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Comparative performance of BEE and non-BEE Mergers and Acquisitions in South Africa

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Submitted to:

Wits Business school

University of the Witwatersrand

Johannesburg, South Africa



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2015

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DECLARATION

I, **Nkanyezi Mwelase** declare that the work presented in this research dissertation is my own, except where otherwise indicated and acknowledged. The submission of this document is in partial fulfilment of the requirements for Master of Management in Finance and Investment at the University of the Witwatersrand (Business school). This dissertation has not either in part or in whole, been submitted at any other university or institution for purposes of a degree or other qualification.

Signature:  Date: 27/07/2016

ABSTRACT

The study revisits the topic of post-acquisition performance of M&A in South Africa. Unlike preceding studies the emphasis was on target firms rather than acquiring firm and on operating performance rather than on share price reaction to M&A announcements. The study explores how operating performance is affected by BEE related M&A and non-BEE related M&A transactions. Operating performance is measured using EVA®. Economic Value Added (EVA®) reveals that target firms experienced a decline in post deal operating performance following an M&A transaction regardless of whether the M&A deal was motivated by BEE or not. The study also found that the decline in operating performance was larger for conventional (non-BEE) M&A transactions relative to BEE linked M&A transactions, though the decline was not statistically significant. Accounting based corporate performance measurement methods used to supplement the EVA® exhibit a marginal and insignificant increased in performance when the average five year post-acquisition returns are compared to the average five year pre-acquisition returns. Overall, the economic performance of target firms declined suggesting that target firms do not benefit significantly from the M&A.

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Above all, I thank God for all the opportunities afforded to me which have enabled me get to this point in my academic career.

Table of Contents

DECLARATION I

ABSTRACT II

ACKNOWLEDGEMENTS III

CHAPTER 1 Introduction 1

1.1 Introduction 1

1.2 Context of the study 1

1.3 Research Problem 3

1.4 Research Questions 5

1.5 Method of Study 6

1.6 Gap in the literature 6

1.7 Benefits of the study 7

1.8 Structure of the research report 7

Chapter summary 7

CHAPTER 2 Literature Review 8

2.1 Introduction 8

2.2 Mergers and Acquisitions 8

2.3 Performance of mergers and acquisitions 11

2.4 History of Black Economic Empowerment (BEE) 15

2.5 Performance of BEE transactions 16

Chapter summary 17

Chapter 3 Methodology 18

3.1 Introduction 18

3.2 Data & Data Source 18

3.3 Research design 19

Chapter summary 21

Chapter 4 Presentation of results 22

4.1 Introduction 22
4.2 Sample Characteristics 22
4.2.1 Distribution of sample by Industry 22
4.2.2 Distribution by payment method and deal type 23
4.2.3 Distribution by year and deal value 23
4.2.4 Distribution by industry and deal type 24
4.3 Mergers and Acquisitions performance analysis 25
4.3.1 Trend Analysis of performance BEE & non-BEE deals. 25
4.3.2 Economic value added (EVA) Analysis 26
4.3.3 Return on equity (ROE) analysis 27
4.3.4 Return on Capital (ROC) analysis 28
4.3.5 Earnings per share (EPS) Analysis 29
4.3.6 M&A Performance analysis by industry 30
4.3.7 M&A Performance analysis based on companies. 31
Chapter summary 32
Chapter 5: Discussion and Conclusion 33
5.1 Introduction 33
5.2 Discussion of findings 33
5.3 Conclusion 35
References 36

CHAPTER 1 Introduction

1.1 Introduction

This chapter provides an introduction, the aim and the context of the research as well as the research objectives. The chapter is structured as follows: section 1.2 outlines the context of the study. Section 1.3 presents the research problem. Section 1.4 presents the research questions. Section 1.5 provides the significance of the study. Section 1.6 discusses the gap in the literature on mergers and acquisitions and section 1.7 highlights the benefits of the study and finally section 1.8 deals with the structure of the research report. The chapter summary concludes the chapter.

1.2 Context of the study

Mergers and acquisitions (M&A) are an important milestone in a corporation's existence. It is a subject of interest to many scholars and the general public especially when they involve a high profile corporation, such as the recent acquisition of Pepkor by Steinhoff international in South Africa in 2014. An acquisition of one firm by another is not only a strategic manoeuvre but also a means of achieving corporate growth (Ooghe et al., 2006). Corporations tend to use acquisition as a means of achieving growth, diversification or profitability (Ooghe et al., 2006). It is the desire for growth that has led to an increase in mergers and acquisition activities, especially in Africa. African M&As have been robust with a majority of investors optimistic about the growing attractiveness of many African economies (Deal Driver Africa report, 2014).

During an M&A transaction, managers typically cite the potential to increase the value of the firm and the returns to shareholders of the merging companies as a reason for engaging in a M&As. Mantravadi and Reddy, (2008) argue that there are three main objectives behind any M&A transaction, namely: faster growth in scale and quicker time to market; improvement of revenues and profitability and acquisition of new technology or competence. Chatterjee (1986) categorises the synergetic gains from M&A as financial synergy, operational synergy and collusive synergy.

Whether or not the synergies from M&As actually materialise has been the subject of debate for some time. Many authors that have delved into the topic of M&A have demonstrated that M&A transactions create shareholder wealth, with most of the gains accruing to the target

company shareholders (e.g., Andrade et al., 2001). Conversely, Agrawal et al (1992) found that shareholders of acquiring firms tend to suffer losses of about 10% after the merger.

The dawn of democracy in South Africa has contributed to an increase in M&A transactions. One of the main drivers of M&A activity in South Africa has been a type of transaction that is unique to South Africa, namely; Black Economic Empowerment (BEE) transactions (Davids and Hale, 2010). Following the democratic elections of 1994, the ANC government developed a programme in an attempt to reverse the social and economic inequalities created by apartheid era regulations that served to ensure the social and economic marginalisation of black people, (i.e. Africans, Coloured and Indian) in South Africa. Wolmarans and Sartorius ,(2009) found that there are generally, three types of BEE transactions, namely: the sale of an equity stake to BEE Company, the purchase of a stake in a BEE company and other BEE transactions using strategic joint ventures and partnerships. Since the introduction of BEE, a number of transactions and BEE schemes focusing on the empowerment of black people have been put in place. This research aims to focus on the first type of BEE transaction identified by Wolmarans and Sartorius, (2009) and its impact on the target firms' subsequent performance.

Numerous studies have been conducted across the globe and domestically to determine if M&A truly add value to the transacting firm. Many of these studies focus on short-term changes in share prices on and after the merger/acquisition announcement date. A South African study on M&A by Smit and Ward, (2007) found that M&A do not result in significant increase in operating performance and that large acquisitions are a zero net present value project for the acquiring firm and its shareholders. Mushidzi and Ward, (2004) conclude that shareholders of target companies earn significantly positive returns, while shareholders of bidding companies are not affected. The findings by Smit and Ward (2007) as well as by Mushidzi and Ward, (2004) are similar to findings of studies conducted abroad. The similar findings may be attributed to the fact that both the South African and international authors looked at short-term returns around the M&A announcement date when they conducted their studies. Negash and Wimberly,(2004) concluded that firms engaging in M&A activity in South Africa do not persistently create positive abnormal returns over the long-term and that investors should avoid being long-term investors in companies that are actively involved in M&A as they suffer losses in the long-term.

The studies conducted in South Africa use share price changes as a measure of performance. Studies by Smit and Ward (2007) as well as Mushidzi and Ward (2004), are based on short-term returns following announcement of the M&A event. However, in reality synergies are observed over time, as a result it is the long-term operating performance of the firm that should be analysed in order to determine the impact of the M&A transaction on the firms performance and returns to shareholders, which is precisely what this study aims to achieve.

The objective of this study is to assess the differential performance of BEE and non-BEE M&As in South Africa. Understanding this is very important as BEE is a policy issue implemented via the BBBEE act of 2003 in an effort to include Black South Africans into the main stream economy after being excluded by Apartheid era laws. Therefore, South African M&A activity has been spurred on not only by pure business interest but also by the need to implement the Black Economic Empowerment, as such when evaluating corporate performance of South African firms post the M&A transaction, it is important to distinguish between BEE related M&A and non-BEE M&A in order to clearly understand how the market reacts to both types of M&As.

1.3 Research Problem

The M&A literature (e.g. Ooghe et al., 2006) suggest that a firm should only implement an acquisition strategy as a means of growth only if it expects to improve its organisational performance and it is preferable to alternative growth strategies. Agrawal et al., (1992) found that M&A do not add value to acquiring firms' shareholders as the shareholders of acquiring firms experience a significant wealth loss of about 10% after the merger. According to findings by Agrawal et al., (1992), M&A offer no significant gains to shareholders; hence shareholders have to look elsewhere to achieve growth and diversification as M&As wipe out shareholder value.

In recent years, studies found that managers pursue growth in physical size of their corporations rather than growth in its profits and stockholder welfare. This behaviour of managers is linked closely to the fact that management compensations (salaries, bonuses etc.) are related to the size of the entity compared to its profits (Mueller., 1969). Therefore, management tends to engage in M&As out of self-interest as opposed to being motivated by the need to increase shareholders welfare, which raises doubt on the use of M&A as a means

of increasing shareholder wealth. Evidence suggests that the shareholders of the acquiring firms earn on-average zero abnormal returns from the acquisitions (Fuller et al., 2002).

