting in –

a) The formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or
b) The survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.

2.2.3 *JSE Listing Requirements*

The JSE Listing requirements adopts the Companies Act definition for amalgamation or merger but defines the term “acquisition issue” as the issueing of securities in consideration for an acquisition of assets or net assets, or an amalgamation or merger with another company in consideration for the securities of that other company and specifically excluding issues for cash.

This definition of acquisition issue as it appears in the JSE listing requirements implicitly links the term amalgamation or merger with acquisition giving a sense that the term mergers and acquisitions can be used interchangeably.

2.2.4 *Competition Act no. 89 of 1998 Definition*

According to section 12 of the Competition Act, a merger is the direct or indirect acquisition or establishment of control by one or more companies over the whole or part of another company. It further states that a merger may be achieved in any of the following manner -

a) The purchase or lease of the shares, an interest or assets of the target company; or
b) The amalgamation or other combination with the target company

The Competition Act uses the term “acquire” to define “merger”. This is borne by Schedule 3(4) (c) of the act which states that an “acquisition” as defined in terms of section 1 of the Maintenance and Promotion of Competition Act, 1979 (Act No. 96 of 1979), must be regarded as a reference to a “merger” in terms of this Act. This is a direct indication that the term merger and acquisition is used interchangeably in pieces of South African legislation.

2.2.5 *Working definitin for the Study*

As seen in the various definitions above, there are differences between the terms “merger” and “acquisition”, however they are often used interchangeably (Gaughan 2011). This is because the differences may not really matter since the net result is often the same – where two or more companies that had separate ownership come together to operate under the same roof through a merger and acquisition transaction, this is usually to obtain some strategic or financial objective (Sherman, Patner, Oshinsky 2006).

This study adopts the definition put forward in the Companies Act no. 71 of 2008 for amalgamation or merger and will refer to the JSE listing requirements definition for the term acquisition. The competition Act succinctly draws the 2 definitions together and implies that they can be used interchangeably, for the purposes of this research report the term mergers and acquisitions will also be used interchangeably.

2.3 Motives for M&A

Companies seeking to gain market share, create economic profits and provide returns to shareholders have long been performing mergers and acquisitions (Nouboussi & Beuke 2008). Other motives behind mergers and acquisitions include synergy, diversification and hubris. The motive behind many of South Africa's REIT merger and acquisition transactions is growth. This motive together with some of the other most commonly cited mergers and acquisitions motives in literature is discussed below.

2.3.1 *Growth*

Growth is one of the fundamental motives behind mergers and acquisitions. Hurtt, Kreuze & Langsam (2000) agree stating that growth is the primary reason for mergers and acquisitions. It is essential for sustaining the viability, dynammism and value-enhancing capabilities of a company (Aluko & Amidu 2005). Company growth can happen in two ways, it can be through an organic growth process which may be slow and uncertain or through a merger and acquisition process that may be faster but it also faces its own uncertainties. In non-REIT M&A transactions, research has shown that the M&A growth strategy can result in increased shareholder value and market share that is achieved faster than in companies that employ only an organic growth strategy (Delaney & Wamurizi 2004 and Ottinger 2012). However, in REIT M&A transactions where growth is described under the empire-building hypothesis, studies have found that the strategy does create wealth (Womack 2010).

Since growth is the primary reason t to.

2.3.2 *Synergy*

Synergy refers to the type of reactions that occur when two companies combine to produce a greater effect together than that which the sum of the two operating independently could account for (Gaughan 2011). Ndadza (2014) describes synergy as the "two plus two equals five" effect. Perhaps the best definition for synergy in terms of a mergers and acquisitions is that proffered by Sirower (1997) as cited in Kim and Olsen (2013), it states that “synergy is the increase in performance of the combined firm over what the two firms are already expected or required to accomplish as independent firms”. This means that a merged or acquired entity would have a positive net present value that is greater than that of the two individual companies (Motis 2007). The two main types of synergy are operating synergy and financial synergy. Operating synergy relates to revenue enhancements and cost reductions whilst financial synergy refers to the possibility that the cost of capital may be lowered by combining one or more companies.

2.3.3 *Diversification*

Some companies merge to diversify their risk and to enter into new markets, according to Gaughan (2011), diversification means growing outside a company’s current industry category and it may also include geographic diversification such as a domestic or cross boarder diversification. The idea of diversification relates to the modern portfolio theory that states that the market value of a company can be increased if it incurs in optimal risk by investing in many uncorrelated instruments (Motis 2007). As such, a company may want to diversify by merging with other companies or acquiring assets in new areas or sectors as a means of balancing the risk profile of its portfolio (Roberts et al. 2010).

2.3.4 *Economic motives*

Up until now, it seems the motives behind mergers and acquisitions have their origins in economic considerations and risk reduction. There are two other economic motives for mergers and acquisitions; they are horizontal integration and vertical integration. Gaughan (2011) explains that horizontal integration refers to the increase in market share and market power that results from mergers and acquisitions of rivals whilst vertical integration refers to the merger or acquisition of companies that are closer to the source of supply or to the ultimate consumer.

Horizontal integration best describes the type of consolidation that is taking place within the South African REIT market where companies are looking to benefit from the economies of scale created by the merged entity.

2.3.5 *Hubris*

A critical non-economic motive behind mergers and acquisitions is hubris. It is not a motive based on the best economic considerations for the company or considerations of shareholder's value. Merger and acquisition transactions motivated by hubris are usually the result of CEO or management ego rather than the economics of the deal. According Roll (1986) as cited in Gaughan (2011), the hubris hypothesis implies that managers seek to acquire companies for their own personal motives. With hubris, the pure economic gains to the acquiring company are not the only motivation or even the primary motivation in the acquisition. In other words, the pride or ego of the managers may be the deciding factor in some mergers and acquisitions and this may see companies overpaying for target companies. This is because managers superimpose their own valuation over that of an objectively determined market valuation (Gaughan 2011).

2.3.6 *Other motives*

The motives for mergers and acquisitions listed above are not exhaustive as this section shows some of the prominent ones cited in the literature. There are multitudes of other reasons that motivate the M&A decision (Gaughan 2011). Having already captured the main reason behind consolidations in the South African REIT market, there is no need to go into detail on the other motives as they fall outside the scope of this research.

According to Harvey and Lusch (1998) the starting point for due diligence should be the motivation for an acquisition. Knowing the motives for merger or acquisition transactions is useful in formulating a suitable due diligence process (Nouboussi & Beuke, 2008). In this study, growth is the primary reason for consolidations in the form of mergers and acquisitions of South African REIT companies. The growth motive means growth that increases the market value of the acquiring company measured by its market capitalisation. It is the increase in shareholder value due to a merger and acquisition transaction. It is also important to consider whether growth is achievable through mergers and acquisitions given the reported high failure rates. This will help in directing due diligence investigations in ways that aim to reduce chances of failure in merger and acquisition transactions.

2.4 M&A as Growth Strategies

Do mergers and acquisitions actually increase shareholder value where when used as growth strategies? This is a fundamental question in understanding the continued use of mergers and acquisitions as they are frequently used as growth instruments. Kim and Olsen (2013) are of the opinion that if companies use M&A well, then there is a possibility that they could achieve value growth. Moordoukoutas (2011) believes that whether or not mergers and acquisitions create value for shareholders depends on how they are planned and executed. M&A that begin with the right strategy and executed at the right price enhance shareholder value whilst those that begin with the wrong strategy and executed at the wrong price destroy shareholder value.

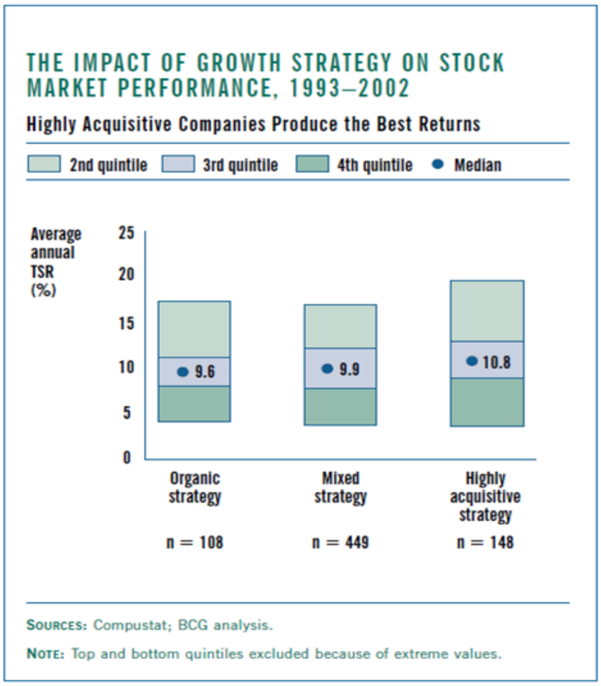
2.4.1 *Basis for Continued use of M&A for Growth*

A study by Lubatkin (1987) investigated whether M&A induce permanent improvements in the wealth position of stockholders of both bidding and target firms. The study focused on mergers between firms listed on the NYSE with a minimum transaction value of $10 million. Using traditional market model procedures as developed in the field of financial economics to measure changes in stockholder value associated with each merger type, Lubatkin (1987) found that mergers and acquisitions in general are a means to permanent gains in common stock value for both bidding and target firms' stockholders.

Recent studies also suggest that acquisitive growth strategies do create shareholder value. Cools et al. (2004) examined the stock-market performance of 705 U.S public companies for a ten year period between 1993 and 2002 and found that acquisitive growth strategies created superior shareholder returns. Cools et al. (2004) divided the companies into 3 categories based on their level of merger or acquisition activity over the study period. This was done to identify how the market values different styles of long term growth. The first category consited of companies that pursued a “highly acquisitive” growth strategy, i.e. companies who engaged in five or more acquisitions over the study period. The second category consisted of companies that made one or no acquisition, these were companies that followed an organic growth strategy. The last category comprised of companies that were neither highly acquisitive nor organic; these were companies that pursued a mixed growth strategy.

Using each of the company’s ten year total shareholder returns as the benchmark of performance; the study found that acquisitive growth strategies do create superior shareholder returns in the long term. Companies that pursued a highly acquisitive growth strategy achieved the highest average annual total shareholder return of 10.8% followed by the mixed strategy at 9.9% with the least total shareholder return being achived by companies that followed an organic strategy at 9.6%.

Figure 2: Growth Strategy Performance



Source: Growing Through Acquisitions: The Successful Value Creation Record of Acquisitive Growth Strategies, Cools et al. (2004)

Cummins and Xie (2008) explored the efficiency and productivity effects of mergers and acquisitions within the US property-liability insurance industry for the 9-year period ending in 2003. They found that mergers and acquisition transactions created significant efficiency gains for acquirers as well as cost and allocative efficiency gains for targets. They were of the view that growth motivated mergers and acquisitions should enable the merged entities to achieve economies of scale and scope, improve efficiency, gain market power, achieve earnings diversification and improve aspects of financial performance and therefore increase shareholder value.

Paskelian and Bell (2015) state that the success of acquisitive growth strategies can also be influenced by the method of payment in the transaction; they investigated the value creating process of a mergers and acquisitions for acquiring shareholders in the United States. Paskelian and Bell (2015) analysed a sample of 158 M&A consisting of transactionns where 100% of the target company shares were acquired over a period of 3 years starting fromm 2009 to 2012. They found value-enhancing characteristics among mergers and acquisitions where the payment form was cash, while the other methods of payments did not show any value enhancing characteristics. Further, their research also found that cash deal mergers experienced a positive abnormal long-term return of 1.368% and 2.125% over six month and one year periods respectively.

The literature survey above indicates that that mergers and acquisitions do create value for shareholders depending on certain factors; this means there is a basis for pursuing a merger or acquisition growth strategy as long as there is a clear strategic vision. This answers the second research question in that it shows that there is a basis for the continued reliance on a merger and acquisition strategy for growth. Researchers caution against using the growth strategy in any and all circumstances, because as much as there is evidence of M&A creating value for shareholders, there are as many studies which contradict this view showing a high failure rate in mergers and acquisitions (McDonald et al. 2005, Bertoncelj & Kovac 2007, Morrison et al. 2008 and Hao & Guoqiang 2013). For growth strategies to succeed acquirers need to understand the role of mergers and acquisitions in achieving their growth objectives far in advance before bidding for targets (Cools et al. 2004); there must be a clear strategic vision for the transaction. They must also understand the reasons why mergers and acquisitions fail to avoid repeating the same mistakes. This can be achieved through thorough due diligence assessments.

2.4.2 *Why do M&A Fail?*

There is usually great expectation and hype created by merger and acquisition announcement as the market anticipates how accretive the transaction will be. As much as there is a basis for mergers and acquisition in realising growth objectives, they do sometimes destroy rather than add value (Perry & Herd 2004, Morrison et al. 2008 and Hao & Guoqiang 2013). An acquisition is a failure if the acquiring company does not achieve the financial, commercial or strategic objectives set at the time of buying the business and for the purposes of this study, if it diminishes shareholder value. The most commonly cited reasons for failure of mergers and acquisitions include:

- Poor synergy and incompatible organisational culture
- Limited strategic or compelling rationale
- Paying too much due to an unjustifiably high valuation
- Lack of communication with key stakeholders during the m&a process
- Weak or inadequate due diligence procedures

2.4.3 *Poor synergy and incompatible organisation culture*

Poor synergy and incompatible organisational cultures can lead to merger or acquisition failure. Schweiger (2002) notes that the execution of a well-designed integration process that captures all forecasted synergies is critical to maximizing value creation and minimizing value destruction. This as mergers and acquisitions are looked upon as an important instrument of creating synergies through increased revenue, reduced costs and reduction in net working capital as well as improvement in the investment intensity. The overestimation of these can lead to failure of mergers (Welingker 2008). Due diligence can help remove doubts about the attainability of certain synergies thereby preventing any overestimation of synergies, it may also indicate additional benefits which may have been missed (Perry & Herd 2004).

Organizational culture concerns symbols, values, ideologies, and assumptions that operate often in an unconscious way to guide and fashion individuals and a business (Cartwright & Cooper 1993). According to Harvey and Lusch (1998), a company may be an ideal merger and acquisition candidate that meets all the strategic considerations but may face significant integration problems post the transaction due to organizational culture differences between the merged companies. Incompatible organisational cultures are widely reported as a cause for poor merger performance; if a merger and acquisition is implemented in a way that does not deal with the different organisational cultures of the merging companies, then the process may lead to a failure of the transaction. Moeller (2009) cites the case of Sony, which acquired Columbia Pictures in 1988 to highlight the effects of incompatible organisational cultures on deal performance. In that transaction there was little consideration of cultural fit between the two companies, as a result the transaction failed to live up to commercial expectations with Sony having to write down a significant amount of money a few years later.

2.4.4 *Limited strategic rationale compelling*

One way for acquirers to find out as much as possible about a potential target company is to carry out a comprehensive investigation into the strategic rationale behind a potential merger or acquisition (Perry & Herd 2004). Clarifying the strategic rationale is a critical problem to overcome as it guides both pre and post-merger behaviour. The strategic rationale should clearly articulate a vision that is centred on the creation of long-term competitive advantage rather than just short-term improvements in operational efficiency (Epstein 2005). Some of the reasons for company mergers and acquisitions typically include attempts to increase scale, geographic scope, knowledge and cross-industry extension (Epstein 2005), and improvement of efficiency and market access (Sacek 2015). It is important that real growth be the main expectation of the merger no matter which concepts are central to the vision and not to have the entire rationale centred on cost cutting and elimination of redundancies (Epstein 2005). Judging by the high failure rates in mergers and acquisitions, there may be little or no strategic rationale behind most merger and acquisition transactions.

McDonald et al. (2005) cite a study by Harding and Rovit (2004) which examined the importance of aligning corporate strategy to planning for mergers and acquisitions. The study found that less than one in three CEOs interviewed had a clear strategic rationale for their mergers and acquisitions, or understood the contribution the deal would make to their company's long-term financial future. In another study by Balmer and Dinnie (1999) cited in McDonald et al. (2005) it was found that there was an over-emphasis on short term financial and legal issues, at the neglect of the strategic direction of the company. The lack of strategic rationale behind mergers and acquisitions is cited as one of the reasons for the high failure rate, McDonald et al. (2005) suggest that an effective tool to ensure there is alignment between an organisations strategic plan and merger and acquisition is due diligence.

2.4.5 *Paying too much due to an unjustifiably high valuation*

Often acquirers overestimate the value of potential benefits that may arise from a merger or acquisition leading to them paying too much to secure the target company (Perry & Herd 2004). This according to Epstein (2005) is another reason for merger or acquisition failure as the new company is overburdened with high debt payments. Sacek (2015) concurs stating that the payment of high price premiums is a significant reason for merger or acquisition failure. The expected future growth of a target company is the main variable in determining the acquisition price. If the financial position is overestimated due to incorrect information in terms of cash flow generation, debt volume, balance sheet advantage, asset valuation; then there is a risk of forecasting unrealistic growth of the target company, which may have serious effects on the valuation and the acquisition price. In line with determining a realistic acquisition price, the due diligence requires enhanced proceedings to attain deeper information in order to achieve reasonable basis for valuation models (Sacek 2015).

