

THE IMPACT OF A SUCCESSFUL
ACQUISITION ON PERFORMANCE AND
MANAGEMENT – A CASE STUDY

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OPSOMMING

Alhoewel daar heelwat bank oornames en samesmelting die afgelope dekade in ons land was, was weinig van die transaksies suksesvol. Die onlangse voltrekking van die Barclays Bank PLC en die Absa Groep oorname het bewys dat so 'n transaksie suksesvol afgehandel kan word. Die doel van hierdie skripsie was om die faktore te identifiseer wat bygedra het tot die sukses van hierdie transaksie en die effek van hierdie faktore op sekere bestuursaspekte en finansiële prestasiemeters te toon.

Die doel van hierdie skripsie is bereik deur eerstens navorsing te doen oor die onderwerp. Die bank sektor in ons land word kortliks omskryf om die basis te vorm vir die oorsig wat gegee word oor die geskiedenis van bank oornames en samesmeltings in ons land. Die risiko's in die bankindustrie spesifiek word bespreek as 'n platform om die potensiële suksesfaktore van 'n samesmeltingstransaksie te identifiseer. Nadat hierdie faktore uitgelig is, is sekere aspekte van bestuur en die verrigting van hierdie bestuurstake bespreek. Finansiële prestasiemeters wat spesifiek op die bankindustrie van toepassing is, is geïdentifiseer en omskryf. Resultate is verkry deur hierdie bogenoemde faktore, aspekte en meters op die Absa-Barclays transaksie toe te pas. Inligting is verder ingesamel deur die voltooiing van vraelyste en die interpretasie van beide Absa en Barclays se finansiële verslae vir 2005.

Die ontleding van die suksesfaktore het getoon dat die Absa-Barclays transaksie op sukses afstuur. Die verandering in die struktuur van Absa se topbestuur en die wyse waarop die bestuur belangrike menslike faktore hanteer het, was ook 'n aanduiding van die suksesvolle afhandeling van die oorname. Die finansiële prestasiemeters het ook 'n duidelike positiewe effek as gevolg van die oorname getoon. Die sukses van hierdie transaksie kan in die toekoms as vertrekpunt gebruik word om soortgelyke transaksies aan te pak.

ABSTRACT

Only a few of the bank merger and acquisition attempts have been concluded successfully. The recent success of the Barclays Bank PLC and Absa Group acquisition has proved that success is possible when the transaction is conducted properly. The aim of this study was to identify the potential driving factors behind this success and to illustrate the effect of these factors on management and performance.

The general objective of this dissertation was reached by conducting research on this subject. The banking sector in South Africa has been described to set the background for discussing the history of bank mergers and acquisitions in our country. Discussing the risk considerations with regard to the banking industry was essential to this study in order to determine the potential driving factors of success. After identifying these factors, certain aspects of management and the conducting of these management tasks were discussed. A few financial performance measures relating to the banking industry specifically were identified and explained. The implementation of all these factors, aspects and measures on the Absa-Barclays transaction has shown some significant results. Apart from the research done, information was gathered through the completion of a questionnaire and the interpretation of both Absa's and Barclays's financial reports for 2005.

The analysis of the driving factors of success has indicated the success of the transaction. The change in management structure as well as the way in which the important human factor was approached and being dealt with by management, has illustrated the potential success of the acquisition. All of the financial performance measures revealed positive results after the announcement of the acquisition. The success of this transaction can be used as benchmark when conducting similar transactions in future.

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LIST OF ABBREVIATIONS

BVE	Book value of equity	Figure 2.1:
CC	Cost of capital	Figure 2.2:
CI	Capital invested	Figure 3.1:
COE	Cost of equity	Figure 4.1:
DPS	Dividends per share	Figure 5.1:
EBIAT	Earnings before interest but after tax	Figure 5.2:
EPS	Earnings per share	Figure 5.3:
EVA	Economic value added	Figure 5.4:
ke	Cost of equity	Figure 5.5:
NI	Net income	Figure 5.6:
NOPAT	Net operating profit after tax	Figure 5.7:
RI	Residual income	Figure 5.8:
ROA	Return on average assets	
ROE	Return on average equity	
ROIC	Return on invested capital	
TE	Total equity	

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Absa is the first South African financial services group to partner with a global player since 1994 and this transaction illustrates confidence in South Africa (Absa, 2005c:2). Because of the effect of this transaction on the South African economy and finance, this subject is worth intense research to broaden knowledge.