Other studies found that shareholders of successful bidding companies tend to realise significant increase in equity values, although this increase is substantially lower than returns earned by the target firm (Jensen and Ruback., 1983). Yook (2004) argued that corporation do benefit from synergies and increase the combined equity value of the target and the acquiring firms, therefore suggesting that acquisitions create shareholder value. An intuitive reason for this value creation is that it comes from the fact that the combined entity enjoys reduced costs, charges higher prices for its products or both (Chatterjee, 1986).

Alessandri et al., (2011) found that BEE deals created value when pursued in earnest, but destroyed value otherwise and that BEE deals resulted in positive and significant returns to shareholders when completed at a discount, but yielded negative returns when completed at a premium. Therefore this suggest that if conducted with the best intentions - to address the needs of various stakeholders such as government, communities and shareholders - BEE acquisitions could be value adding to the company and its shareholders. However, some shareholders are against BEE as they view it a business risk that could dilute their stake in the company (Alessandri et al., 2011). Negative abnormal returns suggest that investors perceive BEE transactions as an unnecessary and insignificant cost, as shares are 'donated' at a discount (Chipeta and Vokwana.,2011).

Majority of studies that investigate the performance of M&A and impact on shareholder welfare were conducted in the US such as a study by Agrawal et al., (1992) and Moeller et al., (2005). Similar "event analysis" studies conducted in South Africa concur with their findings, for instance Mushidzi and Ward (2004) conclude that shareholders of target companies earn significant positive returns, while shareholders of bidding companies were not affected.

Previous studies on M&A conducted in South Africa have not considered the impact of BEE related mergers and acquisitions on shareholders' welfare and operating performance of the target firm. Furthermore, South African based studies on M&A have not investigated the impact of BEE related M&A on the target company relative to non-BEE related M&A.

This research study analyses the performance of target firms post M&A and whether there is a differential performance between ordinary M&As and BEE related M&As. The research study expands further by looking at the performance of companies that completed both types of deals and how each affected their performance. BEE M&As have been criticised for diluting shareholder wealth (Alessandri et al., 2011).Conversely, non-BEE related M&A acquisitions are typically seen as creating value through synergies. The paper will resolve the debate on whether or not BEE M&A enhance value by examining the performance of BEE related mergers and comparing them to traditional non-BEE related M&A. The comparison will help determine if value is created by BEE related M&A by benchmarking them against non-BEE related M&A.

1.4 Research Questions

Since 1994, the South African economy has opened up to the rest of the world which has resulted in an increase in competition faced by South African firms as a result of international firms seeking new growth opportunities in Africa. This factor has resulted in an increase in M&A in South Africa as firms seek growth while others seek to defend their market power.

The introduction of BBBEE has also served as one of the main drivers of mergers & acquisitions in South Africa. The debate on BEE has led to diverse views from society at large, some sections of the population have criticised BEE as benefiting only a hand full of well-connected individuals. Conversely, others praise BEE for its contribution to the economic inclusion and upliftment of Black people. Whether or not there are benefits related to M&A and what the impact of BEE is on corporate performance is a matter that this study aims to address.

The following questions guide the research:

- How do BEE related mergers and acquisitions perform in relation to non-BEE related acquisitions? Do BEE related M&A's destroy or enhance value for the shareholders?
- Is the effect of BEE and non-BEE deals on corporate performance dependent on the industry/sector in which it is happening?
- How is a firm operating performance affected when a firm completes both a BEE and non-BEE M&A transaction?

1.5 Method of Study

The study seeks to investigate and analyse the operating performance of target firms post BEE and non-BEE M&As. For comparability purposes the research focuses on the performance of the target firms involved in an M&A transaction as data relating to BEE acquirers is unavailable in the public domain, mainly because the acquirers are usually unlisted. Data for the study is sourced from *Bloomberg database*, *SENS* and the *Intellidex BEE report*.

In measuring the performance of M&A in a South African context, this study utilises traditional accounting methods in conjunction with Economic Value Added (EVA) method. According to Yook (2004), firms may erode shareholder wealth while earning positive net income due to the fact that accounting earnings are subject to manipulation and earnings may be lower than the required rate of return that shareholders could earn from securities of comparable risk. EVA is a performance measure directly linked to the creation of shareholder wealth and it takes into account the riskiness of investment which is factored into the cost of capital (Yook, 2004).

Despite the limitations in accounting based performance measurement techniques they still remain popular, relevant and a primary tool used in practice to evaluate investment decisions and measure corporate performance. Therefore, this study uses conventional accounting methods in conjunction with EVA when assessing the performance of M&As.

1.6 Gap in the literature

Numerous studies on M&A and BEE transactions have been conducted in South Africa. These have focused mainly on share price reaction to the announcement of a BEE transaction or a M&A transaction. These studies measure performance over a short-term period. For instance, Chipeta and Vokwana (2011) investigated the impact of BEE transaction on shareholder wealth and firm profitability using event study methodology and found that BEE related M&A result in negative returns after announcement. Mushidzi and Ward (2004) investigated the returns on cash vs share funded acquisitions by using similar short-term performance measures, and found that shareholders of bidding firms are not affected by acquisitions. Unlike the South African studies cited above, this study probes the long-term impact of the two transactions to determine whether they add value to the shareholders of the target firm by focusing on the operating performance of the target firm undertaking “normal”

or BEE related M&A. Few if any studies have addressed the impact that M&A have on operating performance subsequent to the merger and how the two types of M&A prevalent in South Africa compare.

Although a vibrant media debate has emerged in South Africa on the BEE process, little academic analysis has been carried out so far (Alessandri et al., 2011). The research aims to fill this gap in academic literature on BEE related transactions and evaluate their impact on the companies' operating performance relative to non-BEE related M&A. The study contributes to the literature on M&A in South Africa by answering the question on whether listed firms should engage in BEE compliant transaction or merely focus on traditional non-BEE related transaction when seeking to expand operations through mergers and acquisitions in a South African environment.

1.7 Benefits of the study

The research aims to assist policy makers in continuously improving BEE policy which would accelerate Black Economic Empowerment and the inclusion of the marginalised Black society into the main stream economy of South Africa. In addition, the research aims to help companies and investors get a better understanding of the short-falls and benefits as well as the performance of BEE related mergers and acquisitions in a South African context. Furthermore the study will help investor and other stakeholders understand how the two types of M&A impact their wealth and value of the firm.

1.8 Structure of the research report

The remainder of this research report is structured as follows: Chapter 2 presents a review of extant literature on BEE and mergers and acquisitions. Chapter 3 describes the methodology used in this study. Chapter 4 presents the research results and their interpretation. Chapter 5 discusses the findings and concludes the study.

Chapter summary

This chapter introduces the thesis and identifies the gap in academic literature on M&As in South Africa. It also highlights issues relating to BEE and non-BEE M&As in South Africa in addition to raising questions about the economic performance of BEE M&A compared to non-BEE M&A. The next chapter presents the literature review.

CHAPTER 2 Literature Review

2.1 Introduction

The current chapter contextualises the study by highlighting relevant literature pertaining to M&A and Black Economic Empowerment (BEE). Section 2.2 presents different types of mergers and acquisitions including the motives behind them. Section 2.3 presents the performance of M&A deals. Section 2.4 presents the history of BEE and previous BEE research. Section 2.5 presents historic performance of BEE deals. Chapter summary completes the chapter.

2.2 Mergers and Acquisitions

Ross et al., (2003) defines a merger as the complete absorption of one firm by another. The acquiring firm can undertake this transaction by either acquiring stock or assets. A merger is regarded as a combination of any two or more firms with the larger being considered the acquirer (Green and Cromley., 1982). The terms merger and acquisition are generally used interchangeably by market practitioners and the public. No distinction is made between mergers and acquisitions because the effects of the two transactions are virtually indistinguishable (Green and Cromley., 1982).According to the South African Competition Act No.89 of 1998, a merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm. This is the definition applied in this research.

There are different types of mergers and acquisitions which can be classified into three broad categories, namely: horizontal, vertical and conglomerate mergers. Horizontal mergers happen when an acquisition of a firm in the same industry is made. The firms normally compete with each other in their product market. This type of merger is often geographic in nature and accompanied by economies of scale (Firer et al., 2004). The acquiring firm in a horizontal merger desires to increase its market share while simultaneously eliminating some of its competitors (Green and Cromley., 1982). A vertical acquisition involves firms at different steps of the production process. It can either be forward (toward the customer) or backward (in the direction of the suppliers of raw material). It leads to control of the value chain & consequently economies in distribution (Firer et al., 2004). In the case of a vertical merger the company desires to increase its control over more resources of supply and

distribution. Therefore the firm expand into associated product lines (Green and Cromley., 1982).

Conglomerate mergers and acquisitions occur when the offeror and the offeree company are not in the same lines of business; these are often justified by claiming diversification of risk or the lowering of the cost of capital in the large company (Firer et al., 2004). Conglomerate mergers represent expansion by a company into new and different product lines. The aim of this type of merger is to reduce business risk by the acquiring company by diversification of its interest (Green and Cromley., 1982). The main benefit of this kind of merger is the reduction in business risk of the firm provided that there is low to negative correlation between the various businesses making up the conglomerate firm. Chatterjee (1986) argues that these types of mergers are motivated by financial synergies that stem from lower business risk due to diversification of the firms and thus ultimately resulting in lower cost of capital.