Epstein (2005) cites the merger between Federated and Fingerhut where a 30% premium price was paid by Federated who were hoping to exploit the direct-marketing experience of the target company in the merged entity. The premium proved to be too high as a result, Federated had to shut down Fingerhut and ultimately sell the operation for less than they what they acquired it for a few years earlier. With the right information through due diligence, such outcomes should be less likely.

2.4.6 *Lack of communication with key stakeholders during the M&A process*

Clear and consistent communication is one of the elements necessary in facilitating a successful company merger or acquisition transaction. Communication can make or break a transaction depending on how well it is done during the merger or acquisition process (Gould 2015). According to Gould (2015) ineffective or a lack of communication causes disruption, confusion and insecurity whereas Price (2012) states that the absence of information and clear communication during the merger or acquisition process causes rumours and leads to unnecessary assumptions being made. This all may negatively affect the prospects of success of the merger or acquisition.

2.4.7 *Weak or inadequate due diligence procedures*

Mergers and acquisitions are complex and they are not easy solutions to growth. Companies aiming to grow via mergers and acquisitions must invest the necessary time and money to ensure that the chosen target company will generate the desired returns. Acquirers need to undertake a thorough due diligence in the pre-acquisition phase, this is necessary for the success of mergers and acquisitions (Sasek 2015). Due diligence is a crucial component of the merger and acquisition process (Moeller 2009); it helps detect financial and business risks that the acquirer inherits from the target company. Some acquirers however cut corners on the due diligence thinking they can gain time, save money, or spare feelings by shortening this deal phase (Hao & Guoqiang 2013). The result of this is a weak or inadequate due diligence which severely affects the accuracy of the valuation of the target company, this can lead to the failure of a merger or acquisition transaction.

Mergers and acquisitions are risky and they can fail for any one of the above reasons or because of a combination of mistakes. Success requires planning, strong management and a good due diligence. When done right, mergers and acquisitions can create value for shareholders and they can bring commercial or tactical advantage to the enlarged company. According to Pearson (2013), a few of the world's top businesses have achieved success without utilising a merger or acquisition strategy. He states that the foundation for success is a balance of buying and selling companies, entering into joint ventures, and organic growth.

Even though the above factors are not exhaustive in terms of what could cause mergers and acquisitions to fail, they are the most prominent ones. The objective was to present that for mergers and acquisitions to succeed, there must be a wide scope of analysis to ensure that all facets of the deal are covered in particular that due diligence is an important factor for success. These factors address question three of the research.

2.5 Due Diligence

2.5.1 *Concept and Definition of Due Diligence*

Due diligence (DD) is defined as the action that is considered reasonable for people to be expected to take in order to keep themselves or others and their property safe or the detailed examination of a company and its financial records, done before becoming involved in a business arrangement with it (Cambridge 2016). According to Jensen and Varano (2011) citing Hoskisson et al. (2004) due diligence has a legal origin and it first came into common use because of a U.S Securities Act of 1933. The US Legal definition refers to due diligence as the level of judgement, care, prudence, determination, and activity that a person would reasonably be expected to do under particular set of circumstances (US Legal, 2015). It is the process by which persons conduct inquiries for the purposes of timely, sufficient, and accurate disclosure of all statements or information or documents that may influence the outcome of a transaction. The purposes for due diligence investigations are to collect all relevant past and present information that will uncover the major risks related to a particular transaction (Jensen & Varano 2011), to assess the benefits and constraints of the proposed acquisition and to predict the future functioning of the business to be acquired (Savovic & Pokrajcic 2013).

Hoskisson et al. (2004) as cited in Jensen and Varano (2011) explain that due diligence is a term used for a number of concepts involving either the performance of an investigation of a business or person, or the performance of an act with a certain standard of care. It can be a legal obligation, but the term more commonly applies to voluntary investigations. A common example of due diligence in various industries is the process through which a potential acquirer evaluates a target company or its assets for acquisition.

Seemingly, the term due diligence has different meanings to different professionals involved in the assessment of a target company; this may be influenced by their own roles in the process (Nouboussi & Beuke 2008). In terms of mergers and acquisitions the term due diligence implies the analysis of key aspects of the target company regarding financial aspects, legal aspects, human resources, operations and business aspects (Naschescu 2010). According to Epstein (2005) due diligence assessment should not only focus on the hard financial aspects but should also include the evaluation of the soft personnel and organisational issues. A protocol for due diligence as suggested by Epstein (2005) includes a formal financial review of assets and liabilities and an evaluation of culture, organizational fit, and other non-financial elements. These are all critical to the success of the organisation.

From an acquirers perspective due diligence investigations are there to ensure that the purchase does not pose unnecessary risk to the acquiring company’s shareholders (Hao & Guoqiang 2013). Essentially due diligence is a process undertaken to give a level of comfort to the acquirers that a target company will not unravel and diminish shareholder value post the merger or acquisition.

Moeller (2009) notes that due diligence is one of the two most critical elements in the success of a merger or acquisition transaction with the other being the proper integration of the consolidated company. It is perhaps of greater importance than target selection, negotiation, pricing the deal and the development of the company's overall merger and acquisition strategy. When done right, due diligence can contribute towards better control of inherent risks in any deal by the acquirers, the effective management of the target company and the realisation of strategic company goals (Moeller 2009); chief amongst those is the increase of shareholder value.

Due diligence assessments are not only about highlighting potential risks for the acquiring company but should also include looking for opportunities to realise future prospects of the consolidated company, identification of synergies between the two companies and post-merger planning (Moeller 2009). Savovic and Pokrajcic (2013) agree stating that due diligence should show how the acquisition will affect the efficiency of internal business processes and the creation of new capabilities of the consolidated company.

2.5.2 *Place of due diligence in the merger and acquisition process*

Nouboussi and Beuke (2008) citing Hawson (2003), state that there are 4 stages in the merger and acquisition process with due diligence being part of stage 2 in that process. The table below depicts the different stages of the mergers and acquisitions process followed by an explanation of each of these stages.-

Table 1: M&A Process

Phase 1	Phase 2	Phase 3	Phase 4
Strategic review	Heads of terms	Sale and purchase negotiation	Post-completion
Systematic search	Due diligence	Completion	
Approach			

Source: The critical stage in mergers and acquisitions, Howson (2003)

Phase 1:

The first phase of the merger or acquisition process is about the strategic review, the systematic search and the approach. The strategic review is about drawing and determining the company’s strategy. This is done through a deep review of strategic objectives and the merger or acquisition must be an answer to those strategic objectives. The strategy needs to be defined and understood early in the process.

The following process after a clear identification of the strategy through strategic review is a systematic search for potential merger or acquisition target companies. During this stage, the company needs to identify the target companies for the merger or acquisition. The company lists a certain number of criteria to consider meeting the strategy and it uses those criteria as a basis for searching for the right target companies.

The result of this process is a drawing of a list of companies that meet the criteria; from there an initial approach can be made to those companies in order to propose to them the merger or acquisition.

Phase 2:

After a successful approach to the potential target companies, the second phase of the merger or acquisition process follows. This stage is about the heads of terms, and the due diligence. Then through a head of terms or a letter of intent, both companies record an agreement to negotiate the merger or acquisition of a business. The documents set the conditions of the deal and elements of the deal.

The due diligence also comes in at this phase of the process; its role is to understand thoroughly the important issues on the target company. This phase helps to plan and evaluate the post-deal integration and minimize risks that could occur.

Phase 3:

The third phase is about the sale and purchase negotiation and the completion. At this stage, the due diligence process is already done and the deal negotiation can proceed. The acquirers use the elements on hand from the due diligence investigation to negotiate with the target companies; this could be negotiating the consideration for the target company according to findings in the due diligence and other salient factors. Then the completion process is about signing the documents that established conditions.

Phase 4:

The fourth phase of the process is about the post completion stage, where it is about integrating the companies and making a return from the new acquisition by increasing shareholder value. The due diligence process is important for this stage, because it is entitled to give a view on the post-completion plan and draw it.

The importance of the role of due diligence in merger and acquisition transactions cannot be over-emphasised. Failure to exercise due diligence prior to entering into a M&A transaction may lead to the precarious situation where a company acquires a target company that may be marred by encumbrances and other liabilities; these are automatically transferred to the new merged entity because of the transaction and they could have serious implications for shareholder value (Ceil 2013).

2.5.3 *Theoretical Perspective on DD and shareholder value*

As defined by Bain & Company (2015) a M&A transaction is a success if it increases shareholder value higher than it would have been possible if the companies had remained separate. Shareholder value is the value enjoyed by a shareholder for possessing shares of a company (Rono 2014). It is the value delivered by the company to the shareholder measured in terms of return on assets (ROA), return on equity (ROE) and earnings per share ratio (EPS) (Rono 2014). To increase chances of a M&A deal's success where shareholder value is increased, acquirers need to perform rigorous due diligence to verify the target company's stand-alone value so as to uncover any problems that could jeopardize the deal (Bain & Company 2015).

Increasing the shareholder value is one of the prime motives behind many mergers and acquisition transactions; however, there are many failed transactions meaning that shareholder value has historically been destroyed where an M&A growth strategy has been used. There are numerous reasons put forward to suggest why mergers and acquisition fail , the most important of these having a poor strategic rationale for undertaking an M&A transaction and inadequate due diligence. According to a report by Baker (2014), if there is a right strategy from the beginning of a deal, then the transaction with the most thorough due diligence has the best chance of success and of increasing shareholder value. As explained by Puranam, Powel & Singh (2006) due diligence offers acquirers a chance to collect additional information and to reconsider the initial bid made in an acquisition. If managers ignore the negative information about the target that arises during due diligence, they may destroy shareholder value by overpaying for the target. Detailed due diligence of a target company is therefore a critical pre-deal activity which can resolve some of the other failure factors (Bertoncelj & Kovac 2007).

An A.T. Kearney report (2013) concurs stating that M&A can deliver significant competitive advantage and value to shareholders, but the criteria by which to assess just how much must answer fundamental business questions such as:

- Is the proposed merger strategically logical?
- Will it deliver cost, revenue, or other financial synergies?
- Will it build management or other capabilities?
- Is the combined company capable of delivering the synergies?

According to the Kearney report (2013) these questions can be answered through a thorough due diligence. In an earlier report by Kelly et al. (1999) where merger and acquisition success was measured using a benchmark based on the movement in share price, it was found that that acquiring companies which prioritized due diligence were 6 percent more likely than average to have a successful deal. In other words, deals that go through a thorough due diligence process have a higher success probability to increase shareholder value. Anand (2016) who states that deploying systematic approaches along the deal cycle such as careful identification of a target a company, detailed due diligence and a focused integration plan in mergers and acquisitions can enhance shareholder value supports this view.

These reports briefly highlight the significance of a thorough due diligence and its role in ensuring that merger and acquisition transactions are successful and that they lead to increased shareholder value post the integration. This research is premised on the notion that by improving or expanding due diligence, the chances of successful REIT M&A transactions will be increased therefore there will be better prospects of increasing shareholder value through acquisitive growth strategies adopted by REIT companies listed on the Johannesburg Stock Exchange.

2.5.4 *Types of Due diligence*

Historically, the role of due diligence has been to document the financial background of a potential target company and to compile legal information on that company (Harvey & Lusch 1998) and then to project the future of the target company based on that information (Moeller 2009). This is known as traditional due diligence; over the years various scholars have expressed the need to expand the traditional due diligence to what some have termed enhanced or improved due diligence Morrison et al. (2008).

The section below details the different types of due diligence assessments starting with the traditional view of due diligence and it shows some of the other due diligence assessments that can be done in addition to the traditional approach. As per Hawson (2003) cited in Savovic and Pokrajcic (2013) there are three main areas of due diligence assessments, they are financial, legal and commercial due diligence.

Table 1: Main Areas of Due Diligence

Due Diligence	Focus of Enquiries	Results Sought
Financial	Validation of historical information, review of management and systems	Confirmation of underlying profit. Providing basis for valuation.
Legal	Contractual agreements, problem solving	Warranties and indemnities, validation of all existing contracts, sale and purchase agreements
Commercial	Market dynamics, target's competitive position, target's commercial prospects	Sustainability of future profits, formulation of strategy for the combined business, input to valuation

Source: The critical stage in mergers and acquisitions, Howson (2003)

Financial Due Diligence

The purpose for a financial due diligence is to verify the factual accuracy of claims made by the sellers and assess the financial state of a target company. Financial due diligence is used to investigate the financial performance of a target company looking at its historic, present and future performance (Savovic & Pokrajcic 2013). A financial due diligence focuses on answering the questions:

- What are the trends of the business; is it growing or declining?
- Are profits being supported by one-off events or the result of smart accounting practices?
- Is there any evidence to support the growth forecasts?

On the balance sheet side financial due diligence should aim to identify any previously unknown liabilities and advise on the level of working capital the business requires. The due diligence findings should then feed into guarantees and indemnities within the purchase agreements to mitigate any risks identified and provide a level of confidence for the underlying performance of the target company (Caprica 2012).

Legal Due Diligence

Legal due diligence is the process of analysing the main legal documents and information of a target company before the parties enter into transactions such as mergers and acquisitions (Tornovsky 2013). The legal due diligence mainly consists of the review of documents to identify potential legal issues that may present risks and/or impediments to the transaction or in the general operations of the target, that could in a certain way affect the value or consideration in connection with the transaction (Tornovsky 2013)

The functions that are typically included in a legal due diligence as per Harvey and Lusch (1995) are:

(1) basic organizational matters; (2) ownership of securities; (3) banks and borrowing; (4) financial history; (5) litigation; (6) general regulatory data; (7) real property; (8) personal property; (9) intellectual property rights; (10) contractual management issues; (11) labour contracts and history; and (12) insurance.

These activities constitute the core of a traditional legal due diligence of a potential acquisition. A vast majority of the legal due diligence is verification of the existence of material elements of the business and, in addition, the lawyers are asked to provide a legal opinion to the acquiring company and its leaders on liabilities or contingent liabilities (Harvey & Lusch 1995).

Commercial Due Diligence

The aim of a commercial due diligence is to understand the market that a target company is operating in. The due diligence will look at the forecast level of future market growth and the target company's competitive position within that market. Commercial due diligence can be of great value when an acquirer is using an acquisition to expand into a new market, though it may be of limited value where the target is in the acquirer's existing market (Caprica 2012).

Traditional due diligence is the most commonly applied due diligence assessment when conducting a merger and acquisition transaction, however from the literature review it is evident that it is no longer sufficient to only conduct this type of assessment. Over the years, various scholars have come to the same conclusion suggesting that there is a need to go beyond traditional due diligence in order to enhance its value and reduce the high failure rates (Harvey & Lusch 1995, Perry & Herd 2004, Morrison et al. 2008 and Moeller 2009). Lebedow (1999) states that it is essential that due diligence goes beyond prior analyses and includes a detailed analysis of own strengths and weaknesses, as well as opportunities and threats which may exist in the environment and that constraining the process to evaluation of financial statements and physical property has serious weaknesses. Recently, Savovic and Pokrajcic (2013) maintain that due diligence assessments should not focus only to financial and legal analyses but rather they should also involve a range of different areas. They believe that since each merger and acquisition transaction is unique; the acquiring company should consider the acquisition by taking into account the type of activity whether the transaction will be profitable and how it will contribute to realisation of benefits. Hawson (2003) identified other due diligence areas that can be included in an M&A review as shown on the table below.