Absa views partnering with a significant global player as key to the creation of long-term shareholder value and the delivery of its strategic vision of becoming the leading financial services business in South Africa and the pre-eminent bank on the African continent. Barclays, as a major global bank with extensive interests in Africa, is an ideal partner and shares Absa's vision (Absa, 2005c:3).

Barclays views South Africa as an attractive market with good growth prospects and a sophisticated economic and financial services infrastructure. The recommended acquisition accelerates Barclays's strategic objective of building its retail and commercial banking, investment banking and credit card presence in selected international markets (Absa, 2005c:3).

As one of the country's big four banks and the leading retail bank, ABSA is an excellent partner for Barclays to expand its interests in South Africa. That is because of Absa's strong market position across major market and product segments, its distribution capabilities in South Africa and its operations and footprint in the rest of the African continent (Absa, 2005c:11).

If successful, it is expected that the recommended acquisition will lead to an enhancement in Absa's earnings growth potential through the deployment of operational best practices. It will also offer access to a broader range of products and services tailored to the specific needs of Absa's existing and potential customers (Absa, 2005c:5).

To achieve the objectives of this research, a literature review is to be conducted to prove an appropriate framework on which to base the practical considerations forming the basis of this study.

1.2 MOTIVATION

Although the merger and acquisition trend is set to continue, bank mergers are complex and time consuming and it is evident that they fail as often as they succeed. Research found that, internationally, of the 41 bank mergers that took place between 1990 and 1995, only 44% have resulted in improved financial performance relative to the peer group. Bankers Magazine also estimated that as many as 85% of all mergers fail to fulfil their long term promises of financial improvement (Joffe, 2000:53).

It is clear that mergers and acquisitions in the banking sector do not always create the value expected from them. Before a deal takes place it is necessary that buyers and sellers examine a variety of financial considerations to assist them in the decision on whether to negotiate the deal and at what price (Barfield, 1998:24). Non-financial issues, for example the change in management structures, must also be considered when negotiating a merger or acquisition.

The Absa merger (Allied, United, Volkskas and Trust Bank) was disastrous for staff morale, resulting in losses of skilled people and customers. It took five years longer than planned at a price of R1,5 billion and it also took quite some time before the merged group settled and began to catch up with its competitors (Beets, 2001:5).

The South African banking scene has been relatively unaffected by global trends until after the transition to democracy in 1994, when foreign players started entering. Although many research papers have already been written on mergers and acquisitions, very few of them refer – specifically - to bank mergers and to the success of such a merger.

1.3 PROBLEM STATEMENT

Only a few of all the bank mergers and acquisitions that have been attempted have become a reality. The recent success of the Absa-Barclays merger highlights a milestone reached in cross-border mergers and acquisitions, specifically in the banking industry. Certain factors attributed to the success of this acquisition and identifying these factors and their effect on performance and management can be of great value in the future.

1.4 RESEARCH OBJECTIVES

The research embraces general and specific objectives.

1.4.1 General objective

The general research objective of this study is to identify the success factors of the Absa-Barclays merger and their effect on financial performance and management.

1.4.2 Specific objectives

The specific objectives of this research are the following:

- 1.4.2.1 To give a brief history of the banking sector and bank mergers and acquisitions in South Africa
- 1.4.2.2 To briefly discuss the risk considerations with regard to mergers and acquisitions – specifically in the banking industry
- 1.4.2.3 To discuss the potential driving factors of merger and acquisition success
- 1.4.2.4 To discuss the non-financial and financial implications of an acquisition
- 1.4.2.5 To analyse the impact of the success factors on the Absa-Barclays transaction
- 1.4.2.6 To discuss the impact of the Absa-Barclays acquisition on non-financial issues

1.4.2.7 To show the effect of the Absa-Barclays acquisition on Absa's financial performance

1.4.2.8 To draw conclusions and make recommendations for the future

1.5 RESEARCH METHODOLOGY

The research consists of two phases, namely a literature study as well as an empirical study.