The post M&A performance of a firm is significantly influenced by the firms' motives for engaging in the transaction. Therefore in order to analyse the performance of a firm it is imperative to understand the motives and drivers of the M&A. Three major motives have been advanced in the literature on M&A as key drivers of M&A: The synergy motive; the agency motive and the hubris motive (Berkovitch & Narayanan., 1993).

Synergies are cited by corporate managers as the main driver behind M&A and the main source from which benefits from the transaction will flow to the shareholders of the firm in the form of higher share price and economic performance. Empirical results show that synergy is the primary motive in takeovers with positive total gains (Berkovitch and Narayanan., 1993). Benecke et al., (2007) defines synergy as: "A concept that describes the systematic processes whereby business units of diverse, complex organisations will generate value through working as one system than working as separate entities". According to Ross et al., (2003), synergy is the positive incremental net gain associated with the combination of two firms through a merger or acquisition. Synergies can be categorised in three broad categories according to Chatterjee, (1986) namely: collusive synergy; operational synergy and financial synergy.

Collusive synergies represent the class of scarce resources leading to market power (Chatterjee., 1986). Collusive synergies encompass those resources that the combined firm can exploit in order to gain greater market power and are typically associated with horizontal mergers. In such mergers profits can be enhanced through higher prices and reduced competition for customers (Ross et al., 2003). The combined firm is able to dominate the market as it enjoys monopolistic power and can increase prices of its product without loss of customers as it is the main supplier of the product/service in the market.

Operational synergy represents the class of resources that lead to production and/or administrative efficiencies **(**Chatterjee., 1986). Operating synergies normally manifest through reduction of operating cost as a result of the firm being able to achieve economies of scale since the combined firm can source inputs cheaply and produce at a lower cost per unit. The operating synergies are normally associated with vertical mergers, which enable the firm to control the distribution process of its produce.

Financial synergy represents the class of resources that leads to a reduction in the cost of capital. The financial synergies are normally associated with conglomerate mergers **(**Chatterjee., 1986). The firm is able to control a larger asset base which can be used as collateral thus resulting in lower cost of borrowing and ultimately lower cost of capital. In addition, conglomerate merges diversify the firm and thus lowering the systematic risk and the cost of capital.

Other than synergy, agency motive is also cited as one of the reasons behind mergers and acquisitions. Agency motive suggests that mergers and acquisitions occur because they enhance the acquirers' management welfare at the expense of the acquirer shareholders (Berkovitch & Narayanan., 1993). According to Berkovitch & Narayanan, (1993) "specialist managers" tends to acquire firms in their line of business so that the success of the combined firm depends on their specific skills. This results in the extraction of value from the acquiring firms shareholders to the acquires management.

The agency motive is directly linked to the concept of "empire building" where managers adopt strategies that expand the size of their empires by undertaking acquisitions that do not enhance shareholder value (Pangarkar., 2000). This occurs when managers attempt to

increase the size of the business through acquisitions with the goal of obtaining higher salary and prestige that is associated with managing a large corporation.

Another driver of M&A by management at the expense of shareholder is the "Bandwagon pressure". According to the bandwagon theory, firms will tend to imitate their close rivals regardless of whether such imitation is value-enhancing or not. If a number of rival firms have already completed mergers, other firms might be tempted to jump on the bandwagon by undertaking merger of their own (Pangarkar., 2000). This behaviour of management to follow the crowd confirms the existence of the agency motive in Mergers and Acquisitions transactions at the expense of the shareholders welfare.

Management hubris also plays a major role in M&A transactions. The hubris motive postulates that managers make mistakes in evaluating the target firms and engage in acquisitions even when there is no synergy (Berkovitch & Narayanan., 1993). The hubris motive therefore implies that mergers and acquisitions are a result of management mistakes and cannot be expected to enhance shareholder value. Berkovitch & Narayanan (1993) argue that mergers and acquisitions happen when managers overestimate their valuation of synergies. Bidding firms infected by hubris simply pay too much for their targets (Roll., 1986). The over valuation of synergies by hubris management effectively leads to a transfer of wealth from acquirer shareholders to the target firms' shareholders.

2.3 Performance of mergers and acquisitions

A plethora of research exists which examine the performance of mergers and acquisitions, but only a few have looked into long-term operating performance of firm post M&A transaction within the South African context. No studies were identified, domestically and abroad, which investigate how a regular M&A compares to a BEE related M&A in terms of economic performance of the target firm post the transaction. The study aims to fill this gap in academic literature relating to M&A.

Previous literature on M&A transactions mostly examine the share price reaction to the announcement of M&A transaction. Based on these studies there seems to be a consensus about the performance of M&A transactions conducted in South Africa and across the globe. Jensen and Ruback., (1983); Bradley et al., (1988);Fuller et al.,(2002); Mushidzi and Ward

(2004) as well as Ward and Muller (2010) agree that the shareholders of the target firms benefit significantly from a merger or acquisition while the shareholder of the acquirer lose or are unaffected by the transaction. According to Bradley et al., (1988) shareholders of both target and acquiring firms realise significant abnormal returns. However, most of the gains were captured by the stockholder of the target and both the rate of return and dollar gains to target stockholder increase over time. These findings are based on event study analysis which computes returns to shareholders as the changes in share price a few days before and after the announcement of the transaction. Studies by Healy et al (1992) and Bruner (2004), indicate that the merged firms total value increased after the merger therefore implying that shareholders of the firm do benefit from M&A. M&A activity does create net gains for the investors in the combined buyer and the target firms and thus presumably, for the economy as a whole (Bruner.,2004). The combined equity value of the bidding and target firms increases as a result of takeovers (Healy et al., 1992)

Jensen and Ruback., (1983) investigated the impact that successful as well as unsuccessful mergers has on the returns to the target shareholders. Their finding was that target firms earn significant returns following an acquisition announcement , regardless of whether the merger is successful or not is consistent with the findings of other event studies by Asquith (1983); Huang (1987); Bruner (2004) and Mushidzi and Ward (2004) which also found that target shareholder earn high returns from M&A. Targets of successful and unsuccessful tender offers & mergers earn significantly positive abnormal returns on announcement of the offer regardless of whether the offer is completed or fails (Jensen and Ruback., 1983). Asquith, (1983) noted that an increase in the probability of a merger benefits the shareholders of the target firm & a decrease in the probability of the merger harms both the shareholders of the target and bidder.

A study by Wang and Xie, (2008) examines the relationship between corporate governance and synergetic gains of an M&A transaction. They found that when the acquirer has strong corporate governance due to stronger shareholder rights it leads to an improved performance in the target. The opportunity to redirect the target company toward more profitable operation would seem to suggest greater opportunity for a profitable merger (Bruner., 2004).

Mushidzi and Ward (2004) found that in South Africa, average abnormal returns for the target company increased considerably two days before the acquisition announcement and then ceased on day 0, then decrease to day +2 and thereafter fluctuate and level off. Huang and Walking (1987) agree with these findings and noted that abnormal returns decline 1.8% over a 50 day post announcement period. Approximately 54% target firms experience negative returns after the merger (Huang and Walking., 1987).

Accounting based performance measures are used in the study for performance analysis. Though they have certain limitations, accounting studies examine the reported financial results of a firm before and after the acquisition to see how financial performance has changed (Bruner., 2004). A problem with stock market event studies is that they are not suitable for measuring the pre- and post-acquisition performance of unquoted companies, contrary to the accounting based studies (Ooghe et al., 2006). Stock price performance studies are unable to determine whether takeovers create real economic gains and to identify sources of such gains. Researchers using event studies have had little success in relating the equity value gains to improvements in subsequent performance (Healy et al., 1992).

Accounting based performance measures have been criticised by academics and industry professionals for their deficiencies in measuring shareholder welfare in a meaningful manner. Traditional accounting based measures such as Return on Investment (ROI), Returns on Equity (ROE), Residual Income (RI) & Price Earnings (PE) ratio are based on accounting data that is susceptible to management manipulation, and therefore these measures may distort the true value destruction/creation of management decisions. These methods of performance measurement do not explicitly consider the cost incurred by providers of capital to generate the required returns. They lack a formal mechanism for determining whether achieving management goals creates value for shareholder (Yook., 2004).

Despite the shortfalls of the accounting based measures and the existence of a superior performance evaluation method (EVA), Chen and Dodd., (1997) find that the accounting measures are still of significant informational value and should be used alongside Economic Value Added (EVA).

Economic value added was introduced by consulting firm Stewart Stern & Co. The Stewart and Stern & Co system of performance measurement (EVA) is designed to provide a single, value-based measure which can be used in evaluating business strategies, valuing acquisitions and capital projects (O'Hanlon & Peasnell., 1998). According to Tully (1993) managers who run their companies according to the precepts of EVA have hugely increased the value of their companies and investors that are aware of EVA and which companies are employing it have grown rich. Economic Value Added (EVA) is a popular non-accounting based performance measurement technique. EVA is essentially the residual income that remains after all cost have been recognised, including opportunity cost of equity employed (Yook., 2004). Costigan and Lovata., (2002); Yook., (2004) agree that EVA is a performance measure that aligns manager's decisions & incentive to shareholder value. Based on this contention by the authors, managers should only engage in M&A if it enhances shareholder welfare.