Table 2: Other Due Diligence Areas

Due Diligence	Focus of Enquiries	Results Sought
HR and Culture	Contents of the workforce, terms and conditions of employment, level of commitment and motivation, organisational culture	Uncovering employment liabilities, assessing potential human resources costand risks of the deal, prioritising the HR issues that need o be dealt with during integration, assessing cultural fit, costing and planning the post-deal HR changes
Management	Managing quality, organisational structure	Identification of key integration issues, outline of new structure for combined businesses
Pension	Various pension plans and plan arrangements	Minimisation of the risks of under-funding
Tax	Existing tax levels, liabilities and arrangements	Avoiding any unforeseen tax liabilities, opportunities to optimize position of combined business
Environmental	Liabilities arising from sites and processes, compliance with regulations	Potential liabilities, nature and cost of actions to limit them
IT	Performance, ownership and adequacy of current systems	Feasibility of integrating systems; associated costs. IT plans for operational efficiency and competitive advantege
Technical	Performance, ownership and adequacy of current systems	Value and sustainability of product development
Operational	Production techniques, validity of current technology	Technical threats; sustainability of current methods; opportunities for improvement; investment requirements
Intellectual Property Rights	Validity, duration and protection of patents and other IPRs	Expiration; impact and cost
Property	Deeds, land registry records and lease agreements	Confirmation of title. Valuation and cost/potential of property assests
Antitrust	Various national filing requirements; degree of market/information sharing with competitors	Merger control filings and clearance; assessment of the enforceability of the target's contracts
Insurance/Risk	Present, future and, most importantly, past exposures of the business. The structure and cost of the existing programme.	The costs and benefits of retaining risk versus transafering it

Source: The critical stage in mergers and acquisitions, Howson (2003)

2.5.5 *The need for an expanded due diligence framework*

Whilst due diligence is supposed to ensure that the deal is sensible and that potential risk elements that could affect the success of the transaction have been adequately dealt with, there is still a high failure rate in mergers and acquisitions (McDonald et al. 2005, Bertoncelj & Kovac 2007, Morrison et al. 2008 and Hao &

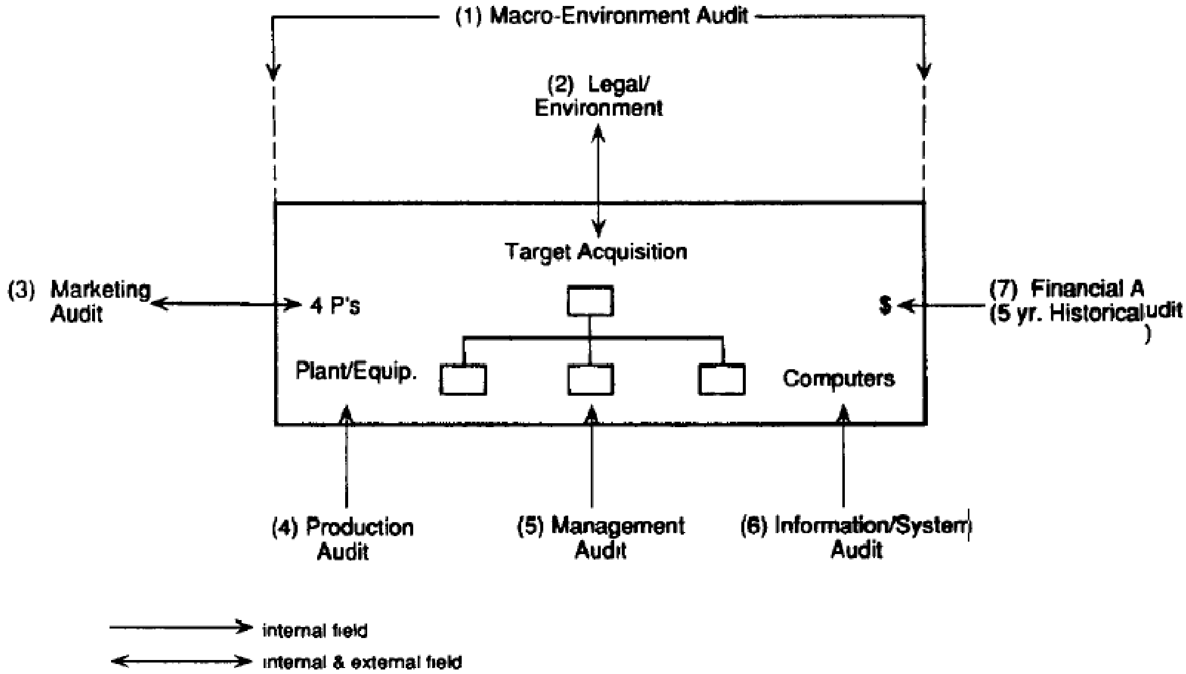
Guoqiang 2013). Gilman (2002) states that the due diligence assessments should challenge the reasons why mergers and acquisitions fail and devise strategies and procedures to reduce or minimise the risk of failure. To improve the chances of success where post-merger shareholder value increases various scholars have suggested the following:

Moeller (2009) states that the focus of due diligence has almost always been limited to financial factors, pending law suits and information technology systems, these factors broadly fall under 'traditional due diligence'. Whilst Moeller acknowledges the importance of these factors in the due diligence process; he suggests that they must be supplemented by paying attention to the assessment

Harvey and Lusch (1995) argue that due diligence should be expanded in both scope and nature and that it should go beyond the traditional accounting, financial and legal issues which are normally considered. In addition, they contend that intangible assets involved in a merger or acquisition need to be taken into consideration. They were of the view that the capabilities of a target company are linked to the intangible dimension of the company. As such, they identified seven crucial audit areas of due diligence that included a macro environment; legal; marketing; production; management; information system and financial audits. Essentially, Harvey and Lusch (1995) suggest that each of the seven audit fields identified should include both tangible and intangible dimensions in the due diligence assessment and that what is included in each audit and how the audits are conducted should be the focal point of expanding the due diligence process. By expanding the nature and scope of due diligence to include the analysis of both these dimensions they were of the view that outcomes of due diligence assessments would support informed merger and acquisition decisions.

The seven due diligence audit requirements as per Harvey and Lusch (1995) follow the sequential process below.

Figure 3: Due Diligence Audit Areas



Source: Expanding the nature and scope of due diligence, Harvey and Lusch (1995)

Similar views are held by McGrady (2005) who states that the track record of merger and acquisition deals points to shortcomings in the traditional due diligence approach. McGrady posits that assessing intangible dimensions during due diligence and using the information that results from there to inform the development of an integration plan could be a significant source of improvement for mergers and acquisitions. The intangible factors which McGrady believes might increase the chances of success include culture, leadership and change management.

Perry and Herd (2004) in an earlier study found that ensuring a successful acquisition requires going beyond performing traditional due diligence, they perform detailed value assessments which they call improved due diligence. In summary the improved due diligence is about obtaining the services of professionals who know the particular industry, are competent to assess the financial, operational, management and legal risks before an investment decision can be made.

Furthermore, Morrison *et al*. (2008) state that traditional due diligence falls short since it focuses on identifying the biggest visible risks and clarifying what is being bought. They propose the idea of enhanced due diligence which is placing the same amount of importance on operational due diligence as on valuation, traditional due diligence and merger integration.

Although there is a convergence of thought that traditional due diligence alone is no longer sufficient for successful mergers and acquisitions transactions, there is a gap in the literature in that it is not clear to what extent the South African REIT market has moved beyond conducting traditional due diligence in M&A transactions. This research aims to fill this gap by analysing the due diligence process applied in the South African REIT market and considering what additional due diligence can be applied. In part, question four of the research questions is answered in that it is established in the literature that traditional due diligence is not sufficient for REIT merger and acquisition transactions. Further analysis of the South African market is needed to fully answer whether the traditional scope is sufficient for South African REIT transactions.

2.5.6 *Strategic due diligence*

The literature above has shown that traditional due diligence is no longer sufficient for successful merger and acquisition transactions, and with a myriad of factors suggested for what constitutes an enhanced or improved due diligence framework, it is difficult to know which of these factors actually improves on the traditional due diligence. Due diligence professionals alike also agree that traditional due diligence is hardly sufficient to ensure a transaction's success however they maintain that it is necessary as a base assessment (May, Anslinger & Jenk 2002). If traditional due diligence is indeed no loger sufficient for assessing merger and acquisition transactions, then how should due diligence analyses be performed? There is a common view that a comprehensive and effective due diligence is one that goes far beyond traditional due diligence; this due diligence approach is known as strategic due diligence, it is vital in anticipating the problems that can derail a merger or acquisition deal.

Strategic due diligence is the disciplined prioritising and organising of a number of fundamental but often neglected principals (May et al. 2002). It involves validating the acquisition target's fit with the acquirer's strategic rationale for the acquisition, and understanding the target's market position and outlook in order to inform the price to be offered for the merger or acquisition transaction (Sarda & Rimner 2013).

In making a case for strategic due diligence Sarda and Rimner (2013) explain that traditional due diligence is not sufficient since it tends to be backward looking and it concentrates on validating historic performance, identifying potential liabilities and risks. This focus on the historic and current performance only addresses a minority of the acquisition target's value. To reflect the real value relationship, the bulk of the due diligence effort needs to focus on helping the acquirer understand the target's future prospects and how those fit with the acquirer's strategy. This requires a disproportionate emphasis on strategic due diligence (Sarda & Rimner 2013).

The purpose of a of strategic due diligence is to assess whether the acquisition will succeed and to identify specifically what will need to be done in the post-merger integration to make the transaction a success (May et al. 2002). This can be determined through a strategic fit assessment, a market assessment and a review of assumptions underpinning the management plan.

A strategic fit assessment is an in-depth analysis of whether the acquisition target enhances the acquirer's competitive position and explores areas where synergies could be realized. Ideally, where there are synergies they should be quantified so the acquirer can evaluate the additional value the combination could create. The strategic fit assessment should occur within the context of the acquiring organization's strategic plan. Beckham (2009) explains that testing a deal against the strategic plan forces important questions of rationale to be asked during the early stages of the due diligence process. These questions should address how a particular deal fits with the acquirer's strategic plan, why a deal is a compelling opportunity that it deserves an overwhelming commitment of time, effort and money?" After a successful strategic fit assessment, attention should shift to the market assessment.

The market assessment and outlook enables the acquirer to assess whether the acquisition target has a realistic management plan. A thorough review of assumptions underpinning the management plan and a comparison with market dynamics, competitive position and operational capabilities can highlight discrepancies in the target's management plan (Sarda & Rimner 2013). Acquirers can address this by applying sensitivity analyses whether they change assumptions to make the management plan more realistic and to value the business appropriately. Strategic due diligence also can highlight potential restructuring opportunities to create further value and identify bolt-on acquisitions that can accelerate grow (Sarda & Rimner 2013). Beckham (2009) agrees, strategic due diligence addresses questions of future leadership, both in the executive suite and in the boardroom. This is usually an awkward discussion in the process which is normally left until the late stages of the negotiations, strategic due diligence ensures that those conversations happen earlier in the process.

Beckham (2009) explains that the one overriding reason for why so many mergers fail to produce the desired results is that the "deal becomes the deal" where acquirers are eager to conclude the deal in order to be the first or the biggest in their industry or sector. In the process, they pay lip service to the strategic rationale of the merger or acquisition and they overwhelmingly focus on the transaction. They begin with negotiations and sign agreements only after a legal and financial due diligence as the deal is propelled by the momentum to close. What often gets lost in the process as a result of this rush, is what should be the first step of any due diligence, the strategic due diligence.

The absence of a well-considered and clearly articulated strategic rationale for the deal according to Beckham (2009) can lead to unintended consequences and the total failure of the transaction. Inadequate strategic due diligence may also result in insufficient consideration of alternatives, with deal makers so focused on closing one deal they may suffer from tunnel vision and fail to see other opportunities that could be a more strategic fit to the company.

Sarda and Rimner (2013) state that the most important effect of a strategic due diligence is that it shifts the emphasis from getting deals done to getting deals done right. Strategic due diligence usually involves a higher number of professionals than the traditional variety and it always makes use of a wider spectrum of information sources. This increases the chances of the merger or acquisition transaction creating rather than destroying value.

According to May et al. (2002) successful acquirers are those that have strategic due diligence built into the transaction process from the outset, as a result the price paid in consideration for the target company is usually a price which takes into account the likelihood that all synergies will be captured. This approach to due diligence ensures an above-average return for shareholders (May et al. 2002). The table below shows the differences between a traditional and a strategic due diligence.

Table 3: Traditional Due Diligence vs Strategic Due Diligence

Different approaches

Traditional due diligence differs from strategic due diligence in a number of areas.

	Traditional due diligence	Strategic due diligence
Focus	Target company's past	Combined companies' future
Key question	Can the deal be done?	Will the acquisition succeed?
Areas of inquiry	Financial, legal, unpleasant surprises	Traditional concerns, as well as validation of key operational and strategic assumptions
Participants	Finance department, accountants, lawyers	Traditional participants, plus operations, IT, HR and other key players, as needed
Information sources	Two to three, mostly for checking management background	A dozen or more, including customers, competitors, joint venture partners, key suppliers and former employees

Source: Avoiding the perils of traditional due diligence, (May et al. 2002)

Clearly strategic due diligence goes far beyond the historic due diligence assessments which just focuses on the financial and legal issues, strategic due diligence assesses whether a merger or acquisition will succeed as opposed to just verifying facts. The time to consider the true benefits of a deal is during strategic due diligence (Beckham 2009).

Strategic due diligence also identifies what needs to be done to ensure the success of the merger or acquisition transaction. This due diligence approach seems to be a more tactical and detailed approach that can reduce the high failure rate in mergers and acquisitions. That extra scrutiny that a potential deal gets through strategic due diligence results in more durable and successful deals (Beckham 2009).

2.5.7 *Strategic due diligence methodology*

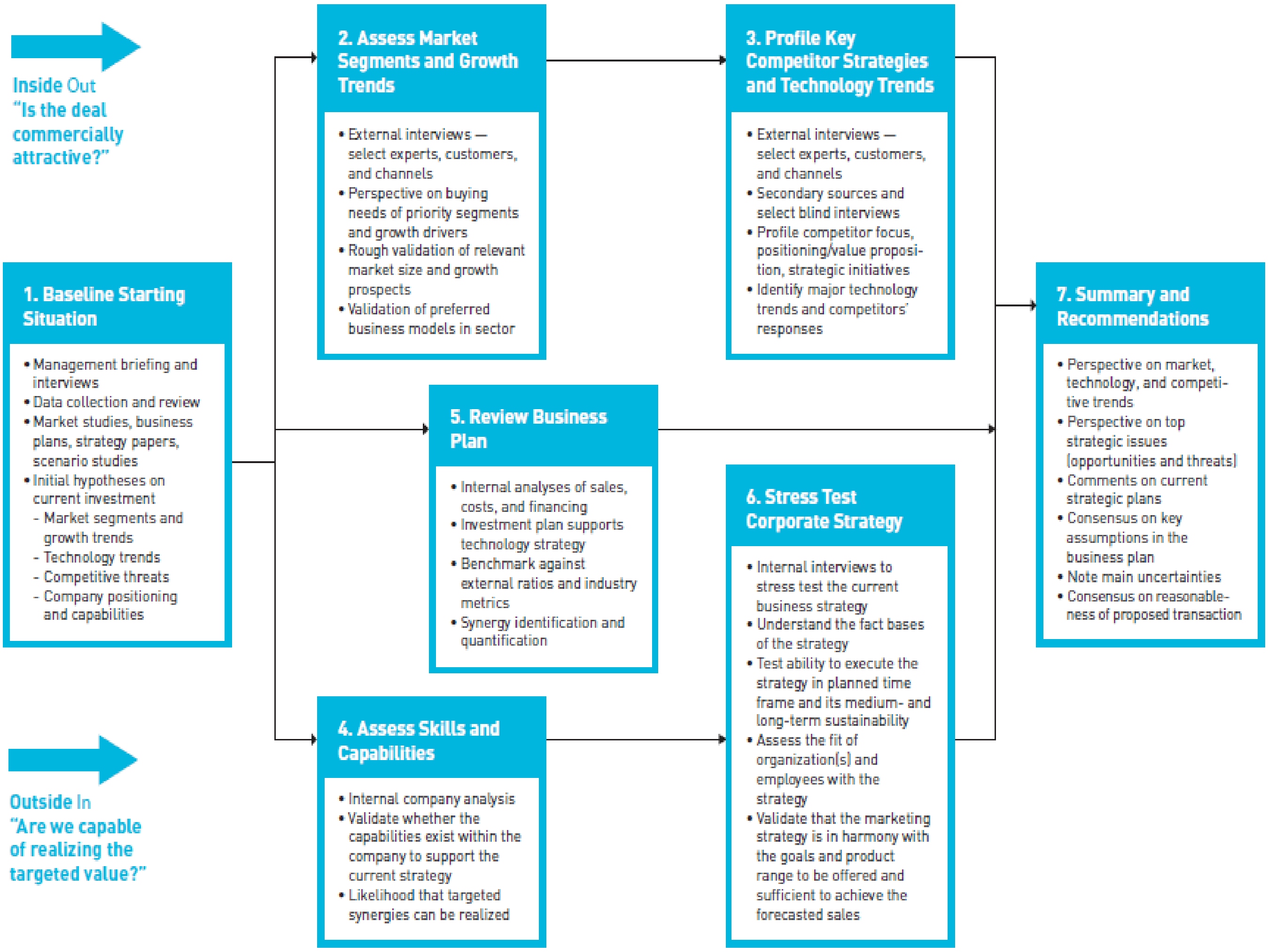
Unlike the traditional due diligence which ascertains the potential value of a deal and is concerned with buying at the right price, strategic due diligence explores whether a potential target is realistic (Adolph, Gillies & Krings 2006). It tests the strategic rationale behind a proposed transaction with two questions:

1. External Inquiry - Is the deal commercially attractive?
2. Internal Inquiry - Is the company capable of realising the targeted value?