1.5.1 Literature study

A combination of data such as journal articles and studies conducted will be used during the research of this study. Ample commercial data are available on this subject and will also be studied.

Text and numerical data which are relevant sources dealing with the subject of mergers and acquisitions, will be studied to provide a theoretical background on which to base the practical findings of the case.

1.5.2 Empirical study

The empirical study can be divided into the specifics of the study field and the techniques and methods that will be used for data analysis.

1.5.2.1 Composition of the study field

Absa will be the only bank used in this case study because of the recent success of the Absa-Barclays transaction and because the success is the main driving force behind the research.

1.5.2.2 Methods and techniques for data analysis

- Employees from Absa Bank, from various departments, will mainly be the persons from whom permission and information for the empirical survey

will be obtained. A questionnaire will be submitted to these persons. A questionnaire to managers in the human resource department specifically will also be submitted in order to ensure the reliability of the information. Management will be assured that the results will be made available to them and will be kept confidential outside the company.

- The financial data needed will be extracted from the 2005 year end Financial Reports of both Absa and Barclays.

1.6 DIVISION OF CHAPTERS

Chapter 1 consists of the introduction, problem statement and objectives as described in this research proposal.

In Chapter 2 a brief history of the success/failures of mergers and acquisitions in the banking industry in South Africa will be given and the risk considerations with regard to mergers and acquisitions in banking specifically will be discussed.

In Chapter 3 the potential driving factors of merger and acquisition success will be discussed.

In Chapter 4 the non-financial and financial implications of an acquisition will be identified and examined.

In Chapter 5 the results of the implementation of the literature discussed in Chapters three and four on the Absa-Barclays transaction will be interpreted and discussed.

Chapter 6 will reflect the conclusions drawn during the study and recommendations for further research will be made.

CHAPTER 2

MERGERS AND ACQUISITIONS IN BANKING

2.1 INTRODUCTION

Over the past decade, the banking industry has experienced an unprecedented level of consolidation as mergers and acquisitions among large banks have taken place at record levels (Pilloff, 1996:4). The consolidation trend currently occurs worldwide, especially in the United States of America and Europe.

Despite the continued pace of merger and acquisition activity, new deals are met with increasing scepticism among investors. The reason for this is that many mergers and acquisitions have simply not delivered the benefits that were promised (Marcus, 2004:4). The two features that stand out in the wave of merger and acquisition activity are that it is a global phenomenon and it is occurring across many industries, with the major motives to raise efficiency and cut costs (Falkena & Llewellyn, 1999:98).

In South Africa, the number and value of mergers, acquisitions and corporate restructuring has grown significantly in the last decade due to factors such as globalisation, deregulation, increasing competition and black economic empowerment (Correia *et al.*, 2003:17-23). A brief history of the banking mergers and acquisitions in South Africa (objective 1.4.2.1, page 3) will be discussed in a section of this chapter (paragraph 2.3, page 8).

2.2 THE SOUTH AFRICAN BANKING SECTOR

The South African banking sector is still highly concentrated as a result of the years of economic isolation during the 1980s. Approximately 60 banks are registered in South Africa, but the largest four own approximately 70% of the assets, and own the bulk of the retail banking system. The others are mainly small niche banks, focusing on specific activities, regions or communities (Marcus, 2004:1).

According to Marcus (2004:1) the "big four" South African banks have always invested heavily in information technology (IT), and their systems are as sophisticated as those in much more developed countries. This has increased the availability of information in the markets and has led to a substantial expansion in cross-border transactions.

Technological developments have also facilitated the design of complex new financial instruments, which have provided innovative ways of hedging against risks. But most importantly, information technology is seen as a major strategic competitive factor, since it forms the basis for South African banks' drive to improve cost efficiencies (Marcus, 2004:1).