Detractors of EVA method argue that it is not conceptually different from existing accounting based measure such as residual income (O'Hanlon & Peasnell., 1998). However these methods differ in terms of assumptions and faith in accounting information, for instance users of Residual income use reported values and while EVA aims to eliminate what is referred to as accounting distortions. Using accounting based measures of performance such as ROI will most likely lead to the same result as an EVA measure (Chen and Dodd., 1997). However the critics of EVA ignore a critical characteristic of the EVA method, that is, adjustment for accounting distortions. Therefore, EVA differs from accounting earnings in two ways: one, EVA redefines GAAP income; Two, EVA deducts the cost of both debt and equity capital whereas accounting earnings deducts only the cost of debt (Machuga et al.,2002).
EVA is considered a superior performance measurement method and a valuable tool to the measurement of post M&A performance of target firms. Horwitz et al., (2002) suggests that the success of M&A can be measured by assessing Economic Value Added. Whatever the firm does, value created should be reflected in the EVA (Chen and Dodd., 1997).

Based on the view advanced by Chen & Dodd.,(2007) and Horwitz et al., (2002) above, EVA is the most appropriate benchmark to use in assessing the success of a M&A transaction in South Africa regardless of whether they are BEE related or not. Hence EVA will be adopted

for the purpose of this study as a performance measurement technique to be used to evaluate & compare the economic impact of BEE and Non-BEE related M&A.

2.4 History of Black Economic Empowerment (BEE)

BEE is the economic empowerment of all black people including: women, workers, youth, people with disabilities and people living in rural areas, through diverse but integrated socio-economic strategies that include, but are not limited to: (a) increasing the number of black people that manage, own and control enterprises and productive assets; (b) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises; (c) human resource and skills development; (d) achieving equitable representation in all occupational categories and levels in the workforce; (e) preferential procurement; and (f) investment in enterprises that are owned or managed by black people (Broad Based Black economic Empowerment Act No.53 of 2003).

Black economic empowerment is an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities (Department of Trade and Industry-DTI).

Wolmarans & Sartorius.,(2009) identified three different types of transactions that can be used to implement a BEE transaction, namely: the selling of equity to a BEE company; the purchase of a stake in a BEE company and other BEE transactions such as the involvement in partnerships and joint ventures.

In a sale of equity to a BEE company transaction, the empowered company (acquirer) purchases a stake in the equity of the empowering firm (target firm). This type of BEE transaction is the most common and is driven by the need to accelerate corporate ownership and equity participation by black population.

A purchase of stake in a BEE company transaction forms part of the Enterprise Development element. This transaction involves providing support to a BEE company to ensure sustainability which could be financial or non-financial. The purchases of a stake in a BEE company allow it to obtain the funds it needs to sustain its operations.

Partnerships and joint venture transactions involve the establishment of a separate entity to operate for the benefit of the empowering firm and the empowered firm. It involves the combination of resources by the firm in pursuit of a mutual goal.

Levitt (2005) concurs with Wolmarans & Sartorius.,(2009) and asserts that there are three ways to structure a BEE related transaction, including where a BEE enterprise acquires a shareholding position, where a joint venture or partnership is structured with a BEE enterprise, where broad-based ownership is structured (such as HDSA dedicated mining unit trusts or employee share ownership schemes).

The political motive of BEE is economic inclusion of previously disadvantaged "black" people, is akin to Corporate Social Responsibility (CSR) which is defined as actions that appear to further some social good, beyond the interests of the firm and that which is required by law (McWillians & Seigel., 2001). Notwithstanding the existence of BBBEE Act of 2003, compliance with the act is still not compulsory for firms. According to Alessandri et al., (2011),in spite of the increasing number of BEE deal, a large portion of firms never participate in BEE deals, highlighting the voluntary nature of this CSR activity. Many firms have demonstrated their corporate social responsibility by selling part of their equity to black empowerment groups (Wolmarans and Sartorius., 2009). Alessandri et al., (2011) and Wolmarans and Sartorius., (2009) concur that BEE deals conducted are largely motivated by desire to achieve social & economic transformation rather than profit maximization. However, it is not clear whether the market rewards or punishes target firms that get into a mergers and acquisitions with a BEE firm.

2.5 Performance of BEE transactions

Event studies on the performance of BEE generally find that the shareholders of firms experience positive returns in the long-term. Wolmarans and Sartorius, (2009) note that companies on the JSE experience significant positive average returns of 1.15% around the BEE announcement date. A study by Ward and Muller, (2010) examined the effect of BEE transactions on companies based on market capitalisation and found that companies with smaller market capitalisation experience positive returns following a BEE deal announcement while large cap companies (>3,5bn) earn marginally negative returns. Chipeta and Vokwana (2011) studied the impact of BEE announcements on short-term shareholder wealth and on a

firms' profitability on the JSE noted that engaging in BEE transactions does not result in abnormal shareholder returns and that shareholders experienced negative wealth effects.

Accounting based performance measures have been criticised by academics and industry professionals for their deficiencies in measuring shareholder welfare in a meaningful manner. Traditional accounting based measures such as Return on Investment (ROI), Returns on Equity (ROE), Residual Income (RI) & PE are based on accounting data that is susceptible management manipulation and therefore these measures may distort the true value destruction/creation of management decisions. These methods of performance measurement do not explicitly consider the cost incurred by providers of capital to generate the required returns. They lack a formal mechanism for determining whether achieving management goals creates value for shareholder (Yook., 2004).

Despite the shortfalls of accounting based measures and the existence of a superior performance evaluation method (EVA), Chen and Dodd., (1997) found that the accounting measure are still of significant informational value and should be used alongside Economic Value Added (EVA).

Chapter summary

The chapter discussed previous research on how M&A impact returns. In addition, motives for M&A are examined while introducing BEE as a new and unique motive of M&A in South Africa. Event analysis studies show that M&A, whether BEE related or not have a positive impact on the shareholder returns. In the short-term, M&A have been found to have a positive effect on shareholder wealth following their announcement but in the long-term the share price gains tend to disappear as the share prices revert to previous trading value before the announcement and eliminating any gains attained in the short-tem. No studies have looked at long-term operating performance post-merger in South Africa. The next chapter presents the methodology of the study.

Chapter 3 Methodology

3.1 Introduction

The chapter presents the methodology applied in the study including data, data sources and research design. The chapter is structured as follows; section 3.2 discusses the data and the data sources. Section 3.3 outlines the research design and the chapter summary concludes the chapter.

3.2 Data & Data Source

The research uses data on M&As completed in South Africa for the period starting in 2004 and ending in 2014. Non-BEE M&A data was obtained from the *Bloomberg database. Bloomberg data* contains the name of the target & acquirer, the value of the deal, date of the deal and the payment method (i.e. cash, stock or both). Due to the fact that there is no central database of BEE related M&A transactions, several sources were used in the research study to identify BEE related M&A that are suitable for the study in order to conduct a performance comparison. *Intellidex* annual BEE reports and the *JSE Securities Exchange News Service (SENS*) were used to identify BEE M&A involving listed companies.

M&A transactions were included in the study if the deal complied with the following criteria: One, the deal was completed. Thus, terminated and pending deals were excluded from the study. Two, the target company in the deal is listed on the JSE. Three, the transaction involved the sale or transfer of a stake in the target firm. Furthermore, financial services firm were excluded from the study due to incomparability with other sectors. For instance, NOPAT used for EVA excludes finance cost while financing costs are considered an operating cost by financial services firms and included in NOPAT which results to incomparability.

The data yielded a sample of 86 M&A for the period of the study of which 33 deals related to conventional M&A and 53 deals were BEE related M&A. Although the sample is relatively small it is sufficient to conduct the study and draw meaningful conclusions from it. The size of the sample is impacted by the fact that listed firms are normally large and are seldom the target in an acquisition and also by the fact that data on M&A related to BEE transaction is scarce due the lack of a central database housing such deals.

Additional analysis is conducted in the research report on companies that concluded both types of deals (conventional and BEE M&As) within the study period as targets in the transaction. The objective of the analysis is to compare the effect of the two deals on performance of corporations that completed both deals. Transactions were included in the study if: One, a company completed both BEE and non-BEE M&A. Two, there is at least a three year gap between the deals in order to facilitate effective performance evaluation. Companies that concluded both types of M&A deals within a three year period or in the same year were exclude from the analysis to avoid confounding results. From the initial sample, a total of 17 deals were identified of companies that completed both types of deals. Subsequent to removing deals that occurred with a three year time horizon 13 deals were available for analysis.

3.3 Research design

3.3.1 Calculating performance using EVA

The performance of the sample companies selected for inclusion in the study is evaluated using EVA as the main performance measurement technique. Supplementary corporate performance measurement techniques are used in conjunction with EVA.

The EVA is defined by Steward Stern & Co as follows:

$$EVA = \ NOPAT \ - (K * CC) \tag{1}$$

Where:

NOPAT - Net Operating Income after Tax

K - Capital

CC - Cost of Capital

NOPAT is the operating income of the company adjusted for tax, i.e., EBITDA*(1-t). Capital (K) refers to the capital attributable to the providers of financing to the company and cost capital (CC) represents the rate of return required by the providers of capital. In the EVA model it represents the hurdle rate, as it is the return that the firm investment decisions must earn in order to be considered value adding to the providers of capital. EVA shows how much value is added to the firm by the decisions taken by managers. The answer to equation 1 above provides a measure of wealth added or eroded from the firm by M&A, through the calculation of "economic profit" (i.e. the amount by which the operating income after tax

exceeds the cost of capital). The answer to equation one could be positive or negative. If positive it means that the company was able to invest in projects that increase the value of the firm and overall shareholder wealth and if negative, the firm invested in projects that provide returns below the cost of capital and erode shareholders wealth.