The first question tests the commercial attractiveness of a deal and involves the validation of both the target company's financial projections and their synergies. Adolph et al. (2006) explain that this can be achieved by the assessing the overall market attractiveness and the competitive position of the target company and how these might change over time. The second question is an internal examination of whether the targeted value of the deal can be realised by the management team of the combined entity, and if so, whether the projected timeframe is realistic.

The benefits of a strategic due diligence approach are that it ensures that each transaction is considered independently; each deal has its own value drivers, therefore the composition of the due diligence strategy and team should be specifically adapted to the transaction. Strategic due diligence helps articulate the strategic rationale and perceived value of a deal, this instils greater confidence among stakeholders that the target company's claims about projected benefits are reasonable and attainable; it also provides a strong platform for integration (Adolph et al. 2006).

Figure 4: Strategic Due Diligence Methodology



Source: Strategic Due Diligence A foundation for M&A Success, (Adolph et al. 2006)

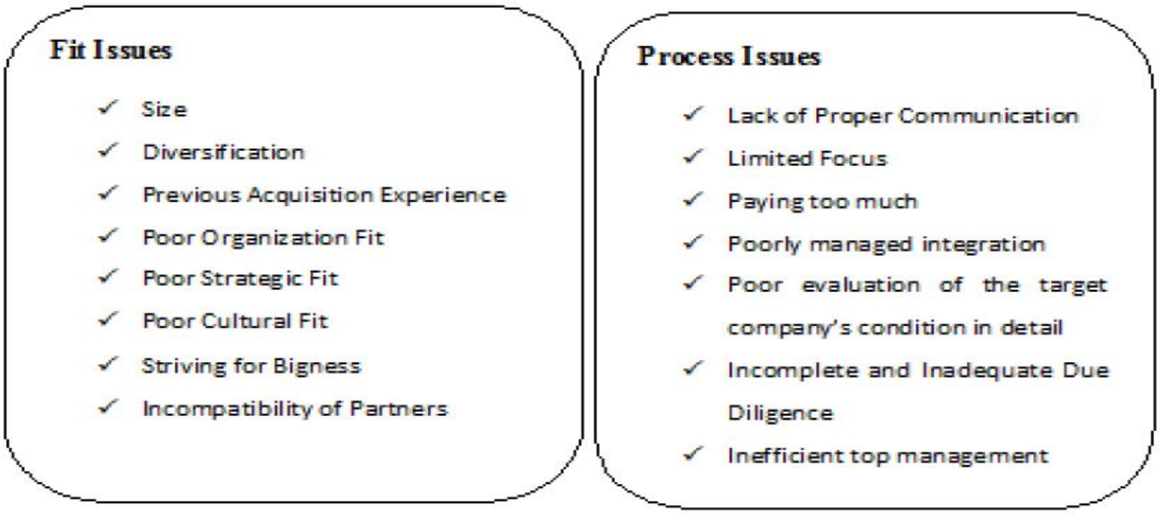
In this literature review it has been established that traditional due diligence alone in not sufficient for merger and acquisition success. The literature suggests going beyond the traditional due diligence to performing strategic due diligence which is a complex exercise that emphasises analysing if the deal will work and if it is worth pursuing. The above graphical presentation shows the strategic due diligence methodology that companies can use to assess the value of target companies and the prospects of deal success. If there is a logical process of analysing deal success in the form of strategic due diligence then the question arises: what kind of due diligence is conducted in REIT merger and acquisition transactions and will strategic due diligence in this sector improve the chances of success? These questions will be further analysed in the research.

2.6 Conceptual Framework for DD in M&As Transactions

Conceptually, mergers and acquisitions (M&A) are a means of achieving growth, gaining market share, creating economic profits and increasing returns to shareholders. South African REITs are in a position where they have to consolidate in order to grow so they can compete with the more developed REIT markets and be able to offer their shareholders more value. Of concern is that there is a large volume of academic literature focusing on M&A in a number of disciplines using different research methodologies for different objectives and they all seem to come to similar conclusions. This is that a large number of M&A fail to reach their potential and that they rarely meet the intended objectives of the acquirers, which for the present research is to increase shareholder value. M&A success and failure issues have been canvassed in the present research, Gupta (2012) summarises them into two broad categories as fit and process issues. Fit issues are those that assess the juxtaposition of the acquirer and the target, the acquirer has limited ability to influence these. Process issues are those over which the acquirer can exert a large degree of control.

Due diligence is a process issue that can affect the success or failure of an M&A transaction, and this is the area where the acquirer can exert control in how well the due diligence process is done.

Figure 5: Fit and Process Issues in M&As

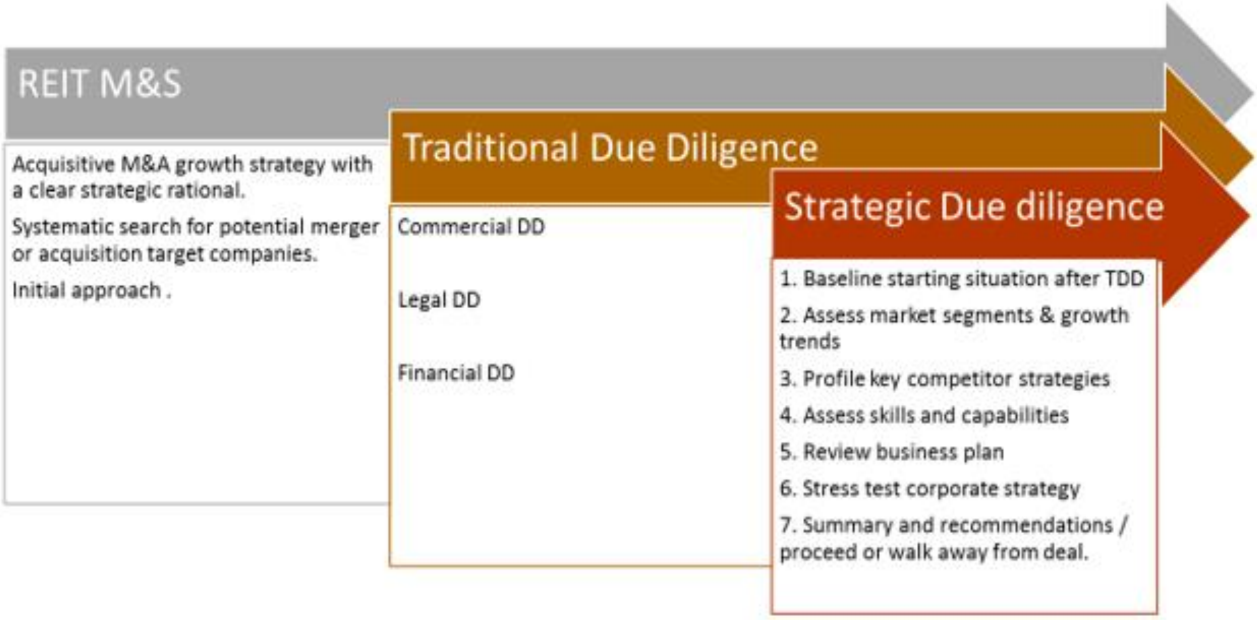


Source: Mallikarjunappa & Nayak (2007) cited in Gupta (2012)

Theoretically, due diligence can improve the chances of success in M&A transactions but there needs to be an improved or expanded due diligence framework as the issue is not that due diligence hasn't been done in the past but rather that it hasn't been done right. The literature shows that historically the preferred method of assessing M&A deals has been through traditional due diligence which focuses on the legal, financial and commercial aspects of the deal. This has been found to be inadequate; many deals that only followed a traditional approach have failed to meet expectations.

The proposition of this study is that traditional due diligence alone is not sufficient for REIT mergers and acquisitions. There needs to be an expanded due diligence framework which not only looks at the financial, commercial and legal issues but one that is strategic in nature and assesses the rationale of the deal and whether the potential target presents realistic opportunities for growth. The proposed framework is the combination of the traditional due diligence assessments with the strategic due diligence approach. The adoption of this framework will potentially lead to greater probability of success and increased shareholder value where mergers and acquisitions are used as growth strategies.

Figure 6 : Proposed REIT M&A Due Diligence Framework



Source: Author (2017); adapted from Hawson (2003) and (Adolph et al. 2006)

2.7 Conclusion of Literature Review

Many listed companies use mergers and acquisitions as growth strategies, real estate companies are no exception to this phenomenon. In light of the high the failure rate associated with M&A and the drive towards more consolidations in the South African REIT market, it is important to analyse the risks involved in pursuing this strategy. A way to analyse risks is through a process of thorough due diligence assessments. Whilst many factors influence the success of corporate merger or acquisition transactions, the quality of the due diligence is one of the most critical aspects.

Due diligence in mergers and acquisitions involves evaluating the risks associated with a particular target company and devising strategies to minimise the chances of merger or acquisition transaction failure. Historically the focus of the due diligence assessments has been conducting the financial, legal, and commercial due diligence in order to verify the ‘facts’ as presented by the target company. This is known as the traditional due diligence.

Based on the literature review above however, traditional due diligence is no longer sufficient and there is a need for improved due diligence. The observed high failure rate in mergers and acquisitions is cited as proof that traditional due diligence is indeed no longer sufficient. As much as there is convergence of thought that traditional due diligence alone is no longer sufficient there are diverse opinions of what constitutes improved due diligence with many different suggestions. This research adopts the strategic due diligence approach as the best way to reduce the high failure rate in mergers and acquisitions.

The purpose of a traditional due diligence is to collect all relevant information that will uncover major risks related to a particular transaction (Jensen & Varano 2011); the purpose of strategic due diligence is to assess the benefits and constraints of the proposed acquisition and to predict the future functioning of the business to be acquired (Savovic & Pokrajcic 2013). Following Sarda and Rimner (2013), this research investigates the extent to which due diligence is done within the South African listed property sector and evaluates how that compares to the proposed strategic due diligence framework thereby shifting the emphasis from getting merger and acquisition deals done to getting them done right.

CHAPTER 3. RESEARCH METHODOLOGY

There are many possible ways of collecting data when conducting research; these can include surveys, interviews, questionnaires and case studies amongst others. This chapter outlines the research methodology followed for the collection and organisation of appropriate research data for this study.

3.1 Chapter Introduction

The objective of this study is to review the due diligence practices in real estate merger and acquisition transactions and develop a framework that will improve the chances of success where acquisitive growth strategies have been adopted. The literature review shows that as much as merger and acquisition transactions are growth strategies, there are many failed cases of such transactions. It has been suggested that due diligence is a way to reduce the high failure rates; however, it has not been done right or it has been limited to the traditional due diligence. This is not sufficient for merger and acquisition success. This raises the question of how is due diligence carried out by different practitioners within real estate merger and acquisition transactions? To get a deeper investigation, interviews with representatives of real estate companies that have been involved in merger and acquisition transactions are used as a source of data. These interviews will assist in guiding how a proper due diligence should be done within the new REIT structure.

The study draws from themes developed through the literature review and the responses from interviews with due diligence professionals.

3.2 Research Methodology / Paradigm

This research takes a qualitative approach. The approach is an interpretive philosophy that studies participants' meanings and relationships between them, within the approach there is a variety of data collection techniques and analytical procedures to develop a conceptual framework (Saunders, Lewis & Thornhill 2012). According to Denzin and Lincoln (2005), cited in Qualitative Data Analysis

(2016), qualitative research studies things in their natural settings, attempting to make sense of or interpret phenomena in terms of the meanings people bring to them. When applying qualitative research methods, the emphasis is on the natural setting and the points of views of the research participants. Yin (2011) describes 5 features of qualitative research, they are that qualitative research:

- studies the meanings of people's lives under real-world conditions;
- it represents the views and perspectives of the people;
- it covers the contextual conditions within which people live;
- it contributes insights into existing or emerging concepts that may help to explain human behaviour and;
- it strives to use multiple sources of evidence rather than relying on a single source.

With the study examining the current due diligence practices from the perspective of the practitioners and seeking to improve on the process, a qualitative approach is best suited to undertake this research as it fits into the five features of qualitative research. The research will observe the experiences of due diligence practitioners using an inductive approach. According to Yin (2011) inductive approaches tend to let the data lead to the emergence of concepts whilst Saunders et al. (2012) state that research using inductive approaches are likely to be concerned with the context in which the study events takes place. This research explores what the current due diligence practices are within the South African listed property sector based on the experiences of due diligence practitioners.

3.3 Research Design

A literature review on the due diligence assessments with specific focus on the adequacy of the traditional due diligence assessments in mergers and acquisitions has been conducted. Included in the literature review were academic journals, master's theses and professional reports on topics that included mergers and acquisitions and due diligence. The scope of the literature review was not limited to only a real estate field but it drew from a variety of industries in order to get a broader understanding of the topic. The literature review of the journal articles as well as the master's theses provided the theoretical grounding of the topic whilst the professional reports gave me a more practical view.

Questions for the research agenda are framed from the issues raised in the literature review, these questions directed the interviews that were conducted with due diligence practitioners from the sample of selected companies. The research questions are in the form of both open and close-ended questions.

3.4 Population and sample

3.4.1 *Population*

Competition Commission was the source of the companies included in the study. Interviews were held with each of the deal makers or persons responsible for due diligence from companies that have carried out a merger or acquisition transaction within the listed property sector (Listed REITs) over the last three years as recorded in the Competition Commission's merger and acquisition update reports.

The Competition Commission (CC) is a statutory body constituted in terms of the Competition Act, No. 89 of 1998. It is one of three independent competition regulatory authorities established in terms of the Act, with the other two being the Competition Tribunal and the Competition Appeal Court. The Competition Commission is an investigative and enforcement agency of the Department of Economic Development, it is empowered to investigate, control and evaluate restrictive business practices, abuse of dominant positions and mergers and acquisitions in order to achieve equity and efficiency in the South African economy (Competition Commission of South Africa 2016). All mergers and acquisitions transactions are regulated by the Competition Act, M&A transactions have to get competition commission approval; as such, the commission keeps a record of these transactions and their approval status.

For the purposes of this study, the Competition Commission's Merger and Acquisition Activity Update was used as the population from which a sample of merger and acquisition transactions was drawn. Section 11(5) “a” to “c” of the Competition Act sets out the classification of mergers and acquisitions as small, intermediate or large. This research is based on the large transactions, as the assumption is that more due diligence effort is placed on the larger transactions. According to Harvey and Lusch (1995) it is generally viewed as uneconomic to invest a lot in due diligence in terms of time and resources for small M&A transactions, therefore the larger transactions represent the best due diligence that can be done in the market, that is the due diligence that is analysed in this research.

3.4.2 *Sample and sampling method*

This research uses purposive sampling; Yin (2011) explains that it is a method where samples are chosen in a deliberate manner. The purpose of selecting this kind of sampling method is so that the most relevant data can be collected. The sample is drawn from a population of listed property companies that were involved in merger or acquisition transactions over the last three years. The period is to coincide with mergers and acquisitions that occurred since the adoption of the REIT structure in South Africa. The selected sample is based on the size of the transaction as categorised in the Competition Commission’s Merger and Acquisition Activity Update, particularly those transactions categorised as large. The sample is also selected based on the status of the transaction; the different statuses of the transactions are either approved, approved with conditions, pending, abandoned or withdrawn. The present research focuses only on the approved transactions.

Yin (2011) explains that in the selection of the units of the sample, it is important to obtain the broadest range of information and perspectives and that those units should include ones that may offer contrary evidence or views, especially given the need for testing rival explanations. This way the research avoids taking a biased view by only choosing sources that confirm a certain view. In this regard, the research sample consists of real estate companies that have been active in the merger and acquisition space over the past three years including those that increased shareholder value and those that diminished shareholder value.

Shown on the table below are REITs that have been involved in large merger and acquisition transactions over this period that have either increased or decreased shareholder value. Interviews with due diligence practitioners or dealmakers from each of the companies in the sample were requested; their responses form the basis of this research paper. For privacy and confidentiality reasons, the specific companies represented in this study are not mentioned specifically, however; it can be mentioned that from the intended sample of fifteen companies there were seven respondents who participated in the research.