A related development has been the liberalisation and modernisation of financial markets. South Africa has adopted a clearly defined policy of actively participating in globalisation, and has implemented a number of economic policies to facilitate this process (Marcus, 2004:1).

Deregulating the exchanges, phasing out exchange controls, restructuring the capital market to provide for more specialised trading in equities, bonds and derivatives, upgrading the national payment, clearing and settlement systems, and more active participation in multinational economic cooperation have all helped integrate South Africa into the global financial markets. Foreign banks are largely free of restrictions. Some 10 foreign banks operate in South Africa, and a further 60 have representative offices. The large banks also have significant operations and interests in several major foreign markets (Marcus, 2004:2).

Over the last three years the banking sector in South Africa has gone through an uncertain and volatile period. Many arguments have focused on the need for consolidation in the sector. Different factors have influenced this line of thinking. There have, however, been stronger arguments. The need for the introduction of competition in the sector, especially in the retail sector, has been the most dominant (Simelane, 2002:1).

Since about 1994, there have been over twenty-one foreign banks operating in South Africa, e.g. Citibank, HSBC, Morgan Stanley, Barclays, Deutsche Bank, to name but some. Almost without exception, these banks have been operating at investment or merchant banking level catering for the upper end of the market. The consequence of their entering the local market has been that the top four local banks, (Standard Bank, Absa, Nedcor and First Rand) have had to reorganise their strategies (Simelane, 2002:1-2).

2.3 A BRIEF HISTORY OF BANK MERGERS AND ACQUISITIONS IN SOUTH AFRICA

Bank mergers are complicated and it can be evidenced that they fail as often as they succeed. Research found that, internationally, of the 41 bank mergers that took place between 1990 and 1995, only 44% have resulted in improved shareholder performance relative to their peer group. It is estimated that as many as 85% of all mergers fail to fulfil their long-term promises of financial improvement (Joffe, 2000:53).

The South African banking scene has been relatively unaffected by global trends until after the transition to democracy in 1994, when foreign players started entering. South Africa, however, has a bad record of bank mergers and acquisitions.

The merger of UBS Holdings, the Allied and Volkskas groups, and part of Sage Financial Services in 1991 resulted in the formation of Amalgamated Banks of South Africa (Absa) at a total value of R1 757,7 million. Absa became the largest financial services group in the country. The offer for Allied resulted in First National Bank (FNB) and Absa making competing bids for Allied. FNB later withdrew after coming to an arrangement with Absa (Correia *et al.*, 2003:17-24).

The Absa merger process was disastrous for staff morale, resulting in significant losses of skilled people and customers. The merging of the computer systems of these four banks took five years longer than planned

and cost an estimated R1,5 billion more than expected. It also took quite some time before the merged group settled and began to catch up with its competitors in terms of costs, capital and profitability (Joffe, 2000:45).

The bank assurance merger which created FirstRand – two life assurers, Momentum and Southern, and two banks, First National Bank and Rand Merchant Bank – has apparently gone smoothly. Insiders concede, though, that it has been tougher, more costly and has lasted longer than expected (Joffe, 2000:54). The value of this merger was R59 billion (Correia *et al.*, 2003:17-24).

In late 1999, the third largest retail bank, Nedcor, launched an application for the hostile takeover for Stanbic, the operator of Standard Bank, the largest retail bank. A successful takeover would result in one competitor exiting the market, leaving the retail market with only three players.

Nedcor estimated the operating synergies from the merger to be R600 million per year, although Stanbic's management did not agree with this figure and indicated that Stanbic would achieve higher earnings growth as a stand-alone bank. The management of Standard Bank (Stanbic) aggressively and effectively fought off the merger by informing shareholders of the dismal success rate of hostile bank takeovers, questioning the accuracy of operating synergies indicated by Nedcor and engaging in court actions which ensured time delays and allowed management time to report higher operating returns. This caused a rise in the Stanbic share price thereby forcing Nedcor to revise its offer to the point that the value to be derived from the merger would be minimal for Nedcor's shareholders (Correia *et al.*, 2003:17-25).