The superiority of EVA relative to similar accounting based measures such as Return on Income model is mainly due to the fact that EVA makes adjustments for accounting "distortion" in computing the NOPAT. Thus, in calculating the NOPAT, a company can make approximately 120 adjustments to accounting profit (Net Income), however companies typically need only 10 adjustments to arrive at an appropriate EVA for performance measurement. The adjustments have the effect of taking the accounting method used to prepare financial statements back towards "economic value" accounting. The adjustments are made in order to deal with the problems of earnings management, past accounting error and accounting conservatism, through the removal of non-cash flow items and the accrual concept of accounting advocated by IFRS/GAAP from the profits of the company (O'Hanlon & Peasnell., 1998).

3.3.2 Accounting based performance measures:

Accounting based corporate performance measurement techniques are used in the study in addition to EVA. These measures focus on evaluating returns earned by providers of capital and include Earning per share (EPS), Return on Equity (ROE) and Return on Capital (ROC).

3.3.2.1 Earnings per Share

The earnings per share serves as an indicator of the company's profitability and is the portion of the company's profit that is attributed to each share outstanding. It is the return earned by the shareholder for each share that he/she owns.

$$EPS = \frac{Net\ Income}{Issued\ Shares} \tag{2}$$

Where:

Net income - total earning reported in the financial statement

Issued shares - this is the total number of shares outstanding as reported in the financial statements.

3.3.2.2 Return on Equity

The return on equity is the percentage return earned on the equity invested by the shareholders of the firm.

$$ROE = \frac{Net\ Income}{Equity\ Capital} \tag{3}$$

Where:

Net income - total earning reported in the financial statement

Equity capital - book value of issued equity.

3.3.2.3 Return on Capital

The return on capital (ROC) is indicative of how well the company uses its capital. ROC measures a company's ability to generate returns using all capital at its disposal (i.e. debt & equity).

$$ROC = \frac{NOPAT}{Total\ Capital} \tag{4}$$

Where:

NOPAT - Net Operating Income after Tax

Total capital – Total debt and equity capital

3.3.3 Statistical analytical method

The mean paired t-test is employed in the analysis in order to establish whether or not the change in the performance is statistically significant. A two tailed test will be used based on the following hypothesis.

H_0: Post M&A returns for BEE and non-BEE mergers and acquisitions are not significantly different from pre M&A returns.

H_a: Post M&A return for BEE and non-BEE mergers and acquisitions are significantly different pre M&A returns.

Chapter summary

The chapter outlined the methodology and the data used to evaluate performance of the target firm in M&A deals. The main tool used in assessing the corporate performance of the selected companies (i.e. EVA) is explained in the chapter as well as supplementary performance evaluation techniques that are used in this research. The next chapter present the research results.

Chapter 4 Presentation of results

4.1 Introduction

This chapter presents the descriptive statistics of the sample and later presents the empirical results. The chapter is organised as follows: Section 4.2 presents the sample characteristics. Section 4.3 performances of BEE and non-BEE M&As and the chapter summary concludes the chapter.

4.2 Sample Characteristics

4.2.1 Distribution of sample by Industry

Table 1 presents BEE and non-BEE related M&A deals by industry. Industries that did not have M&A deals were excluded from the analysis. The industrials and basic materials industries accounted for 29% & 26% of total deals respectively. Cumulatively, the two industries (Industrials& Basic materials) account for more than half of the deals undertaken during the sample period. Classification based on the nature of the deals (BEE & non-BEE) reveals that the industrial and basic materials industries contributed significantly to the number of deals undertaken between 2004 and 2014. Basic materials industry contributed 25% to BEE related deals and 27% to non-BEE related deals, while the Industrial sector contributed 32% and 24%, respectively. The two industries – basic materials and industrials- were the main drivers of M&A deals undertaken during the sample period. The remaining four sectors jointly contributed 45% to the total deals, with the consumer goods industry being the highest contributor with 19% total contribution to total deals.

Table 1: Transactions by Industry and nature of deals

INDUSTRY	BEE Deal		Non BEE Deal		Total	
	No. of Deals	% Deals	No. of Deals	% Deals	No. of Deals	% Deals
Basic Materials	13	25%	9	27%	22	26%
Consumer Goods	9	17%	7	21%	16	19%
Consumer Services	7	13%	4	12%	11	13%
Healthcare	4	8%	3	9%	7	8%
Industrials	17	32%	8	24%	25	29%
Telecommunications	3	6%	2	6%	5	6%
Grand Total	**53**	**100%**	**33**	**100%**	**86**	**100%**

4.2.2 Distribution by payment method and deal type

Table 2 reveals the nature of the payment structures used in financing the different types of M&A. Approximately 50% of companies that disposed of a share of the organisation have opted to receive cash, while 47% of the companies do not disclose the payment method. Less than 50% of the BEE deals entail the corporation receiving cash when relinquishing their shares in a BEE linked M&A. This is consistent with the fact that most of the empowerment groups do not have sufficient funds for an outright purchase of shares in the target firm. Similarly, non-BEE related M&A prefer cash when selling a stake in the firm. Cash related share disposals by firms accounted for 96% of all non-BEE related M&A. Based on the data in table 2, it could be inferred that the companies prefer to receive cash that can be ploughed back into the business and generate synergies.

Table 2: Transactions based on payment method

Payment Method	BEE Deal		Non BEE Deal		Total	
	Deal Value (Mil)	% of deal value	Deal Value (Mil)	% of deal value	Deal Value (Mil)	% of deal value
Cash	35 632	44%	9 308	96%	44 940	49%
Cash and Stock	279	0%	0	0%	279	0%
Debt	1 500	2%	0	0%	1 500	2%
Stock	1 569	2%	341	4%	1 909	2%
Undisclosed	42 835	52%	66	1%	42 900	47%
Grand Total	**81 814**	**100%**	**9 714**	**100%**	**91 529**	**100%**

4.2.3 Distribution by year and deal value

Table 3 shows the year , numbers as well as the value of M&A in South Africa. The non-BEE related M&A appears evenly distributed over the period of the study, except in 2006 when they peaked at 6 deals. BEE related M&A exhibit a spike in 2005, with 16 deals. The spike in deals could be attributed to a rush to comply with the BBBEE Act introduced two years prior. An inspection of the value of deals reveals that the value of BEE related M&A in 2008 was at its highest since the introduction of BBBEE Act. Non-BEE related M&A deal values increased to R 2 469 million and averaged R 2 136 million between 2008 and 2010. From 2009 to 2011 non-BEE deals experienced an upswing after dipping to 0% in 2007. The increase can be attributed to the global financial crises which saw company values plummet thus, encouraging acquirers to spend more. The lower asset/share prices could have prompted the increase in acquisitions as most stocks may have been perceived to be undervalued and trading below their fundamental values. The 2010 soccer world cup may also have been a contributing factor to the increase in M&A activity in South Africa during this time, the

country was viewed as an attractive investment destination. Overall M&A activity in South Africa seems to have decelerated post the 2010 soccer world cup, with only a cumulative total of 18% M&A taking place after 2011.

Table 3: M&A by year and deal value

Year	BEE Deal			Non BEE Deal			Total		
	No. of Targets	Value of Deal %	Value of Deal "000"	No. of Targets	Value of Deal %	Value of Deal "000"	No. of Targets	Value of Deal %	Value of Deal "000"
2004	6	11%	1 090	2	6%	114	8	9%	1 204
2005	16	30%	9 169	4	12%	177	20	23%	9 346
2006	9	17%	2 608	6	18%	1 454	15	17%	4 062
2007	6	11%	4 511		0%		6	7%	4 511
2008	6	11%	46 810	2	6%	2 469	8	9%	49 278
2009	3	6%	368	4	12%	1 307	7	8%	1 676
2010	3	6%	16 600	5	15%	2 632	8	9%	19 232
2011	3	6%	658	4	12%	805	7	8%	1 463
2012	1	2%	0*	1	3%	61	2	2%	61
2013		0%		4	12%	528	4	5%	528
2014		0%		1	3%	167	1	1%	167
Grand Total	**53**	**100%**	**8 1814**	**33**	**100%**	**9 714**	**86**	**100%**	**9 1529**

.*value of the deal was not disclosed

4.2.4 Distribution by industry and deal type

Table 4 below reports industries with companies that concluded both BEE and non-BEE deals within the sample period. The table shows the absolute number of deals, their percentage weighting as well as the total value of the deals. Only companies that under took both deals (i.e. BEE M&A and non-BEE M&A) are included in table 4. Thirteen companies completed both types of deals within the sample period. Companies in the basic materials and the industrials sector completed most of the BEE and non-BEE deals that took place during the sample period. The high number of deals within these two sectors is constant with the results presented in table 1, which showed that most the deals (BEE related & non-BEE) were completed within the two industries. The basic materials and industrial sector accounted for 58% of the deals. The healthcare industry, though made up of a few companies, contributed 15% to the total number of deals. The remaining industries accounted for a mere 27% of all the deals, suggesting that companies within these industries preferred to complete only one of the two types of deals but not both.