Table 4: Mergers and Acquisition Update 2013 - 2017

Case Number	Primary Acquiring Firm	Primary Target Firm	Initial date filed	Size	Status	Date Finalised
2015Oct0572	Accelerate Property Fund Limited	Old Mutual Life Assurance Company (South Africa) Limited	16/10/2015	L	Approved	03/11/2015
2015Aug0447	Accelerate Property Fund Limited and AZRAPART Proprietary Limited	The Redevelopment of Fourways Mall	03/08/2015	L	Approved	17/09/2015
2015Oct0577	ARROWHEAD PROPERTIES LIMITED	REDEFINE PROPERTIES LIMITED in respect of the property letting enterprise known as Cleary Park	19/10/2015	L	Approved	03/11/2015
2016Feb0032	Ascension Properties Limited	Mutodo Properties Proprietary Limited in respect of jorissen Place	02/02/2016	L	Approved	23/02/2016
2015Jul0385	Delta Property Fund Limited	Orthotouch Limited, in respect of fifteen target properties	08/07/2015	L	Approved	15/09/2015
2015Dec0748	Delta Property Fund Limited	Redefine Properties Limited in respect of 15 target properties	22/12/2015	L	Approved	01/03/2016
2015Aug0487	Emira Property Fund Limited	Pilot Peridot Investments 1 (Pty) Limited, in respect of a 50% undivided share in Buildings A,C,D,E and G1 known as Summit Place	25/08/2015	L	Approved	20/10/2015
2015Mar0107	Emira Property Fund Limited, previously Friedshelf 1556 (Pty) Ltd	Property Fund and Strategic Real Estate Managers (Pty) Ltd	11/03/2015	L	Approved	21/04/2015
2013Apr0144	Fortress Income 2 (Pty) Ltd	The immovable properties and property letting enterprises of Pick 'n Pay Rustenburg, Central	04/04/2013	L	Approved	14/05/2013
2013Sep0440	Fortress Income 2 (Pty) Ltd	The property letting enterprise trading as "Arbour Crossing" and "Galleria Shopping Centre"	11/09/2013	L	Approved	08/10/2013
2013Apr0144	Fortress Income 2 (Pty) Ltd	The immovable properties and property letting enterprises of Pick 'n Pay Rustenburg, Central Park Bloemfontein, Nelspruit Plaza, New Redruth Alberton, Sterkspruit Plaza and Tzaneen Centre	04/04/2013	L	Approved	14/05/2013
2013Sep0440	Fortress Income 2 (Pty) Ltd	The property letting enterprise trading as "Arbour Crossing" and "Galleria Shopping Centre"	11/09/2013	L	Approved	08/10/2013
2015Jul0376	Fortress Income Fund Limited	Capital Property Fund Limited	03/07/2015	L	Approved	15/09/2015
2013Oct0498	Growthpoint Properties Limited	Abseq Properties (Pty) Ltd	15/10/2013	L	Approved	12/11/2013
2013Nov0557	Growthpoint Properties Limited	Tiber Property Group (Pty) Ltd	20/11/2013	L	Approved	21/01/2014
2013Oct0498	Growthpoint Properties Limited	Abseq Properties (Pty) Ltd	15/10/2013	L	Approved	12/11/2013
2013Nov0557	Growthpoint Properties Limited	Tiber Property Group (Pty) Ltd	20/11/2013	L	Approved	21/01/2014
2013May0184	Hyprop Investment Limited	Sycom Property Fund Managers Limited, in respect of the property letting enterprise known as 'Somerset Mall" and Somerset Mall Property Management Company (Pty) Ltd	07/05/2013	L	Approved	11/07/2013
2013May0184	Hyprop Investment Limited	Sycom Property Fund Managers Limited, in respect of the property letting enterprise known as 'Somerset Mall" and Somerset Mall Property Management Company (Pty) Ltd	07/05/2013	L	Approved	11/07/2013
2015Dec0663	INDLUPLACE PROPERTIES LIMITED	CLIDET NO.947 PROPRIETARY LIMITED, SUGAR CREEK TRADING 289 PROPRIETARY LIMITED, THE TRUSTEES FOR THE TIME BEING OF THE SAWHF SA RENTAL 3 TRUST	04/12/2015	L	Approved	09/02/2016
2015Jun0344	Investec Property Fund Limited	Certain target properties that are ultimately controlled by Griffin Holdings Properitery limited	23/06/2015	L	Approved	21/07/2015
2015Sep0518	INVESTEC Property Fund Limited	Friedshelf 113 Proprietary Limited, Double Flash Investments 51 Proprietary Limited and certain property letting enterprises held by associated trusts and managed by ZENPROP Property Holdings Proprietary Limited	10/09/2015	L	Approved	20/11/2015
2015May0250	Investec Property Fund Limited	Certain target properties that are ultimately controlled by Griffin Holdings Proprietary Limited and Raidel International Investments Limited	15/05/2015	L	Approved	21/07/2015
2015Aug0449	REBOSIS Property Fund Limited	TUPELO Properties Proprietary Limited ,	04/08/2015	L	Approved	25/08/2015
2015Feb0049	Rebosis Property Fund	Ascension (Pty) Ltd	25/02/2015	L	Approved	19/05/2015
2013Aug0410	Redefine Properties Limited	Chantilly Trading 95 (Pty) Ltd in respect of the property letting enterprise known as "Ellerines Warehouse Cato Ridge"	27/08/2013	L	Approved	17/09/2013
2013Dec0599	Redefine Properties Limited	Grapnel Property Investments (Pty) Ltd	11/12/2013	L	Approved	24/01/2014
2013Aug0410	Redefine Properties Limited	Chantilly Trading 95 (Pty) Ltd in respect of the property letting enterprise known as "Ellerines Warehouse Cato Ridge"	27/08/2013	L	Approved	17/09/2013
2013Dec0599	Redefine Properties Limited	Grapnel Property Investments (Pty) Ltd	11/12/2013	L	Approved	24/01/2014

Case Number	Primary Acquiring Firm	Primary Target Firm	Initial date filed	Size	Status	Date Finalised
2015Jul0423	REDEFINE PROPERTIES LIMITED	RESPUBLICA STUDENT LIVING PROPRIETARY LIMITED	21/07/2015	L	Approved	04/08/2015
2015Oct0586	REDEFINE PROPERTIES LIMITED, THE PIVOTAL FUND LIMITED, ABSHELF PROPRIETARY LIMITED	CIRANO 300 INVESTMENTS PROPRIETARY LIMITED in respect of a 75% undivided share in Erf 221, Rosebank, known as the Galleria	21/10/2015	L	Approved	02/02/2016
2013Dec0616	Redefine Retail (Proprietary) Limited	The Trustees for the Time Being of the Maponya Mall Property Trust and Redefine Retail (Proprietary) Limited	19/12/2013	L	Approved	31/01/2014
2013Dec0616	Redefine Retail (Proprietary) Limited	The Trustees for the Time Being of the Maponya Mall Property Trust and Redefine Retail (Proprietary) Limited	19/12/2013	L	Approved	31/01/2014
2013Sep0429	Resilient Properties (Pty) Ltd	Arbour Town (Pty) Ltd	06/09/2013	L	Approved	17/09/2013
2013Sep0429	Resilient Properties (Pty) Ltd	Arbour Town (Pty) Ltd	06/09/2013	L	Approved	17/09/2013
2013Jun0288	SA Corporate Real Estate Fund c/o Old Mutual Property Limited	A portfolio of commercial property of Lushaka Investments (Pty) Ltd	21/06/2013	L	Approved	27/08/2013
2013Jun0288	SA Corporate Real Estate Fund c/o Old Mutual Property Limited	A portfolio of commercial property of Lushaka Investments (Pty) Ltd	21/06/2013	L	Approved	27/08/2013
2013Jun0271	Vukile Property Fund Limited	5 properties owned by Encha Properties (Pty) Ltd	11/06/2013	L	Approved	23/07/2013
2016Mar0104	Vukile Property Fund Limited	SA Retail Properties (Proprietary) Limited, Known as Pinecrest Centre	17/03/2016	L	Approved	30/03/2016
2015Jul0410	Vukile Proprietary Fund Limited	Flanagan & Gerard Investments (Proprietary) limited and East & West Investments (Proprietary) Limited, in Respect of each firm's 50% interest in the Bedworth Centre Letting Enterprise	15/07/2015	L	Approved	04/08/2015

Source: Author (2017) adapted & modified from Competition Commission M&A Update April 2013 – March 2016

3.5 The research instrument

The main research instrument according to Yin (2011) is the researcher; Farber (2006) concurs stating, "no matter what you are studying, your research instrument will always remain the same, the research instrument is you." This is because in qualitative research the researcher participates in the research by interviewing and interacting with the participants. It is therefore important for a researcher to be aware of the biases that they may bring to the study.

The research makes use of in-depth and semi-structured interviews; Saunders et al. (2012) are of the view that in-depth and semi structured interviews enable respondents to share their experiences in their own words and they allow the researcher the opportunity to probe answers where more detail in needed. This method is used in the present research as it is necessary to determine what the standard practices are amongst real estate due diligence practitioners when investigating a potential merger and acquisition transaction. Inferences of the due diligence practices drawn from the interviews are compared with findings in the literature as well as to due diligence practices employed in the more developed REIT markets. This will direct the research on the kind of interventions needed to improve due diligence.

3.6 Procedure for data collection

Data collection in qualitative research generally includes two processes, interviews and observation. Depending on the type of study, research may make use of other data collection procedures (Farber 2006). Yin (2011) extends on this list of procedures for data collection to include collecting and examining of materials and feeling. This research is based on a sample of seven listed property companies that have undertaken major mergers and acquisition deals in the last 3 years. With all the selected companies having their head offices in the broader Johannesburg area, it was possible to conduct interviews with the dealmakers in the respective companies. Below is a summary of the data collection procedure applied in this research.

Interviews

Interviews are a commonly used source of data in qualitative studies with the person-to-person format being the most prevalent of interview formats. Depending on the scope and time constraints under which a particular research is done, group interviews and focus groups can be conducted (Thomas, Nelson & Silverman 2010). Interviews can range from a highly structured style where questions are determined before the interview, to an open ended, conversational format (Thomas et al. 2010).

Yin (2011) describes three features of structured interviews. Firstly, the researcher uses formal questionnaires that list all the questions, secondly he adopts the role of an interviewer and elicits responses from the interviewee and thirdly he must try to adopt the same consistent behaviour and demeanour when interviewing each of the respondents in order to collect the data as uniformly as possible. The semi-structured or conversational format that is termed “qualitative interviews” in Yin (2011) differs to the structured interviews in that it less rigid and it allows for two-way interactions. According to Brenner (2006) cited in Yin (2011) structured interviews follow directly the word usage, phrases, and hence meaning of the researchers, whereas qualitative interviews aim at understanding participants on their own terms and how they make meaning of their own lives, experiences, and cognitive processes.

In the present study, a semi-structured interview approach was taken where a set of both open and close-ended questions were posed to the respondents. Flexibility was allowed where the respondents could raise any other pertinent issues. The venue for the interviews must provide an environment that is conducive for the respondents to speak freely and openly about their experiences, for that reason interviews were conducted at each of the respondent’s places of work. This is in keeping with Farber (2006) who states that it is important to make respondents feel as comfortable as possible when asking them to share their experiences, they should decide where the interviews are to be conducted and they must be assured of privacy and confidentiality. In this way, they will be at ease to share their experiences. After explaining the purpose of the interviews, how the information the participant’s shared would be treated and receiving consent from the participants, each of the interviews was recorded and later transcribed for analysis.

Due to the amount of time between the different merger and acquisition transactions analysed in this research which span from 2013 to 2016, it was important to get representatives from companies who were involved in due diligence assessments within that time frame or who had recent experience. From one of the questions asked, it is determined that 6 of the 7 interview participants have recent experience. Therefore, their responses are not at risk of having significant distortions due to memory lapses.

When conducting the interviews, a similar approach was followed with each participant where set questions were posed and where necessary for more clarity there were follow up questions. In instances where new themes came up that were not part of the questionnaire, respondents had the opportunity to express their views. However, attention was given to ensure that all the set questions were posed to and answered by each participant.

Interviews were conducted with experienced professionals who have intimate knowledge and insight of the transactions they were involved in. Since the participant were assured of privacy and confidentiality, they could speak candidly about the transactions knowing their identities or the particular transaction would not be divulged thereby avoiding but not eliminating bias from the participant.

The interviews were recorded using a digital recording devise; this method of recording and storing interview data is the most commonly used method as it preserves the entire verbal part of the interview for later analysis (Thomas et al. 2010).

3.7 Data analysis and interpretation

Saunders et al. (2012) suggests an analysis approach based on the work of Miles and Huberman (1994) as an approach to use for qualitative data analysis. The approach consists of three concurrent sub-processes that include data reduction, data display and drawing and verifying conclusions. The present research has followed this approach together with a manual content analysis of the summarised data.

In data reduction, the collected data is summarised and simplified or there is data that is focused on selectively. The aim here is to condense the data for analysis by way of producing interview or observation summaries, coding and categorising data and constructing a narrative. Data display involves organising and assembling the summarised data into diagrammatic or visual displays in matrices or networks.

Drawing and verifying conclusions involves comparing and contrasting as well as noting patterns and trends in the data. According to Saunders et al. (2012) the researcher has to verify the conclusions by way of triangulation, this means using alternative data sources which in this case will be the literature review and the interviews to provide verification of the key findings.

The present research has used the approach where the transcribed data from the interviews was analysed and summarised in order to develop a narrative from the recurring themes within the participant's responses. The analysis process entailed coding the emerging themes so that visual representations of these could be produced, these representations form part of the research report. The research instrument uses semi-structured interviews; the interviews were fairly standardised so this allowed comparisons to be made between the different responses and the literature review when conclusion were drawn.

3.8 Limitations of the study

This study is limited to reviewing the due diligence process in order to improve the chances of success in mergers and acquisitions and there by produce a framework of an improved due diligence assessment for the listed property sector in South Africa. It is limited to reviewing due diligence practices of merger and acquisition transactions between companies listed on the JSE. Respondents from fifteen companies were selected to share their experiences and due diligence procedures however less than half of ended up agreeing to be part of the research. The number in the sample is much smaller than the population of due diligence practitioners in the South African listed property sector. Due to the time in which the study has to conducted, it would be impossible to interview all the practitioners. The research is limited in this regard but it does give an indication of the due diligence practices; as such, the findings are to be read in that context.

The research is also limited in that there has been no control for other factors that may have an influence of the performance of merger and acquisition transactions other than due diligence.

3.9 Validity and reliability

The credibility of the findings of this research is improved by the use of triangulation in the data collection procedures where the themes which were developed from the literature review about the adequacy of traditional due diligence in mergers and acquisitions were tested against the responses from the interviews. The validity and reliability of the information gathered during the literature review phase was ensured by relying on peer reviewed journal articles and theses from reputable institutions of higher learning. To ensure the validity and reliability of the interviews, each of the respondents was given an opportunity to read over any notes taken in the interview and listen to the voice recordings.

This has ensured that the data is captured and recorded correctly, it also gives the respondents a chance to add any other pertinent information that they may have missed. This is respondent validation which is obtaining feedback from the people studied in order to lessen the misinterpretation of data gathered (Yin 2011).

Responses were then analysed against the literature reviewed. In this way, the plausibility of the responses was determined and selections were made on which responses to utilise in the research (Saunders et al. 2012).

3.10 Ethical Considerations

It is necessary to obtain informed consent from the respondents and ensure that their privacy is respected. Informed consent was achieved by giving the respondents the full information on the purposes of the research and by explaining to them the manner in which the interview were to be conducted. For the purposes of privacy, respondents have been allocated pseudonyms so they are not easily identifiable and the specific company that they represent in the sample is not be divulged. This is in keeping with the recommendations by Allmark et al.(2009) who conducted an extensive literature review on the topic of ethical issues in in-depth interviews in qualitative research focusing on the themes of privacy and confidentiality, informed consent, harm, dual role and over-involvement and politics and power. On the themes that are relavant to this study namely privacy and confidentiality and informed consent, Allmark et al. (2009) recommend the following ways to deal with the ethical considerations:

- Privacy and Confidentiality

  The use of pseudonyms or initials where possible, it is further recommended that the researcher change any other identifying details in the report. Participants must be informed that it may be impossible to assure complete confidentiality, even if pseudonyms are used, as some readers may be familiar with the information discussed in the interview process.

The papers reviewed by Allmark et al. (2009) also recommend that researchers draw up a plan of action for instances where it may be appropriate to breach confidentiality. These instances may be where disclosures are made about illegal activities; no such instances arose in during the interviews

- Informed Consent

The recommendations on informed consent focus on the importance of providing detailed information to participants about the nature of the research and the need to gain written consent. Allmark et al. (2009) note that some studies recommend oral consent in research but they advise against such type of consent. As such, written consent was sort in the present research; respondents were informed at the outset of the purpose and scope of the study and the types of questions likely to be asked.

Other information used in the study was already available in the public domain such as the company’s annual financial statements, thus there are no ethical considerations in dealing with that type of information.

CHAPTER 4. PRESENTATION OF RESULTS

4.1 Chapter Introduction

To aid the analysis process and answer the research questions at hand, the transcribed and summarized data from the recorded interviews is presented in data displays. This is in keeping with Miles and Huberman (1994) who state that "valid analysis is immensely aided by the use of data displays that are focused enough to permit viewing of a full data set in one location and are systematically arranged to answer the research question at hand."