This proposed merger has not realised at all. After nine months of dithering by the government the merger was blocked on 26 June 2000 by the Minister of Finance on the grounds that it would reduce competition in banking and cost too many jobs (Deloitte and Touche, 2000). An estimated ten thousand employees would have lost their jobs if the takeover had occurred.

At the beginning of 2002, Unifer, a micro-lending arm of Absa, the fourth largest retail bank experienced problems. The collapse of Unifer led to worries about Saambou's micro-lending exposure. This triggered the collapse of Saambou, the seventh largest retail bank in South Africa. Deposits were frozen and only limited withdrawals were permitted. The other banks stood in line to take over various loan and mortgage accounts of the failing bank. During that process, the fate of the employees remained unclear. It soon became obvious that some would have to be retrenched within weeks of the collapse. Eventually, 2500 employees were retrenched and 680 were absorbed by First Rand Bank who acquired the home loan book (Simelane, 2002:4).

The Nedcor-BoE merger has resulted in the formation of South Africa's largest bank. The impetus for the merger arose due to the liquidity crisis experienced by BoE following significant withdrawals by depositors, which required the government and the Reserve Bank to step in and provide guarantees. This merger means that South Africa now has four large banking groups. These banks are now considered to be too large to fail and the country has seen a significant consolidation and concentration in the banking sector. This is in line with international developments in the banking sector (Correia *et al.*, 2003:17-25).

It is clear that mergers and acquisitions in the banking sector do not always create the value expected from them. According to Barfield (1998:24) this value destruction may be due to, amongst others, unrealistic assessment of opportunities, illusory synergy, sluggish integration and cultural differences. Koch (1995:871-872) states that before a deal takes place, it is necessary that buyers and sellers examine a variety of financial considerations to assist them in the decision on whether or not to negotiate a deal and at what price.

Non-financial issues, for example cultural differences, must also be considered when negotiating a merger or acquisition. This is because mergers generally have both beneficial and detrimental aspects, depending

on how stockbrokers, bank employees or bank customers view transactions (Schwencke, 2002:423).

2.4 THE BARCLAYS OFFER

On the 9th of May 2005 Barclays Bank PLC from Europe made Absa Group Limited an acquisition offer they cannot refuse. The first part of the proposed acquisition by Barclays is a 60% interest in Absa. The second part is the partial offer to all ordinary shareholders to acquire an additional 28% of their shares. Barclays is offering R82.50 per share, payable in cash, representing a total consideration for the scheme and partial offer of R33 billion. Figure 2.1 shows the intended timeline for the transaction since the first announcement was made in September 2004 (Absa, 2005f:1-2).

Figure 2.1: Intended transaction timeline

September 2004	First announcement of the intended takeover by Barclays Bank
9 May 2005	Announcement of firm intention to make an offer and declaration of Absa's final dividend
20 May 2005	Post joint circular to Absa's shareholders Offer period formally open and Code timetable applies
13 June 2005	Scheme meeting of Absa's shareholders and general meeting of Absa's shareholders to be held
5 July 2005	Court hearing to sanction scheme
22 July 2005	Record date for the scheme and tender offer
27 July 2005	Anticipated settlement date for the acquisition

On 27 July 2005 Absa Group and Barclays Bank PLC announced the completion of a landmark deal that sees the UK-based international banking business acquiring a majority stake of 53.96% of all ordinary shares in Absa

Group Limited. This deal has enjoyed the support of the South African regulators, the Absa Group board and shareholders (Absa, 2005b:1).

At a cost of nearly R30 billion (£2.6 billion), this is the largest foreign direct investment in South Africa and represents a historic deal for South Africa as well as Barclays (Absa, 2005b:2). Absa has more than 30 000 employees, seven million customers and 670 outlets. It is also South Africa's largest internet bank and is therefore a valuable addition to the Barclays Group (Absa, 2005c:3).