Table 4: Companies with BEE and non-BEE Deals

	BEE Deal			Non BEE			Total		
Industry	**% of Deals**	**No. of Deals**	**Value of Deals**	**% of Deals**	**No. of Deals**	**Value of Deals**	**% of Deals**	**No. of Deals**	**Value of Deals**
Basic Materials	31%	4	784	31%	4	1 938	31%	8	2 722
Consumer Goods	15%	2	1 500	8%	1	808	12%	3	2 308
Consumer Services	8%	1	1 100	8%	1	2 087	8%	2	3 187
Healthcare	15%	2	136	15%	2	413	15%	4	549
Industrials	23%	3	3 168	31%	4	277	27%	7	3 445
Telecommunications	8%	1	872	8%	1	0*	8%	2	872
Grand Total		**13**	**7 560**		**13**	**5 523**		**26**	**13 083**

* Value of deal was not disclosed

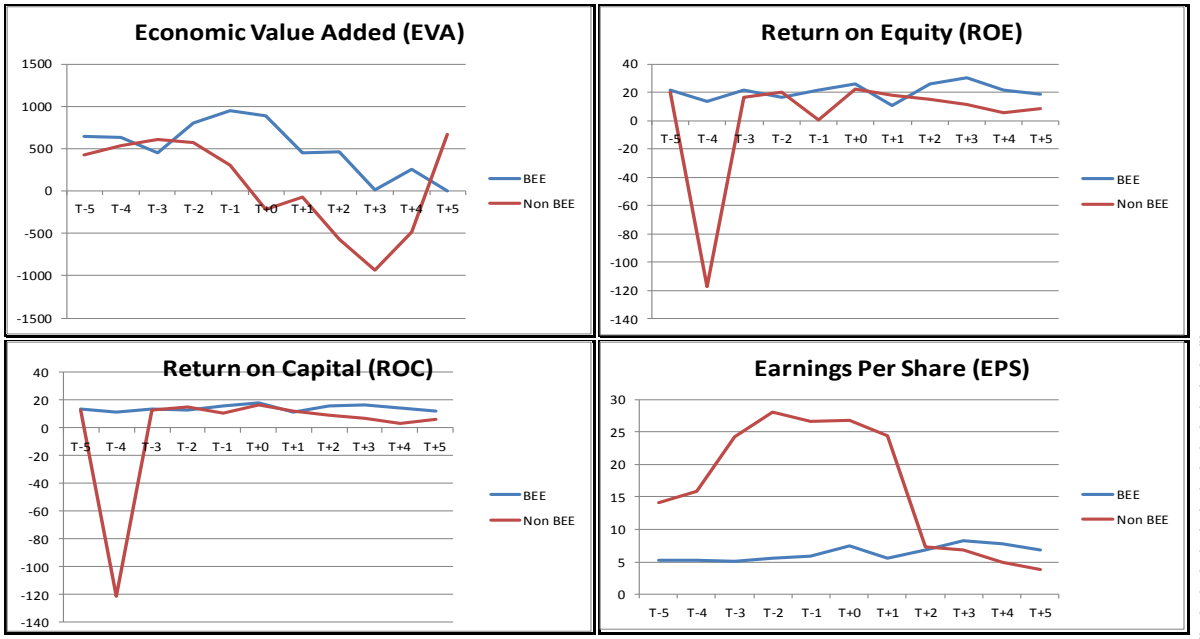
4.3 Mergers and Acquisitions performance analysis

4.3.1 Trend Analysis of performance BEE & non-BEE deals.

Figure 1 below, provides a trend analysis of the impact that BEE and non-BEE mergers and acquisitions have on the performance measures. The effect of M&A on the four performance measures employed in the study can be seen overtime (pre & post-merger). EVA® is displays the biggest decline due to the M&A transaction relative to the other performance measure followed by EPS. According to the figure, both BEE and non-BEE deals erode value; however the extant of the erosion differs between the two deals. EVA drops below zero for when non-BEE deal is completed – suggesting no value is added – and remains in negative territory for a prolonged period of time, while BEE related deals display a gradual and constant decline following completion of the deal. EPS measure concurs with EVA, as earnings per share experience a steep decline on deal completion and in subsequent years, more so for non-Bee deals.

ROE and ROC are also impacted in a similar fashion to the other two measures, though to a lesser extent. ROE & ROC for non-BEE deals commences a steady decline following the deal from T+0 to T+4, while the ROE and ROC for BEE deals initially decline before recovering. The recovery however remained lower than the average return levels achieved prior to the deal.

Figure 1: Performance measurement techniques of the study period.



4.3.2 Economic value added (EVA) Analysis

The objective of this research is to analyse the long-term impact of BEE and non-BEE M&As on corporate performance using Economic Value Added (EVA) technique developed by Stewart Stern & Co to establish whether the shareholders of the target firms are better/worse-off after BEE or non-BEE M&As. Table 6 reports the EVA of firms pre & post the M&A transaction. Prior to the M&A transaction, the two types of M&A deals exhibit positive EVA. Subsequent to the M&A transaction the EVA of BEE related transactions is positive for four years after the deal while the EVA of non-BEE mergers is negative for four out of the five years after deal completion. Considering the level of criticism aimed at black economic empowerment, these results are very intriguing as they indicate that both types of deals erode shareholder wealth though to a lesser extent for BEE related deals relative to non-BEE deals. In the acquisition year, BEE M&As have a mean EVA of R883 million while non-BEE M&A have a negative mean of R-212 million suggesting a complete destruction of value. The BEE related EVAs are positive for four out of five years after the deal is complete but they are lower than the values achieved in the year of the deal as well as prior to the deal. Non-BEE deals had a negative EVA in the year the deals were completed (T0) and in the four succeeding years (i.e. from T+1 to T+4), reaching their lowest value at R -939 million. EVA of BEE deals exhibits a gradual downward trend while the non-BEE deals experience a steep decline in the deal year (T0) and in subsequent years as can be seen on figure 1. Based on the observation that EVA declines after the deal, one may be tempted to infer that a portion of

shareholder wealth is eroded by the BEE & non-BEE M&A as the post M&A EVAs are lower than the average EVA achieved prior to the deal. Based on the empirical test results in table 5, the annual changes in EVA are not significant at a 5 percept level.

Table 5: EVA-summary statistics for BEE and non-BEE Deals in Millions

BEE Related M&A Deals						Non-BEE Related M&A Deals					
Year	Mean	Median	t Stat	t Critical	p_value	Year	Mean	Median	t Stat	t Critical	p_value
T-5	641	58	-	-	-	**T-5**	432	191	-	-	-
T-4	631	100	0.169	2.007	0.866	**T-4**	538	135	1.023	2.037	0.314
T-3	448	183	0.755	2.007	0.454	**T-3**	610	224	-1.066	2.037	0.294
T-2	806	217	-1.944	2.007	0.057	**T-2**	572	152	-0.400	2.037	0.692
T-1	953	186	-0.796	2.007	0.430	**T-1**	303	-1	1.146	2.037	0.260
T0	884	232	0.446	2.007	0.657	**T0**	-212	-4	-1.305	2.037	0.201
T+1	454	220	1.200	2.007	0.236	**T+1**	-72	-51	0.467	2.037	0.644
T+2	459	136	-0.010	2.007	0.992	**T+2**	-574	-204	0.718	2.037	0.478
T+3	8	158	1.136	2.007	0.261	**T+3**	-939	-252	1.322	2.037	0.195
T+4	252	31	-0.542	2.007	0.590	**T+4**	-489	-139	1.517	2.037	0.139
T+5	-5	0	0.813	2.007	0.420	**T+5**	663	0	-0.882	2.037	0.384

Mean paired (two tailed) t- test results:

The mean paired t-test compared the average EVA attained before and after the M&A deal with the objective of assessing the statistical significance of the M&A deal on corporate performance. BEE related deals are found not to lead to statistically significant changes in EVA after the deal. As a result, the null hypothesis cannot be rejected. However non-BEE related deals are statistically significant at a 5% level of significance. The significance implies that the non-BEE deals significantly erode shareholder value.

	BEE related deal	**Non- BEE related deal**
t-stat	-1.4251	-2.8879
t-critical	2.0066	2.0369
p-value	0.1600	0.0069
Decision	Insig	Sig**

** Significant at 5% level of significance

4.3.3 Return on equity (ROE) analysis

Table 6 presents the return on equity pre & post the M&A transaction. Return on equity shows that target companies experience an improvement in their ROE in the year of the M&A deal (i.e. T0). The ROE achieved by firms in both types of M&A deals is higher than the average ROE achieved in the five years prior to the M&A transaction. In the year the deal is concluded (T0) firms in BEE M&A achieved an increase of 37% in ROE while those in

non-BEE related M&A achieved approximately 283% improvement in their ROE when compared to the average return attained in the five preceding years. Both BEE and non-BEE M&A ROE is positive after the deal is completed. ROE of BEE deals fluctuates and reaches a peak at 30.5% in year 3 (T+3) before showing signs of a decrease in year 4 & year 5. ROE for non-BEE deals improved in the year the transaction was consummated (T0) and peaked at 21.9%, but subsequently declined gradually for four years after deal completion.