4.2 Demographic profile of respondents

The respondents to the research have extensive experience in due diligence assessments of property related merger and acquisition transactions with forty-nine years combined experience. They represent a number of REIT companies listed on the Johannesburg Stock Exchange. For privacy and confidentiality reasons none of the respondents names or the companies they represent is specifically mentioned, rather the respondents are identified as Respondent 1, 2,3,4,5,6 and 7 where a reference is made. The respondents comprise of real estate professionals who hold management or executive positions within their companies; their responsibilities include looking after the company's M&A transactions, managing the acquisition and disposal processes on individual property transactions or property portfolios and conducting due diligence analyses.

As mentioned in paragraph 1.3, the local REIT market was valued at R380 billion as at December 2016; this is according to the South African REIT Association. The respondents in this research represent companies with a combined market capitalisation of approximately R175.4billion, which translates to 46.16% of the total market. The companies represented in the study include a variety of listed funds from large, medium and small property funds that were involved in large merger and acquisition transactions over the last three years.

Since the adoption of the REIT structure in South Africa in April 2013 to December 2016, the listed property sector managed to raise R153 billion in equity raises to fund consolidations in the sector (Anderson 2016). This amount is used as the total value of merger and acquisition transactions, with the assumption being that a significant portion of the amount raised would have gone to funding such transactions. Using the Competition Commission's (CC) Merger Activity update it was established which of the approved transactions were between REIT companies listed on the JSE and what the size of the transactions were as per CC categorisation. Data sourced from publicly available media reports assisted in attaching values to each of the transactions in the sample size, the value of the transactions in the sample size therefore came to R123.2 billion (80.52%) of the total transaction value in the population.

As mentioned in chapter 3.4.2 the intended sample size was to get responses from fifteen REIT companies, ultimately respondents representing seven REIT companies agreed to participate in the research. These respondents make up a combined M&A transaction value of R56.4 billion which translates to 37.37% of the population value or 45.8% of the sample value. Even though the response rate seems low in percentage terms, the aggregate transaction value of R56.4billion is quite significant, it would be reasonable to expect that due diligence assessments conducted in these transactions would be reflective of review processes conducted in other large transactions.

Table 5: REIT Merger and Acquisition Transaction Values

Demographics	Estimated Transaction Value	%
Population Value	R153 billion	100.00%
Sample Value	R123.2 billion	80.52%
Respondents Value	R56.4 billion	45.77%

The REIT companies represented here were involved in seventeen large merger and acquisition transactions as characterised by the competition commission. An analysis of the impact of each of these transactions on the share price one-year post the completion of the transaction suggests that there is a 59% failure rate where merger and acquisitions were used as a growth strategy within the South African REIT market. The share values of each company were noted from Sharenet, a reputable financial and investment website, the share values were tracked from the date that the transaction was finalised to exactly one-year post the transaction completion date, a similar approach is used in a KPMG survey of merger and acquisition transactions. The difference in the share price conveys whether the M&A transaction succeeded or if it failed. The 59% failure rate noted in South African REIT M&A transactions is better than the 83% failure rate noted in non-REIT M&A transactions noted KPMG's 1999 mergers and acquisitions report. The KPMG mergers and acquisitions report uses a sample drawn from 107 transactions in various industries. The report found that successful companies were those that prioritised hard key components such as DD in the pre-deal phase. Due diligence is considered one of the most important factors for REIT M&A success amongst the respondents to the present research. The better success rate in South African REIT M&A transactions can be attributed to the fact that practitioners in the SA REIT market realise and appreciate the importance of due diligence in M&A transactions whereas most of the respondents in the KPMG report focused more on issues surrounding arranging finance for the deal.

Table 6: Transaction Impact on Share Price

Transaction by Sample	Size	Status	Date Finalised	Value of Transaction (R'000'000)	Share Price in Cents at transaction date	Share Price in Cents 1 year post	Impact	Outcome
Transaction 1	L	Approved	20/10/2015	403.00	1,798.00	1,394.00	-22.47%	Failure
Transaction 2	L	Approved	21/04/2015	448.00	1,806.00	1,586.00	-12.18%	Failure
Transaction 3	L	Approved	12/11/2013	1,300.00	2,405.00	2,618.00	8.86%	Success
Transaction 4	L	Approved	21/01/2014	6,600.00	2,308.00	2,943.00	27.51%	Success
Transaction 5	L	Approved	12/11/2013	18,000.00	2,405.00	2,618.00	8.86%	Success
Transaction 6	L	Approved	21/07/2015	826.00	1,661.00	1,490.00	-10.30%	Failure
Transaction 7	L	Approved	20/11/2015	7,600.00	1,495.00	1,580.00	5.69%	Success
Transaction 8	L	Approved	25/08/2015	495.00	1,129.00	1,079.00	-4.43%	Failure
Transaction 9	L	Approved	19/05/2015	4,000.00	1,239.00	1,033.00	-16.63%	Failure
Transaction 10	L	Approved	20/05/2015	5,000.00	1,239.00	1,033.00	-16.63%	Failure
Transaction 11	L	Approved	04/08/2015	1,203.50	1,173.00	1,160.00	-1.11%	Failure
Transaction 12	L	Approved	31/01/2014	1,300.00	885.00	1,138.00	28.59%	Success
Transaction 13	L	Approved	23/07/2013	1,400.00	1,605.00	1,640.00	2.18%	Success
Transaction 14	L	Approved	30/03/2016	389.00	1,712.00	1,920.00	12.15%	Success
Transaction 15	L	Approved	04/08/2015	355.00	1,830.00	1,782.00	-2.62%	Failure
Transaction 16	L	Approved	01/12/2016	3,800.00	1,050.00	950.00	-9.52%	Failure
Transaction 17	L	Approved	02/08/2015	3,287.00	1,115.00	900.00	-19.28%	Failure

Source: Author (2017)

Based on the demographic profile of the respondents and the value of the transactions represented in this research, it is fair to assume that the responses generated in this study are reliable and representative of the market. Therefore, inferences are made from the responses.

4.3 Close-ended questions results

The research contains both open ended and close-ended question; results in this section pertain to close-ended questions that limit the respondents to the set of alternatives offered (Reja et al. 2003). In this case, either the respondents could answer “yes” or “no” to nine questions, this was necessary to capture the essence of their views. The respondents had the opportunity to explain points further if they wanted to. The full interview questions are attached annexure D for reference.

Table 7: Results of Close-ended questions

Question	Yes	%	No	%	Total
3	6	86%	1	14%	7
11	2	29%	5	71%	7
13	3	43%	4	57%	7
14	4	57%	3	43%	7
15	7	100%	0	0%	7
16	5	71%	2	29%	7
20	2	29%	5	71%	7
21	7	100%	0	0%	7
24	7	100%	0	0%	7

4.4 Subjective-ranking questions results

In question eight, the respondents were asked what types of due diligence assessments they consider most relevant for REIT M&A transactions. Legal due diligence was mentioned the most appearing thirteen times in the responses explaining the areas of due diligence that need to be investigated. Sustainability and post-merger issues was the least mentioned appearing only once in the responses.

Table 8: Results of Subjective Ranking Questions

Areas of DD	Number of Mentions
Legal DD	13
Tax DD	9
Company/Commercial DD	8
Financial DD	6
Regulatory Issues	5
Property DD	5
Environment DD	2
Technical DD	1
Sustainability Issues Post Transaction	1

In question ten respondents were asked to rank the following nine categories in order of importance wherein one was most important and nine the least important.

- Arranging finance for the deal
- Developing the company's overall merger and acquisition strategy
- Developing a post M&A integration plan
- Evaluating the possible synergies that can be exploited
- Identifying the management team that will lead the merged/new company
- Performing the due diligence assessment
- Selecting the target company to merge with
- Understanding and resolving the different companies' cultural issues

The raw data of the responses obtained from respondent 1 to 7 is as follows:

Table 10: Factors Most Important for REIT M&A Success

Order of Importance	R1	R2	R3	R4	R5	R6	R7
Arranging finance for the deal	6	6	7	9	5	9	5
Developing the company's overall merger and acquisition strategy	1	1	1	1	4	1	1
Developing a post M&A integration plan	8	8	6	6	7	2	7
Evaluating the possible synergies that can be exploited	3	4	2	7	8	5	9
Identifying the management team that will lead the merged/new company	7	7	8	2	6	3	6
Performing the due diligence assessment	5	5	5	4	3	4	3
Pricing the deal right to avoid over paying	4	3	4	5	2	7	4
Selecting the target company to merge with	2	2	3	3	1	6	2
Understanding and resolving the different companies' cultural issues	9	9	9	8	9	8	8

The aggregated data for responses to question ten is as follows:

Rank #	Order of Importance	Weighted Response
1	Developing the company's overall merger and acquisition strategy	10
2	Selecting the target company to merge with	19
3	Performing the due diligence assessment	29
4	Pricing the deal right to avoid over paying	29
5	Evaluating the possible synergies that can be exploited	38
6	Identifying the management team that will lead the merged/new company	39
7	Developing a post M&A integration plan	44
8	Arranging finance for the deal	47
9	Understanding and resolving the different companies' cultural issues	60

Preforming due diligence was ranked as the third most important factor for the success of REIT mergers and acquisitions. It fell behind developing the company's overall merger and acquisition strategy and selecting the target company with which to merge. Understanding and resolving the different companies' cultural issues was ranked the least important, similarly in question eight where respondents were asked what types of due diligence are most relevant for REIT M&A transactions sustainability issues which would be the soft due diligence was mentioned the least.

4.5 Summary of open ended questions results

This section provides an overview of the responses received during the interview process; it summarizes the main points and highlights the emerging themes from the data.

The first set of questions in the interview agenda, specifically questions one to four dealt with the background information such as the respondents' position, experience, their most recent involvement in due diligence assessments and their specific roles and areas of responsibility in those assessments. These questions helped establish the relevance of the respondent’s participation in the research; and the responses are captured in the demographic profile of respondents section above. For this reason, the executive summary of the results commences from question five.

Defining due diligence

The respondents defined diligence using the following phrases:

An investigation of the detail and assumptions of the target, verifying and understanding transaction, checking or verifying facts, a process to de-risk the transaction, a thorough investigation, confirmation of what has been presented, an assessment of the target acquisition, and making sure of the detail of the transaction.

The importance of due diligence assessments for the success of REIT M&A. Is DD a box ticking exercise?

The respondents described due diligence as crucial, very important, very crucial, essential, critical, and very important for the success of REIT merger and acquisition transactions. A majority of respondents do not see due diligence as a box ticking exercise with four respondents saying it is about verifying facts, 2 saying it depends on the nature and size of the transaction and only 1 respondent saying it is a box ticking exercise.

One of the respondents said:

“Due diligence assessments are absolutely essential for the actual transaction to be successful to the company, to actually be of value-add and to make sure that the acquisition is a good deal for you or not. If you view them as just box ticking exercises then the impact of that transaction on your company whether it is a merger or just merely an acquisition will one day come through the woodwork. I do not think you would meet the objectives that you set out to achieve if that DD is not carried out correctly.”

Objectives of conducting due diligence assessments in terms of REIT M&A and are these objectives met?

Five broad themes emerged on what the objectives of due diligence are, they are that due diligence should mitigate risk, verify facts, help the acquirers understand what is being acquired, to align the parties strategic objectives, test for synergies between the companies and to deal with structural issues of the transaction. Respondents say that due diligence meets these objectives but there are caveats.

Areas of due diligence most relevant for REIT M&A transactions

Legal, tax, company, commercial, financial, property, environmental and technical due diligence. Other areas of due diligence were in relation to the regulatory issues and sustainability of the transaction post the M&A.

Aspects of practitioners due diligence assessments; are they effective?

The deal or transaction must be informed by a corporate strategy. Due diligence process involves assembling a team with different expertise, these will focus on commercial DD, tax DD, legal DD, investment bank to deal with stock exchange requirements, debt structuring, commercial aspects, property DD, company/commercial DD, financial DD, and legal DD.

According to one respondent the process starts from the company strategy. If a potential deal fits the strategy and the target company shows interest then the deal will be brought internally for investment committee approval. Non-disclosure agreements are signed, information is shared and preliminary due diligence process starts then you move onto the actual due diligence, the outcome of the due diligence would then determine if you go and make a revised offer to the seller or you walk away or you conclude on the same basis.

On whether these are effective, respondents felt that due diligence could always be more effective or more thorough but it is about finding that right sort of balance between doing the due diligence and concluding the deal.

Most important factors for the success of a REIT merger and acquisition transactions.

Developing the company's overall merger and acquisition strategy is by far the most important aspect for the deals success with 86% of the respondents rating it number one, it was followed by selecting the target company to merge with and performing the due diligence assessment was at number three. The least important according to the respondents is understanding and resolving the different companies' cultural issues.

Recurring reasons for M&A failure

- Deals that don't work for both parties
- Parties not being reasonable in what they expect (price issues)
- Timing, non-alignment of incentives between management and shareholders, pricing, cultural issues, different views in strategies.
- Unrealistic pricing, seller's behaviour, failure to agree on a price, agreeing on future management, doing things in haste.
- Lack of buy in on a single strategy by the two sets of managers, aggressive yields (price), lack of shareholder buy in / support.

Cost implications and its influence on intensity of DD done for a particular REIT M&A deal.

- It is a factor depending on where one is in the process, cost implications do sometimes influence due diligence intensity. Companies are probably more concerned about time and effort spent rather than the rand or figures. We are willing to pay a premium for quality, we'll negotiate but we won't let price issues compromise the quality.
- I don't think it should, I don't think really costs are a factor, you have to bear those costs, I don't think cost saving should be a factor because there has to be an in depth DD investigation on an M&A. No, I am not aware of those being an issue. Well I would not say so; the cost of acquiring something is the cost...I think regardless of what it costs.

Does the size of the M&A deal influence the amount of due diligence that is done?

No, no, it depends. Yes, some of them size brings complexity. Yes, I would say it certainly would. You have to follow the same intensity of due diligence irrespective of the size. Yes, absolutely. Yes, it definitely would. It influences the complexity.

Does the nature of the M&A deal affect the type of due diligence that is conducted?

The nature of a deal affects the DD that is done this is because of the access to information or lack thereof when a transaction is hostile versus when it is friendly.

Views on traditional way of conducting due diligence assessments. Is it sufficient for REIT M&A?

It depends on deal, traditional DD is ok for straightforward transactions otherwise not, there needs to be a wider scope. No, no it is not you need to extend wider. Sufficient depending on detail of each of the categories. Somewhat sufficient but moving into a time where not. Yes it should be sufficient... depends on depth of investigation. No, I think it is definitely not. The traditional due diligence ticks the boxes.

Most common mistakes made in performing due diligence assessments?

Lack of detail in due diligence. Not being thorough enough is part of the problem, lack of focus on the long term sustainability of aspects, getting bogged down by detail that is potentially not relevant, assuming that the seller's assumptions are correct and paying too much attention to detail that doesn't really affect the deal.

Has the execution of due diligence changed in your experience where due diligence techniques have been modified i.e. where the traditional due diligence has been modified?

It's a constantly evolving and changing process for all companies. As companies become more exposed to different risks and experience different market factors impacting them, they will adjust their due diligences accordingly to try and create mitigating strategies for those risks that do arise. I think it's sort of a live and learn scenario where you improve things as you go.

<u>How and why have these due diligence techniques changed in your opinion?</u>

The space has become more and more competitive. There is all sorts of additional structuring that you would need to do and because of that and everyone trying to find an angle where you would do a deal with me as opposed to another REIT you would have to do a more thorough DD to make sure all of that structuring stacks up

<u>Research supports the idea that the new techniques improve the chances of M&A success as they are more efficient than the traditional due diligence. They take into account other critical success factors such as strategic due diligence. What is your opinion on this?</u>

I think it does up to a limit, so you know if you go and say here is the traditional scope I'm going to increase it slightly then I think that's okay. If you increase it like two or three times then you are just going to over complicate the process and increase the timelines of the deal and potentially upset your counter party by being too detailed. So there is a balancing act, you cannot just widen the scope indefinitely because then you are just going to impede the deal

<u>Overall, do you think that the combination of traditional due diligence with new techniques can improve the chances of M&A success?</u>

Yes definitely. I think the only point I want to highlight is that particularly in a modern company there is a lot more complexity and you have to ensure that you have people that are properly trained to carry out the due diligence exercise.

CHAPTER 5. RESENTATION AND DISCUSSION OF THE RESULTS

5.1 Chapter Introduction

The chapter presents the analysis and discussion of the results obtained from interviews and it refers to the literature review for triangulation purposes.