2.5 RISK CONSIDERATIONS

Risk is an inherent characteristic of all strategic decisions – for example mergers and acquisitions – because there is some degree of uncertainty associated with decision outcomes (Pablo & Sitkin, 1996:2). Thornhill (1990:1) states that risk can be defined as follows:

- The possibility of or exposure to loss
- The probability or chance of loss
- Peril which may cause loss
- Hazard, or a condition which increases the likely frequency or severity of loss
- The potential amount of loss
- Variations in actual losses
- The probability that actual losses will vary from expected losses

Heffernan (2000:164) defines risk in banking as the volatility or standard deviation of the net cash flows of a bank. It could also be the unpredictability of future returns (Sinkey, 1983:38) or the adverse impact that several sources of uncertainty can have on profitability (Bessis, 1998:5). With regard to mergers and acquisitions, risks can also be described as any event or circumstance that impedes the attainment of goals or successful transaction

(Saavedra-Lim, 1998:2). Therefore, banking risk can be seen as undertaking the uncertainty of the outcome, when undertaking any action/transaction.

The involvement and presence of risk in any merger/acquisition is inevitable. During a takeover the bank is exposed to several major risks in the course of its business. These risk considerations with regard to mergers and acquisitions in the banking industry specifically (objective 1.4.2.2, page 3); will be discussed next in terms of definition and management.

2.5.1 Credit risk

Credit risk is paramount in terms of the importance of potential losses. Credit risk is the risk that customers default, that is fail to comply with their obligation to service debt (Bessis, 1998:6; Koch & Macdonald, 2003:199). This default could cause total or partial loss of the amount lent to the counterparty. Credit risk is also the risk of a decline in the credit standing of a counterparty. This deterioration does not necessarily imply default, but means that the probability of default increases (Bessis, 1998:6). Koch (1995:107) describes credit risk as the potential variation in net income and market values of equity resulting from non-payment or delayed payment.

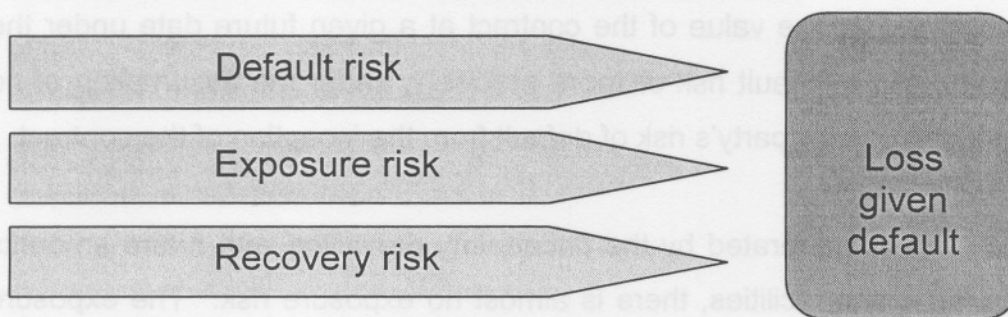
Credit risk is critical for banks since the default of a small number of important customers can generate large losses, which can lead to insolvency (Bessis, 1998:6). Despite innovation in the financial services sector, credit risk is still the major single cause of bank failures. The reason is that more than 80% of a bank's balance sheet generally relates to this aspect of risk management (Van Greuning & Bratanovic, 2000:126). There are three main *types of credit risk*:

- Personal or consumer risk
- Corporate or company risk
- Sovereign or country risk

The costs of not fulfilling the financial obligations to the creditor must be considered as a part of credit risk, according to Falkena & Kok (1991:18) and although the debtor and creditor may arrange new terms, the creditor is nevertheless faced with additional cost.

Default is an uncertain event and the future exposures of default are, in many cases, not known in advance. The potential recoveries from default cannot be predicted either. Figure 2.2 on the following page shows how credit risk can therefore be divided into three risks (Bessis, 1998:82):

Figure 2.2: Credit risk and its underlying risks



2.5.1.1 Default risk

Default risk is the probability of the event of default. The event of default has to be defined. Then, proxies that can be used to estimate its probability are reviewed. There are several possible definitions of default risk. It could be missing a payment obligation, breaking a covenant, entering a legal procedure or economic default (Bessis, 1998:82). According to Koch and Macdonald (2003:272) default risk is the probability or likelihood that a borrower will not make the contractual interest and principal payments as promised.