The changes in the ROE as a result of the M&A transaction for BEE related deals are not significant except for the year preceding the deal (T-1). With regards to the non-BEE deals, the null hypothesis cannot be rejected for the entire period covered in the research as the ROE is not significant.

Table 6: ROE-Summary statistics for BEE and non-BEE deals

BEE Related M&A Deals						Non-BEE Related M&A Deals					
Year	Mean	Median	t Stat	t Critical	p_value	Year	Mean	Median	t Stat	t Critical	p_value
T-5	21.7	17.5	-	-	-	**T-5**	20.2	17.3	-	-	-
T-4	13.6	16.3	1.689	2.007	0.097	**T-4**	-117.4	17.0	1.023	2.037	0.314
T-3	21.7	20.4	-0.855	2.007	0.397	**T-3**	16.3	20.3	-1.066	2.037	0.294
T-2	16.8	19.0	0.490	2.007	0.626	**T-2**	20.4	18.9	-0.400	2.037	0.692
T-1	21.3	20.9	-2.136	2.007	0.037**	**T-1**	0.3	15.4	1.146	2.037	0.260
T0	26.0	21.4	-1.490	2.007	0.142	**T0**	21.9	16.3	-1.305	2.037	0.201
T+1	11.0	21.2	1.212	2.007	0.231	**T+1**	17.8	15.9	0.467	2.037	0.644
T+2	26.0	22.4	-1.071	2.007	0.289	**T+2**	14.7	15.2	0.718	2.037	0.478
T+3	30.5	19.9	-0.618	2.007	0.539	**T+3**	11.4	11.9	1.322	2.037	0.195
T+4	21.7	16.9	1.496	2.007	0.141	**T+4**	5.5	5.7	1.517	2.037	0.139
T+5	18.6	15.7	0.974	2.007	0.334	**T+5**	8.7	0.0	-0.882	2.037	0.384

** Significant at 5% level of significance

4.3.4 Return on Capital (ROC) analysis

Table 7 presents the ROC before & after an acquisition of a firm. The ROC behaves in a similar fashion to the ROE by exhibiting an improvement in the year the deal is completed. Similar to the ROE, the ROC of non-BEE deals improved in the year the transaction was consummated (T0) and peaked at 16.7% before beginning the gradual decline for four years post M&A. The ROC decreased by 64% between T0 and T+5. An inspection of the ROC for companies in BEE related M&A indicates that there was a 31% decline between T0 and T+5, however the post deal five year average ROC of 13.9% is slightly above the 5 years average of 13.4% achieved prior to the deal which insinuates slight improvement in performance. The changes in the ROC are not statistically significant for both BEE related and non-BEE related M&A except for the year preceding the BEE deal (T-1) and in year four(T+4).

Table 7: ROC-Summary statistics for BEE and non-BEE deals

BEE Related M&A Deals						Non-BEE Related M&A Deals					
Year	Mean	Median	t Stat	t Critical	p_value	Year	Mean	Median	t Stat	t Critical	p_value
T-5	13.9	12.7	-	-	-	**T-5**	13.2	11.7	-	-	-
T-4	11.1	12.6	1.092	2.007	0.280	**T-4**	-121.6	13.1	1.000	2.037	0.325
T-3	13.7	13.7	-0.857	2.007	0.395	**T-3**	13.0	15.6	-1.031	2.037	0.310
T-2	12.8	13.5	0.344	2.007	0.733	**T-2**	15.3	13.4	-0.545	2.037	0.590
T-1	15.6	14.5	-2.428	2.007	0.018**	**T-1**	10.8	11.2	1.494	2.037	0.145
T0	17.7	15.3	-1.214	2.007	0.230	**T0**	16.7	10.7	-1.121	2.037	0.271
T+1	11.3	14.0	2.004	2.007	0.050	**T+1**	12.3	10.7	0.669	2.037	0.508
T+2	15.8	14.5	-1.092	2.007	0.280	**T+2**	9.3	7.9	0.976	2.037	0.336
T+3	16.4	13.1	-0.317	2.007	0.753	**T+3**	6.6	6.3	1.484	2.037	0.148
T+4	14.0	12.6	2.097	2.007	0.040**	**T+4**	3.5	2.8	1.371	2.037	0.180
T+5	12.2	9.4	0.823	2.007	0.414	**T+5**	6.1	0.0	-1.204	2.037	0.237

4.3.5 Earnings per share (EPS) Analysis

Table 8 reports the performance of firms following a M&A transaction using EPS. The EPS measure indicates that the EPS achieved by target firms in the year of the deal (T0) is higher than the 5 year average attained prior to the deal in both types of M&As. However the EPS of companies in non-BEE related M&A experiences a consistent decline in the five year period after the deal, resulting in an average return of 9.5% which is lower than the 21.8% achieved five years before the deal. The five year average EPS for BEE deals is positive as it improves from a five year average of 5.4% prior to the deal to a five year average of 7.1% after the deal. The changes in non-BEE related M&A EPS are insignificant while the BEE related M&A are also insignificant except for the year of the deal (T0) and in year two (T+2). The earnings per share improved significantly in the year the BEE deal is completed suggesting a positive reaction from the market.

Table 8: EPS-summary statistics for BEE and non-BEE Deals

BEE Related M&A Deals						Non-BEE Related M&A Deals					
Year	Mean	Median	t Stat	t Critical	p_value	Year	Mean	Median	t Stat	t Critical	p_value
T-5	5.2	1.4	-	-	-	**T-5**	14.1	1.7	-	-	-
T-4	5.2	1.5	0.096	2.007	0.924	**T-4**	15.9	1.8	-1.755	2.037	0.089
T-3	5.1	1.8	0.092	2.007	0.927	**T-3**	24.2	2.4	-1.579	2.037	0.124
T-2	5.6	2.0	-0.587	2.007	0.560	**T-2**	28.0	1.9	-1.096	2.037	0.281
T-1	5.8	2.2	-0.528	2.007	0.599	**T-1**	26.6	1.7	0.576	2.037	0.568
T0	7.4	2.1	-2.507	2.007	0.015**	**T0**	26.8	1.9	-0.067	2.037	0.947
T+1	5.6	2.5	1.227	2.007	0.225	**T+1**	24.4	1.5	0.998	2.037	0.326
T+2	6.8	3.9	-2.046	2.007	0.045**	**T+2**	7.3	1.9	0.890	2.037	0.380
T+3	8.3	3.9	-0.902	2.007	0.371	**T+3**	6.9	2.2	0.382	2.037	0.705
T+4	7.9	4.1	0.371	2.007	0.712	**T+4**	5.0	1.2	1.144	2.037	0.261
T+5	6.9	3.9	0.590	2.007	0.558	**T+5**	3.8	0.1	0.773	2.037	0.445

** Significant at 5% level of significance

4.3.6 M&A Performance analysis by industry

In addition to performance analysis, the study seeks to investigate which industries benefit the most from M&A in SA. Table 9 presents the change in EVA for the sample period according to industries. In BEE related M&As, basic material sector has the largest absolute decline in EVA in the year of the deal compared to the other industries for both BEE(R 27 088 million) and non-BEE (R -10 076 million) related M&A. The decline suggest that both types of M&A erode shareholder value as operating performance deteriorates in the year that the deal is carried out.

Examination of T0 and T-1 change in EVA for BEE related M&A reveals that target firms in most of the industries included in the study benefited from BEE transactions. Target companies that experienced negative change in their EVA one year preceding the deal (T-1) experienced an improvement in their EVA after the BEE M&A as their EVA improved either from a large negative value to a lower negative or from a negative to a positive value in the year of the deal (T0) with the exception of the basic material sector. However in the long-term, the gains attained in T0 are erased as the EVA become negative, for a majority of the years subsequent to the deal; this phenomenon is most notable in the consumer goods, healthcare and industrials sector.

The non-BEE related M&A eroded shareholder value as the EVA deteriorated across all sectors except for the healthcare sector in the deal year (T0). The EVA either changed from positive to negative or became more negative compared to the one year before the deal was concluded. The industrial, healthcare and consumer goods industries underperformed compared to the other industries as they each have at least three years of negative economic profit in the five year period after the deal. The basic material sector experienced four years of positive and rising EVA in the five years after having completed the non-BEE related M&A transaction, thus leading one to infer that non-BEE deals are value adding for companies within the basic materials sector.