5.2 Discussion of Results

In the literature the concept of due diligence is said to be a process of analysing key aspects of the target company including financial aspects, legal aspects, human resources, operations and business aspects. Due diligence is done in order to give a level of comfort to the acquirers that a target company will not unravel and diminish shareholder value. This section analyses the respondents' understanding of due diligence based on the results from the research questions.

5.2.1 *Practitioners Perceptions of Due Diligence*

In question 5 the respondents were asked to define due diligence, generally, the respondents' definitions of due diligence are in line with the literature as far as the definition relates to analysing key aspects of the target company. In their definitions of due diligence, the respondents use phrases such as "investigation into the detail of a transaction", and "thorough investigation of the entity". Of concern, is that some of the respondents view due diligence as simply a process of verifying information rather than a process of analysing information and digging deeper into the detail of the target company.

The word verify was used the most amongst the respondents in defining due diligence, this means that practitioners may just be scratching the surface in terms of their due diligence assessments. They may only be verifying the information that they receive from the target companies and not examining it in a methodical manner in order to explain and interpret what that information means for the deal. Although the respondents say due diligence is a tool to de-risk transactions and help them make informed decisions, this may not necessarily be the case as their processes are limited to just verifying information. Due diligence professionals in the REIT environment need to verify the information and conduct a thorough analysis of it in order to arrive at a point where an informed decision can be made. Otherwise, transactions may be no less risky than they were prior the due diligence assessment if the process is limited to verifying information from the target company.

Objectives of Due Diligence

In response to question 7, which deals with the objectives of due diligence, seven broad themes emerged from the responses. They are that due diligence should mitigate risks, verify facts, help the acquirers understand what is being acquired, help the acquiring firm determine if the target is aligned to their strategic objectives, test for synergies, deal with the structural issues of the transaction and it should help investors in making informed decisions. These objectives concur with those outlined by Moller (2009), Jensen and Varano (2011) and Savovic and Pokrajcic (2013) in the literature review. Moller (2009) advances the best description of due diligence objectives, he proffers that due diligence should contribute towards the realisation of strategic company goals and that it should not only be about identifying risks but also be about identify opportunities that can help realise future prospects of the consolidated company and increase shareholder value. Evidently, the respondents understand these objectives, and 57% believe that the objectives of due diligence are met.

The 59% failure rate observed in the sample results of REIT merger and acquisition transactions in the last four years suggests the contrary, respondent 2 explains that objectives are sometimes not met due to parties not divulging full information and respondent 7 says objectives of due diligence are met depending on the extent and the rigour of the due diligence. The caveat is that as long as there is full disclosure of the facts surrounding all aspects of the target company followed by a rigorous due diligence, then the objectives should be met. In this context, the 59% failure signifies that there are instances where there is limited disclosure of information between the transacting parties, therefore it is incumbent on the acquiring party not just to verify the information given by the target but to also conduct their own thorough due diligence.

Importance of Due Diligence

The importance of due diligence cannot be stressed enough; according to Moeller (2009) it is perhaps of greater importance than target selection, negotiation, pricing the deal and the development of the company's overall merger and acquisition strategy. It is encouraging to see that 86% of the respondents do not view due diligence as merely a box ticking exercise. The respondents view due diligence as crucial for the success of REIT mergers and acquisitions. Respondent 1 said it's crucial because there is hardly a time when due diligence is done and nothing is found that requires further negotiation or further structuring; whilst respondent 2 said it is crucial due to the need to understand the risks and provide for them. Respondent 3 was of the opinion that due diligence is absolutely essential for the actual transaction to be successful to the company, for it to actually be of value add and to make sure that that acquisition is a good deal. Only respondent 7 viewed due diligence as a box ticking exercise saying "it is box ticking yes, but it is also a very important process in that it gives management a better understanding of the assets". If due diligence is viewed merely as a box ticking exercises then the impact of a transaction on the company whether it's a merger or an acquisition will one day come through the woodwork and the objectives of that transaction won't be met.

Even though the respondents acknowledge the importance of due diligence, for them it is not the most important factor for merger and acquisition success as Moeller (2009) suggests. Respondent 1 is of the view that the most important factor is being able to structure the deal upfront on a high level and determining its strategic fit with the acquiring firm. According to the respondent, if the structure works and it is in line with the company strategy, one can always make sure later on during the due diligence that other factors also work.

On a subjective ranking scale of one to nine where the respondents had to rank the order of importance for the success of a REIT merger and acquisition transaction based on the factors mentioned in question 10, with 1 being most important and 9 being the least important, due diligence was ranked third. This shows that the respondents disagree with Moeller's (2009) assertion that due diligence is the most important factor. According to the consolidated responses, "*developing the company's overall merger and acquisition strategy*" is the most important factor for the deal success, with 86% of the respondents ranking it as number 1. This is in line with Moordoukoutas (2011) who opines that mergers and acquisitions that begin with the right strategy enhance shareholder value. McDonald et al. (2005) concurred, stating that the lack of strategic rationale behind mergers and acquisitions is one of the reasons for the high failure rate.

According to McDonald et al. (2005) due diligence is an effective tool to ensure there is alignment between an organisations strategic plan and the potential merger and acquisition transaction. In that case, due diligence cannot be the most important aspect when one of its objective is to ensure that the transaction meets the strategic rationale of the acquiring company. The respondents realised this, and ranked strategy ahead of selecting the target and performing due diligence. Respondent 4 stressed that the company's merger and acquisition strategy needs to be clear so that if there is a potential transaction that looks attractive but is not in line with the strategy, then it is clear from the onset that it should not be pursued. The least important factor according to the responses is resolving the different companies' cultural issues. Once the companies merge, there needs to be a buy in into one set of culture and values otherwise the merged entity will not function efficiently. The fact that resolving these issues is so low on the priority of practitioners is concerning as unresolved cultural issues are cited in the literature as recurring reasons for merger and acquisition failure. A concerted effort by practitioners towards understanding and resolving the cultural issues that may exist between the merging companies post the deal closure is necessary to diminish the levels of M&A failure. Practitioners must devise strategies to resolve cultural issues; leaving them unattended can negatively affect the chances of success of merger and acquisition transaction even if due diligence is done properly and it doesn't just focus on the traditional scope.

5.2.2 *Due Diligence in Practice*

<u>Aspects of Due Diligence</u>

Due diligence practices vary widely from transaction to transaction, what is clear is that there are a number of professionals involved in the process. The different professionals focus on their areas of speciality and compile reports based on their own assessments. The respondents processes include a preliminary due diligence where a potential transaction is considered based on its strategic fit with the acquiring firm, the results of this stage are then presented to internal investment committees for consideration. If approved an offer is made subject to a full due diligence where all the specific areas of the due diligence will be investigated. The outcomes of the full due diligence will determine if the price is either renegotiated or if the parties walk away from the transaction. If it is single property acquisition, the complexity reduces as some areas of due diligence are not necessary.

The respondents were further asked what in their experience had been the recurring reasons for merger and acquisition failures. The prominent reasons mentioned by the respondents were timing, paying too much for the acquisition, different views in strategy and doing things in haste. These reasons for failures encompass some of the ones mentioned in the literature. Literature mentions poor synergy, incompatible organisational culture and a lack of communication with key stakeholders during the m&a process as reasons for failure. Curiously, the respondents did not mention poor synergy and incompatible organisational culture as reasons for failure, an answer to a preceding question suggests that the respondents view resolving cultural issues as the least important factor for merger and acquisition success. This could be the contributing factor to the high failure rate observed in the sample of REIT transactions; respondents have a very low opinion of cultural issues on deal success. Respondents also need to consider how they communicate with stakeholders of the target company, it is important to establish rapport upfront with stakeholders, in this way challenges associated with limited disclosure of information can potentially be resolved. It would still be the responsibility of the acquiring firm to perform their own due diligence to check the veracity of the information and perform their own analyses to inform their decision. Respondent 4 cautions against relying on the information received from the target company without interrogating it saying;

> “never assume that the assumptions are correct; go and do your investigation, never ever just take the sellers word”.

When the respondents were asked if their due diligence practices could be more effective, the general view was that due diligence could always be better. In any transaction, it is about striking a balance between doing the due diligence and concluding the deal. Risks can never be fully mitigated by a due diligence assessment, at some point a decision has to be made. Once the decision is made, only through hindsight will it be determined whether more due diligence should have been done. Respondent 3 said that in his experience with some of the due diligence he has been involved in, he would have preferred to have done more or understood more or documented better, but due to the need to close the deal the due diligence was stopped when a certain level of comfort was reached.

<u>Most relevant areas of due diligence for REIT merger and acquisition transactions</u>

The respondents consider the following areas of due diligence as most relevant for REIT mergers and acquisitions, these are legal, tax, commercial, financial, physical property, environmental and technical due diligence. Other areas that practitioners concern themselves with include regulatory and sustainability issues. The regulatory issues are in relation to the prescripts that govern REITs and issues of sustainability focus on financial sustainability of the transactions in the long term. The areas of due diligence mentioned above exceed what is considered in the traditional scope which typically focuses on financial, legal and commercial due diligence, suggesting that practitioners have moved beyond the traditional scope. From these responses it is established that the traditional scope is not sufficient for South African REITs otherwise there would have been no reason to look at all these additional areas of due diligence if the traditional scope was sufficient. This fully answers question four for the research which pertains to the adequacy of the traditional scope for REIT mergers and acquisitions. However, the respondents feel that their due diligence processes could still improve where more areas are investigated and where they are more thorough.

It is worth noting that respondents only considered "hard" due diligence as the most relevant areas of due diligence for REIT merger and acquisition success, and they have largely ignored the "soft' due diligence. Hard due diligence focuses on the collection and evaluation of concrete data whilst soft due diligence focuses on understanding the people behind the enterprise (Naughter, 2017). Focusing only on hard due diligence goes against the literature, as Epstein (2005) had earlier suggested that due diligence assessments should not only focus on the hard financial aspects but should also include the evaluation of the soft personnel and organisational issues. Interestingly, Ross (2015) notes that when merger and acquisition transactions fail, it is often because the human element is ignored, perhaps this may be the reason for the high failure rate observed in the transactions analysed in the present study. A way to improve the assessments within the local REIT market may lie in the protocol for due diligence suggested by Epstein (2005) which includes a formal financial review of assets and liabilities and an evaluation of culture, organizational fit, and other non-financial elements as these are all critical to the success of the merged organisation.

<u>What influences the extent of Due Diligence?</u>

The literature suggests that a good due diligence takes time and does not try to save on costs as it is imperative to arrive at the right decision whether it is to walk away from a potential deal or to transact. 57% of the respondents said no when asked if cost implications of conducting due diligence influenced the intensity of the assessment that they do. The 43% that said costs influenced the intensity of their assessments stressed that it is not feasible to spend on due diligence unless you are in exclusive discussions with the target company, otherwise those costs may be incurred for no reason if ultimately the deal does not go through because of a competing bidder. It is not that there would be an attempt to save on costs in the due diligence. Respondents say there is usually enough time given to conduct a due diligence and caution against doing things in haste.

The literature suggests that irrespective of the size of the transaction, a good due diligence follows the same intensity. According to the respondents, the size of the transaction does influence the scope of due diligence with 57% agreeing whilst 43% say it does not. According to Respondent 2, size brings complexity and it becomes relevant to intensify the due diligence. Harvey and Lusch (1998) say that with complexity there is stimulated interest in due diligence, however the basic principles of due diligence should be followed as well in smaller transactions. Practitioners in the local environment seem to vary the level of intensity or the rigour of the due diligence based on the size of the transaction. This is a significant finding, as it can explain the differences in success rates between large and small REIT merger and acquisition transactions. If the rigour of due diligence decreases with the size of the transaction, it is reasonable to infer that smaller transactions would have a lower success rate. The finding however, has no bearing on the present research as all the transactions that were analysed were categorised as large transactions by the Competition Commission.

The respondents unanimously agree that the nature of the transaction influences the type and intensity of the due diligence, this is because if it is a hostile transaction there will be limited information that the target company makes available to the acquiring company. The acquiring company can only rely on publicly available information during the due diligence therefore; more diligence is required with hostile transactions.

Views on Traditional DD

According to the literature, due diligence has predominantly been limited to factors broadly defined as traditional due diligence. Traditional due diligence usually includes financial, legal and commercial due diligence. Moeller (2009) acknowledges the importance of these factors in the due diligence process but suggests that they must be supplemented by newer areas of due diligence which will reduce the high failure rate. There were mixed views amongst the respondents about the adequacy of the traditional due diligence for REIT merger and acquisition transactions, some respondents felt that it is insufficient, others felt that it is somewhat sufficient depending on the transaction and there were those who felt that it is sufficient.

Looking at each of the opposing views, there are two respondents who say that the traditional due diligence scope is not sufficient because it does not include a physical property due diligence. For REITs, physical property is essential because that is the underlying asset from which income is generated, there is a need to ensure that the properties are in a condition that can sustain that income, hence the emphasis on property due diligence. If there are capital expenses that are going to be required, they need to be accounted for upfront in order to use them to renegotiate the price of the transaction. Two other respondents were of the view that traditional due diligence is somewhat sufficient depending on the deal. Respondent 1 explains that traditional due diligence is sufficient if you are buying a very clean, straightforward portfolio of properties and it is not if you are doing a hostile takeover or a more complex transaction. Respondent 3 concurred that traditional due diligence is somewhat sufficient but he felt that it was moving towards a time where it would not be sufficient due to the increasing complexity of the transactions. The final three respondents viewed the traditional due diligence scope as sufficient, with Respondent 5 stating, “It should be sufficient; I don’t see why it’s not sufficient I mean that’s the way”.

The respondents suggest that there have been many changes in their due diligence approaches in recent years brought about by the need to be more thorough in their investigations. Some maintain that that traditional due diligence is still the core, but they concede that a wider due diligence scope could potentially reduce the risk of merger and acquisition failure. Due diligence should be a constantly evolving and changing process, as companies become exposed to different risks and experience different market factors impacting them, they should adjust their due diligences accordingly. Even though there have been changes in the South African REIT market in terms of the scope of due diligence, it is still focused on the “hard” due diligence factors. Emphasis now needs to move away from solely focusing on hard due diligence, there needs to be a balance between hard and soft due diligence and the strategic consideration of why a merger or acquisition transaction needs to be pursued must to be top of mind.

5.2.3 *Strategic Due Diligence*

The majority of the respondents agree that traditional due diligence is inadequate for assessing REIT merger and acquisition transactions; 57% of the respondents view traditional due diligence as highly insufficient. It is noted from the literature that traditional due diligence should be expanded in both scope and nature (Harvey & Lusch 1995) in order to ensure more successful merger and acquisition transactions (Perry & Herd 2004). The respondents already consider a wider scope of due diligence which is not limited to the financial, legal and commercial due diligence when considering potential merger and acquisition transactions. In question eight, the respondents were asked what types of due diligence assessment they consider most relevant for REIT M&A transactions success. Their responses to that particular question suggests that the scope is an expanded scope within the South African environment. However, a high failure rate prevails among South African REIT transactions noted over the last four years. In this instance, strategic due diligence could be the expansion in nature which was alluded to by Harvey and Lusch (1995) which could further improve the chances of success for South African REIT merger and acquisition transactions.

The respondents were asked what their views are on expanding due diligence as research supports the theory that expanding the scope improves the chances of success. Overwhelmingly, all the respondents expressed the view that expanding the scope of due diligence could improve chances of merger and acquisition success. Respondent 3 was of the opinion that anything that places the acquiring company in a position where they can propose solutions faster and make the process less drawn out, would aid the ultimate results of mergers and acquisitions. Respondent 5 opined that increasing the scope of due diligence would lead to more knowledge that would lead to more success. The argument was that if more details are uncovered during the expanded due diligence, then the decision makers can be more certain of the facts relied on to make their decisions and that could save them from potential failures. Respondent 7 was of the view that the traditional elements will always be there but acknowledged that due diligence has become ‘intense and increased’, and according to him the increase in the due diligence scope was necessary. Whilst there is a need to expand the scope of due diligence to improve chances of success, respondent 1 says by increasing the scope too much, then there is a possibility of over complicating the process and of increasing the timelines. This could frustrate the counter parties involved in the potential merger and acquisition transaction resulting in the deal failing to take off all together. Therefore, there is a balancing act, as the scope cannot be widened indefinitely, as that would impede the deal.