Table 9: Presentation of performance by industry

BEE Deal											
EVA	**T-5**	**T-4**	**T-3**	**T-2**	**T-1**	**T0**	**T+1**	**T+2**	**T+3**	**T+4**	**T+5**
Consumer goods	-1792	1788	-1910	-945	-556	3522	-161	-276	-170	-349	-324
Consumer services	238	216	445	408	463	176	199	290	365	-190	-900
Healthcare	393	210	469	348	-509	3167	-5022	2195	-5804	-991	-6379
Industrials	462	1798	1338	-1380	-1142	311	-1202	-2710	-2564	-146	2750
Telecommunications	1467	2587	4489	1770	-4556	-1702	15215	-20219	30834	-18744	-3168
Basic Materials	-923	-15284	14539	5313	827	-27088	-8351	-3291	-10656	7439	10131

Non BEE Deal											
EVA	**T-5**	**T-4**	**T-3**	**T-2**	**T-1**	**T0**	**T+1**	**T+2**	**T+3**	**T+4**	**T+5**
Consumer goods	896	-353	-541	-135	-2736	-1341	130	544	-2226	-1928	-5176
Consumer services	-284	420	831	-134	-80	-236	-338	431	233	-23	898
Healthcare	230	83	246	147	515	2165	-1747	-5422	-7808	7700	11064
Industrials	682	-1442	2089	-558	392	-2823	-1417	-3845	-3029	2042	-393
Telecommunications	3070	481	1374	1439	-3408	-5236	13150	-13145	425	-10028	18125
Basic Materials	-2371	2606	-1513	1438	-4322	-10076	-4898	2422	4289	4611	6541

4.3.7 M&A Performance analysis based on companies.

The study further investigated the impact that the two types of M&As have on corporate performance of a company that has conclude both types of deals by examining the financial impact of the deals at a company level. The objective was to determine whether the performance is better post BEE M&A or post non-BEE M&A. Table 10 presents the EVA for companies that completed a BEE and a non-BEE related M&A. Prior to concluding BEE related M&A, firms were able to achieve a 3-year average EVA of R 2 565 million but all the gains achieved by the companies were erased in the year that the transaction was completed as the EVA became negative at R -4 332million. Post deal, the average EVA continued to be negative at R -2 734 million. An investigation of corporate performance after completing a traditional non-BEE transaction showed that firm performance did not improve but worsened. The three year average EVA before the M&A was R -4535 million. The EVA declined to R-15671million in the year the deal was completed (T0), subsequently the firms EVA declined to a three year average of R -4535million. Considering the details discussed above, firms do not seem to benefit regardless of which of the two deals they opt for and they are much worse off if they complete both deals.

Table 10: BEE and non-BEE deals based on companies

BEE Deal							
	T-3	**T-2**	**T-1**	**T0**	**T+1**	**T+2**	**T+3**
Adcock Ingram Ltd	158	355	-289	74	9	-202	-624
AngloGold Ashanti Ltd	306	-1 019	-43	-792	560	-1 160	1 173
Assore Ltd	-158	45	370	-252	7	1 654	-641
Barloworld Ltd	3	0	-6	-3	-1	3	2
Gold Fields Ltd	586	1 513	157	-3 283	77	1 833	-5 301
Grindrod Ltd	647	-1 375	-944	117	9	-533	-458
Illovo Sugar Ltd	247	-406	-342	328	230	-19	-102
Massmart s Ltd	93	100	-258	350	738	-144	119
Mediclinic Ltd	31	44	57	-168	229	2 565	-4 825
M&R Ltd	-203	28	-88	309	139	-327	-976
Sasol Ltd	1 507	-2 685	5 559	-1 154	-11 791	-2 272	6 275
Steinhoff Ltd	-62	-32	232	-44	-185	322	-94
Telkom SA SOC Ltd	3 403	-142	304	286	-4 452	-5 922	15 857
Non BEE Deal							
	T-3	**T-2**	**T-1**	**T0**	**T+1**	**T+2**	**T+3**
Adcock Ingram Ltd	0	158	355	-289	74	9	-202
AngloGold Ashanti Ltd	-43	-792	560	-1 160	1 173	1 438	-462
Assore Ltd	1 654	-641	-1 838	1 783	750	-6 504	2 075
Barloworld Ltd	752	-17	-11	-491	203	-521	-1 144
Gold Fields Ltd	157	-3 283	77	1 833	-5 301	1 677	-2 529
Grindrod Ltd	647	-1 375	-944	117	9	-533	-458
Illovo Sugar Ltd	247	-406	-342	328	230	-19	-102
Massmart Ltd	738	-144	119	-593	-154	37	-209
Mediclinic Ltd	57	-168	229	2 565	-4 825	-131	-7 507
M&R Ltd	-88	309	139	-327	-976	-1 391	474
Sasol Ltd	-2 685	5 559	-1 154	-11 791	-2 272	6 275	6 168
Steinhoff Ltd	-624	995	-1 385	-1 725	311	-48	-849
Telkom SA SOC Ltd	304	286	-4 452	-5 922	15 857	-13 270	-960

Chapter summary

The chapter presented the financial impact of disposing of a stake in the company in a BEE related & non-BEE related transaction from the perspective of the target firm. According to EVA, BEE related M&As produce a positive but declining EVA value while non-BEE deal show that EVA of target firm became negative in the year the deal was completed and remained in negative territory for four years. Overall, the performance measures applied in the study do not indicate that there is a significant deterioration in the performance of the firm as a result of completing anyone of the two types of M&A deals. The last chapter discusses the results and conclude the thesis.

Chapter 5: Discussion and Conclusion

5.1 Introduction

The chapter aims to shed light on the results presented in the preceding chapter and provide a conclusion on whether or not the different types of M&A covered in the study create value for the target firms. The chapter is segmented into two sections. Section 5.2 presents a summary discussion of the findings. Section 5.3 provides the conclusions of the study.

5.2 Discussion of findings

The study undertook an investigation into corporate performance of firms embarking on M&A in South Africa, specifically focusing on the target firms operating performance. Economic value added (EVA) was used as a performance measure & supplemented by conventional accounting based performance evaluation methods such as return on equity, return on capital & earnings per share. The goal was not to conduct an event study whereby the share price reaction to an announcement is studied, but to examine the impact of M&A on operating performance & to conclude on whether synergies from the transaction eventually materialise from the target firms perspective.

The main performance measurement method used in the study (EVA) indicated that target firms of both types of M&A experienced a decline in operating performance when completing the deal and in subsequent years. Non-BEE M&A experienced the worst decline in absolute value compared to BEE related M&A, which also turned out to be statistically significant. Return on Equity (ROE) and Return on Capital (ROC) methods found that there was a slight improvement in the return earned by target firm following the completion of an M&A deal. The average five year returns achieved subsequent to the deal were found to be marginally higher than the average five years returns attained prior to deal completion for both performance measures, therefore implying an improvement in performance over a five year period. Using earnings the per share (EPS) method, it is noted that the returns per share earned by shareholder improved slightly for BEE related M&A while non-BEE related transaction experienced a decline in performance consistent with the decline observed when using the EVA.

Economic profit of conventional M&A as measured by EVA decreased when the deal was completed and remained negative for four out of five years, while the EVA for BEE related M&A deteriorated over the five year period after the disposal of a stake in the firm but remained positive for four out of five years. This finding of the study is akin to that of Yook.,(2004) who used EVA to examine operating performance from the acquirer's perspective and found that firms experience deteriorating post acquisition performance after completing an acquisition. Wang and Xie, (2008) found that when the acquirer has strong corporate governance and strong shareholder right in the target, it led to improved performance in the target firm. These observations explain why the M&A studied yielded disappointing results for the target firms. Acquires in the M&A transactions studied do not have sufficient shareholder rights to influence corporate policy and governance in the target thus leading to poor performance. They are unable to restructure and transform the entity to generate positive economic profits and the envisaged synergies. According to Yook,(2004) the decline in operating performance is linked largely to industry effects, that is, industries experiencing poor operating performance are likely to be the objects of takeover attempts. This assertion supports the results of this study carried out in order to determine the impact of M&A (BEE or non-BEE) on corporate performance based on industry. The study discovered that most industries that experienced poor performance prior to the merger showed an improvement when the merger was completed but the improvement in industry performance was short-lived as operating performance deteriorated soon after deal completion as EVA was negative for most of the post M&A period.

This finding attest to the notion that the inability of the acquirer to influence governance of the target in the deals studied could be responsible for lacklustre performance of firms in BEE and non-BEE M&A. The inability of the acquirer to positively influence the targets business strategy and steer those firm to success could be compounded by the fact that the targets may have been experiencing poor performance prior to the merger. For instance, some firm may be spurred on to sell a stake in a BEE deal by poor performance and the hope that an improved BEE status may lead to more business from government. Furthermore, because BEE investors have no influence on governance they are unable to meaningfully improved corporate performance.

The decline in EVA for BEE related M&A may be exacerbate by the fact that some companies view BBBEE act as a legal burden that they must comply with in order to improve their BEE ratings. This attitude of target corporations may lead to the deal not being structured adequately as to enable the company to maximize the synergies linked to BEE transactions. Alessandri et al.,(2011) concurs as they found that BEE deals create value when pursued in earnest and destroy value otherwise. The findings in the study are in agreement with those of Huang and Walking, (1987) who conducted an event study analysis and found that more that 50% of target firms experience negative returns in mergers. According to Chipeta and Vokwana,(2011) BEE mergers and acquisitions erase shareholder wealth as firms experience negative cumulative annual returns.

5.3 Conclusion

Based on the research conducted, the appropriate inference that one can make is that BEE as well as non-BEE related M&A resulted in a decrease & erosion of economic profit of corporations included in the study. The conclusion is similar to that of Makhele.,(2013) who found that firms in M&A acquisitions experience a deterioration in operating performance, however these changes were found not to be significant. The decline in EVA suggests that M&A do not benefit the target firms through improve performance.

The synergies cited as benefits of mergers do not materialise for the target firms since operating performance does not improve substantially subsequent to the M&A transaction. The conclusion of this research study may differ from prior research studies largely because previous studies were event studies and focused on price changes to the M&A announcement which may include irrational “noise” trading by the market while the focus of the study was on operating performance which is not influenced by irrational behaviour of the market.

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