A way of bringing balance to the expanded scope is to introduce strategic due diligence to the process, May et al. (2002) describes strategic due diligence as the disciplined prioritising and organising of a number of fundamental but often neglected principals. The problem with traditional due diligence is that it is limited as it tends to be backward looking and it neglects many of the fundamental due diligence principles. The expanded due diligence addresses the issue of neglected principles, as it is much wider in its area of assessment. Fortunately, due diligence practitioners within the South African listed property environment have already gone beyond the traditional due diligence scope. There is a need to incorporate strategic due diligence into the process, this will assist the practitioners in better planning their due diligence assessments according to the literature. The advantage with strategic due diligence is that it is forward looking therefore it overcomes the challenge of traditional due diligence of relying on historic information. Strategic due diligence assists the acquirers understand the target's future prospects, and it allows the acquirers to determine if the prospects fit with their own strategic objectives. This is important for the future success of REIT merger and acquisition transactions as both the literature and the practitioners identify the failure to have a clear strategic rationale for a merger and acquisition transaction as the recurring reason for failure.

Overall, the respondents agree that the combination of traditional due diligence with the expanded scope which includes strategic due diligence could improve the chances of REIT merger and acquisition success as proposed in this research. That alone however is still not sufficient to ensure deal success, practitioners within the South African REIT environment as represented by the respondents disregard the importance of resolving different cultural issues when companies merge. If cultural issues are not resolved, then even a transaction with the best thought out due diligence that incorporates an expanded scope and is backed up by a strategically sound rationale could still fail to increase shareholder value.

CHAPTER 6. CONCLUSIONS & RECOMMENDATIONS

6.1 Chapter Introduction

This chapter presents and discusses the conclusions made in this study as well as recommendations based on this research. Suggestions are provided for further study based on the analyses of the literature and the participant's responses.

6.2 Conclusions of the study

The respondents provided good insights on the process of due diligence assessments and how it is performed within the South African REIT environment. From the responses received, the research deduces that some respondents have a narrow view of due diligence. There are respondents who view due diligence simply as a process of verifying facts rather than analysing and interpreting the facts to understand how those facts affect the transaction whether positively or negatively. This narrow view of due diligence is classified as cursory due diligence in the literature and it said to have disastrous consequences. Due diligence performed in such a manner should not be relied on to make merger and acquisition decisions.

The research explored whether or not the respondents understand the objectives of conducting due diligence, which broadly are to identify synergies and opportunities that can help realise future prospects of the consolidated company and mitigate risks that can pose a threat to shareholder value. The respondents understand the objectives of due diligence and they believe that their assessment processes are sufficient to achieve these objectives. The research points to the contrary as there was a 59% failure rate based on the sample of respondents, meaning that the even though the objectives are understood, they are sometimes not met. The failure rate noted amongst the South African REIT M&A transactions is inconsistent with the findings of Womack (2010) who found that real estate mergers are generally wealth-creating events. Reasons put forward by respondents for the high failure rate are that they are faced with challenges when performing due diligence as sometimes they do not have access to information or there is limited disclosure of information by the target company. This situation hinders the process because with limited information the practitioners cannot get an overall view of the target company; therefore, the outcomes of their assessments have deficiencies. As a result, even though the respondents understand what the due diligence should achieve, due to these constraints they do not meet the objectives.

The importance of due diligence for the success of REIT merger and acquisition transactions is appreciated by a majority of the research respondents. However, the respondents do not view due diligence as the most important factor for the success of a REIT transactions. Developing the company's overall merger and acquisition strategy and selecting the target company to merged with ranks higher than due diligence according to the respondents. A transaction that begins with the right strategy and is between well-matched companies has a higher probability of success if it is followed by an extensive due diligence. The research further investigated if the respondents view due diligence as a box ticking exercise and it was found that a majority of the respondents understand that if they fail to carry out thorough due diligence they are jeopardising shareholder value.

Due diligence conduction in REIT merger and acquisition transactions is dependent on a number of professionals with varying skills set, what is clear is that the process within the South African environment far exceeds the traditional scope of financial, legal and commercial due diligence. The efficiency of this expanded due diligence scope is still under question, as the respondents experience shows that there is always an element of doubt after any due diligence as one cannot mitigate all risks. There is also a need to balance between widening the scope of due diligence and being able to conclude a deal. This means that the due diligence investigation needs to be done to a point where a decision maker is comfortable to proceed with the deal knowing that there is still some level risk in that transaction.

The common reasons for REIT merger and acquisition failures were the timing of the deal, paying too much for the acquisition, different views in strategy and doing things in haste. Respondents seem to be less concerned about ensuring that there is synergy between the merging companies and resolving any cultural differences that exist between the companies. This is concerning as devising strategies to resolve cultural issues and ensuring synergy is one of the key factors for deal success. If there is continued neglect of this step in the due diligence process then future REIT mergers and acquisitions are destined for the same fate as that witnessed in the sample

Additionally, the research explored whether or not the cost of concluding a transaction and the size influences the extent of due diligence. The two mentioned factors, together with the nature of the transaction whether it is a hostile or a friendly acquisition are said to have some influence on how due diligence is conducted in the literature. The research demonstrated that a thorough due diligence requires substantial time so that all facets of an extended due diligence can be investigated. The expanded due diligence adds on to the areas assessed in traditional due diligence, the wider scope can include a tax, property, environmental, and regulatory due diligence amongst others. These add to the cost of the overall due diligence and the respondents appreciate this fact, 57% of the respondents say cost implications do not influence their assessments and the remaining 43% do not worry about costs if they are in exclusive negotiations. Size does influence the due diligence as it brings complexity and it becomes relevant to intensify the due diligence according to the respondents. The nature of the transaction also influences the due diligence; with respondents suggesting that it is difficult to go beyond the traditional scope in a hostile takeover, reliance has to be placed on publicly available information is such instances.

Lastly, the combination of the expanded due diligence scope with strategic due diligence is seen as a possible solution to reduce the high failure rate, this was the initial proposition of this paper which a majority of the respondents endorsed. During the conduction of this research, it was realised that the respondents already go beyond the traditional scope and they understand that having a clear strategic rationale for a deal is very important to its outcome. What the respondents discarded was the importance of the resolving the different cultural issues between the merging companies and identifying the possible synergies. This is crucial for deal success, the fact that this is currently very low on the practitioner's priorities when pursuing mergers and acquisition is possibly the reason for the high failure rate in South African REITs over the last four years. For this reason, the proposed framework has to also include a cultural due diligence which focuses on the "soft" due diligence elements, this will aid the integration process should a deal be executed between the merging companies.

6.3 Recommendations

Mergers and acquisitions are one of the favoured methods of achieving growth targets, appeasing stakeholders and increasing shareholder value (McDonald et al. 2005). They are central techniques for overall organisational growth; likewise, the South African listed property sector has seen aggressive merger and acquisition activity since the conversion to a REIT structure, this is in pursuit for growth and increased shareholder value (Grindrod Asset Management 2014). The growth

Given the high failure rates associated with a merger and acquisition growth strategy, the results of this research can add to the body of knowledge on how future due diligence assessments should be conducted in order to reduce the failure rate and to preserve shareholder value, particularly in South African REIT mergers and acquisitions.

Based on the outcomes of this study, it is recommended that:

- Practitioners change their attitudes towards dealing with cultural issues when considering a merger and acquisition transaction. It cannot continue being seen as the least important factor to the success of REIT mergers and acquisitions when the literature clearly indicates that failure to resolve cultural issue is one of the leading reasons for failure.
- Expanded due diligence must incorporate strategic due diligence which is forward looking and can assist in determining how the future merged company will be structured. By following the expanded due diligence

scope which incorporates strategic due diligence then investors can be better placed to make the right investment for their shareholders.

6.4 Suggestions for further research

An interesting area of study would be an investigation on why "soft due diligence" is not highly regarded amongst due diligence practitioners. The study could look at whether the phenomenon is prevalent specifically amongst REIT due diligence practitioners or if it is a general view amongst due diligence practitioners in South Africa.

Another area is that developing the company's overall merger and acquisition strategy emerged as the most important factor for deal success based on the participant's responses whilst some literature suggested that conducting a thorough due diligence was the most important factor for deal success. Future studies need to analyse which of these two factors has the most impact on a deal.

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ANNEXURE A: Ethics Clearance Certificate

School of Construction Economics & Management

University of the Witwatersrand, Johannesburg -PO Box 20, Wits 2050, South Africa • Tel: +27 (0)11 717 7652/77669 • Fax: +27 (0)11 717 9729 Email:CEM@wits.ac.za

SCHOOL OF CONSTRUCTION ECONOMICS AND MANAGEMENT RESEARCH ETHICS COMMITTEE

CLEARANCE CERTIFICATE — PROTOCOL NUMBER CEM/16/11/YM/MSC

PROJECT TITLE: A framework for the real estate due diligence process: Lessons from selected REITs in South Africa

INVESTIGATOR	Yongama Mabece 863139
SCHOOL/DEPARTMENT	SCHOOL OF CONSTRUCTION ECONOMICS AND MANAGEMENT
DATE CONSIDERED	01/12/2016
DECISION OF THE COMMITTEE	Approved conditionally with respect to the declaration.
EXPIRY DATE	30th November 2017

DATE 03 December 2016

CHAIRPERSON ______________________
Dr. Kola Ijasan

cc: Supervisor: **Mrs P Simbanegavi**

DECLARATION OF INVESTIGATOR (S)

To be completed in duplicate and **ONE COPY** returned to the Secretary Mrs. M. Sithole at the CEM reception desk.

I fully understand the conditions under which I am/we are authorized to carry out the abovementioned research and I/we guarantee to ensure compliance with these conditions. Should any departure to be contemplated from the research procedure as approved I/we undertake to resubmit the protocol to the Committee. **I agree to completion of a yearly progress report.**

Signature ______________________ Date 20 / 01 / 2017

ANNEXURE B: Participants Information Letter

PARTICIPANT INFORMATION LETTER_ Due Diligence Professionals, Deal Managers and Asset Managers.

MA Study Title: A framework for the real estate due diligence process: Lessons from selected listed REITs in South Africa.

My name is Yongama Mabece I am currently studying for an MA in the School of Construction Economics and Management at Wits University with my research entitled "A framework for the real estate due diligence process: Lessons from selected listed REITs in South Africa". This study is under the supervision of Mrs. Prisca Simbanegavi who can be contacted on 011 717 7683 or 076 733 5396, her E-mail address is Prisca.Simbanegavi@wits.ac.za. I can be contacted on 011 944 6225 or 073 762 7422 and my E-mail address is ymabece@growthpoint.co.za.

This information document serves to inform you of the study. REITs are globally recognized and accepted property investment vehicles used in more than 25 countries. The REIT structure was only introduced in South Africa three years ago. Since then, many property companies which previously operated as either property loan stocks or property unit trusts have converted to this structure in order to align the local listed property sector with other property sectors in the world. This has spurred on consolidations in the form of mergers and acquisitions as the local REITs seek to gain scale and compete with other global REITs. The literature however suggests that mergers and acquisitions pose a threat to shareholder value as they often fail to meet expectations.

The purpose of this research firstly is to review the due diligence processes that are currently being applied within the South African REIT context and secondly to identify how they can be improved in order to reduce the chances of merger and acquisition failures. The outcome of this will be the recommendation of an improved due diligence framework for the listed property sector.

You are invited to participate in an interview that will last approximately 30 to 45 minutes. As part of my data collection procedure, I would like to record the interview onto an audio devise and take notes where possible. You will be presented with the interview transcripts for your review and approval before the data can be used for this study.

I'd like to assure you that any information you provide for this study will be treated with strict confidentiality and your identity will not be divulged. The information obtained from you will only be used for the purposes of completing the above research and will not be disclosed to any other person. The analysis of the study will not be on individual bases but group basis to ensure it does not reflect on individual information obtained.

I'd like to reiterate that the study is in completion of my masters' thesis and any information provided will be used purely for that purpose. Should you choose to participate in this study, please can you provide your consent by signing the 'consent form' that will be given to you?

ANNEXURE C: Signed Consent Forms

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 1 Date, 15/02/2017
Researcher's signature, ________ Date 15/02/2017
Supervisor's signature ________ Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may withdraw at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I ________ hereby agree to participate in this study.
I ________ agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 2 Date, 23/02/2017

Researcher's signature, ____________ Date 23/02/2017

Supervisor's signature ____________ Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may withdraw at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I ____________ hereby agree to participate in this study.

I ____________ agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 3 Date, 02/03/2017
Researcher's signature, ________ Date 02/03/2017
Supervisor's signature P.S Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I ________ hereby agree to participate in this study.
I ________ agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 4 Date, 31/03/2017

Researcher's signature, [signature] Date 31/03/2017

Supervisor's signature [signature] Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may withdraw at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I Andile MAGIBA hereby agree to participate in this study.

I Andile MAGIBA. agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 5 Date, 19/04/2017

Researcher's signature, ______ Date 19/04/2017

Supervisor's signature P.S Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I Grant Abrahams hereby agree to participate in this study.

I Grant Abrahams agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 6 Date, 26/04/2017

Researcher's signature, ______ Date 26/04/2017

Supervisor's signature ______ Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I ______ hereby agree to participate in this study.

I ______ agree to be audio recorded and notes taken.

FORMAL CONSENT FORM INDIVIDUAL DEAL MANAGERS FROM THE REIT COMPANY

Pseudonym number, 7 Date, 09/06/2017

Researcher's signature, [signature] Date 09/06/2017

Supervisor's signature [signature] Date 13/02/2017

PLEASE TICK:	YES	NO
I have been adequately informed by the researcher about the nature, conduct, benefits and risks of the study.	✓	
I have also received, read and understood the "participant information letter" provided to me and understood what the study is about	✓	
I am aware that the results of the study will be anonymously analyzed into a research report for academic publication and seminars.	✓	
I understand that my participation is voluntary and that I may at any stage of the interview, without prejudice.	✓	
I understand that I can withdraw my consent and participation at any time and point of the interview.	✓	
I had sufficient opportunity to ask questions to understand more about the study	✓	
At my own free accord, I will give my agreement to participate in the study.	✓	

I [signature] hereby agree to participate in this study.

I [signature] agree to be audio recorded and notes taken.

ANNEXURE D: Research Instrument (Questionnaire)

Real estate professionals' perspective of the Due Diligence process in REIT Mergers and Acquisitions.

<u>INTERVIEW QUESTIONS</u>

Background Information

1. What position do you hold in the company and what does it entail?
2. How many years' experience do you have in your current position?
3. Have you been involved in any due diligence assessments on REIT mergers and acquisitions in the last 3 years, if not when was your most recent one?
4. What were your different roles in the previous due diligence assessments that you have been involved in?

Professionals' perception of Due Diligence

5. How would you define due diligence?
6. How important are due diligence assessments for the success of REIT M&A, are they a means to verify facts or are they merely a box ticking exercise?
7. What in your opinion are the objectives of conducting due diligence assessments in terms of REIT mergers and acquisitions, and based on your experience do the due diligence assessments meet these objectives? Please substantiate.
8. What type/s of due diligence are most relevant for REIT M&A transactions?
9. Can you please describe the aspects of your due diligence assessments; do you feel that these are as effective as they could be?
10. How would you rate the following in order of importance for the success of a REIT merger and acquisition with 1 being most important and 9 being the least important?
    - Arranging finance for the deal
    - Developing the company's overall merger and acquisition strategy
    - Developing a post M&A integration plan
    - Evaluating the possible synergies that can be exploited
    - Identifying the management team that will lead the merged/new company
    - Performing the due diligence assessment

- Pricing the deal right to avoid over paying
- Selecting the target company to merge with
- Understanding and resolving the different companies' cultural issues

11. Are there any other factors you consider important for the success of M&A, if so what are they?
12. In your experience what have been the recurring reasons for M&A failure? Could they have been prevented by a due diligence assessment?
13. Do cost implications influence the intensity of due diligence done for a particular M&A deal, if so how?
14. Does the size of the M&A deal influence the amount of due diligence that is done?
15. Does the nature of the M&A deal affect the type of the due diligence conducted, i.e. is there a difference in the DD if it's a hostile or friendly takeover?
16. Are there any other constraints or limitations of conducting the due diligence process, if so what are they and how do you deal with them?

Reality of Due Diligence Practices

17. What do you think of the traditional way of conducting due diligence assessments which typically focuses on financial, legal and commercial aspects, is it sufficient for REIT M&A? Why is it or why isn't it sufficient?
18. In your experience what can you suggest are the most common mistakes made in performing due diligence assessments?
19. Can you share cases where the due diligence assessments lead to the success or failure of a REIT M&A. What in your opinion were the determinant factors of the deal outcome?
20. In your experience, when a M&A has failed, was there a possibility that due diligence could have prevented that failure?

New Due Diligences Approach

21. Has the execution of due diligence changed in your experience where due diligence techniques have been modified i.e. where the traditional due diligence has been modified?
22. How and why have these due diligence techniques changed in your opinion?
23. Some research supports the idea that the new techniques improve the chances of M&A success as they are more efficient than the traditional due diligence. They take into account other critical success factors such as strategic due diligence. What is your opinion on this?
24. Overall, do you think that the combination of traditional due diligence with new techniques can improve the chances of M&A success?

ANNEXURE E: Interview Summaries