The definition of default is important in estimating the chances of default, for instance from historical records. The various events of default do not necessarily generate immediate losses, but certainly increase the likelihood of ultimate default – which is bankruptcy (Bessis, 1998:83).

2.5.1.2 Exposure Risk

Exposure risk can be defined as the amount which would be lost in default given the worst possible assumption about recovery in the liquidation or bankruptcy of a debtor. For a loan or fully drawn facility, this is the full facility amount plus accrued interest; for an unused or partly used facility the prevailing practice is to still say that the full facility amount is "exposed". This is because the worst assumption is that the borrower draws the full amount and then immediately defaults (Cherubini *et al.*, 2004:127).

According to Jameson (1996:51) the exposure risk generated by a contract can be defined as the value of the contract at a given future date under the assumption of no default risk or more precisely, under the assumption of no change in the counterparty's risk of default from the inception of the contract.

Exposure risk is generated by the uncertainty prevailing with future amounts at risk. For some facilities, there is almost no exposure risk: The exposure risk can be considered small or negligible for all credit lines for which there is a repayment schedule (Bessis, 1998:83-84).

Unfortunately, this is not true for all other lines of credit. Committed lines of credit allow the borrower to draw on those lines whenever he wants to, depending on his needs and subject to a limit fixed by the bank. Overdraft balances, for instance, change at the initiative of the clients and those future exposures are highly likely.

2.5.1.3 Recovery risk

Cherubini *et al.* (2004:159) define recovery risk as the amount that a creditor would receive in final satisfaction of the claims on a defaulted credit. The most common practice is to state this risk as a percentage of the debt's par value. An alternative definition, which is commonly in the reduced form models, is to state recovery as a percentage of market value. This definition is more tractable, but is not well aligned with creditor's true claims in default.

Recovery risk is the amount that is likely to be recovered – using a recovery rate – if the counterparty does indeed default. This rate can be used to determine the expected recovery risk or a worst case scenario (Jameson, 1996:115). The recoveries in the event of the default are not predictable. They depend on the type of default and numerous factors such as the guarantees received from the borrower, the type of such guarantees, which can be collateral or third-party guarantees and the context at the time of default (Bessis, 1998:84).

The existence of collateral minimises credit risk if the collateral can be easily taken over and sold at some significant value. Third-party guarantees transform the default risk of the borrower into a joint default risk of the borrower plus the guarantor (Van Greuning & Bratanovic, 2000:145).

Credit risk management covers the decision-making process before the credit decision is made and the follow-up of credit commitments, as well as all monitoring and reporting processes. The decision-making process covers all the steps followed by a credit application, while the follow-up is done through periodic reporting reviews of the bank commitments by customer, industry and country (Bessis, 1998:85-86).

2.5.2 Liquidity risk

Liquidity risk is considered a major risk. This risk can be defined in different ways: extreme liquidity, as the safety cushion provided by the portfolio of liquid assets, or the ability to raise funds at a normal cost (Bessis, 1998:7). Koch and Macdonald (2003:122) define liquidity risk as the current and potential risk to earnings and the market value of shareholders' equity that result from a bank's inability to meet payment or clearing obligations in a timely and cost-effective manner. This risk effectively means that a bank has insufficient funds on hand to meet its obligations (Van Greuning & Bratanovic, 2000:158). Because extreme liquidity results in bankruptcy, it is labelled as a fatal risk. However, such extreme conditions are often the outcome of other risks for example, important losses due to default of a big customer.

Another common meaning of liquidity risk is that short-term asset values are not sufficient to match short-term liabilities or unexpected outflows. Liquidity is necessary for banks to compensate for these unexpected as well as expected balance sheet fluctuations and to provide funds for growth. It represents a bank's ability to efficiently accommodate decreases in deposits and/or the runoff of liabilities, as well as fund increases in a loan portfolio (Van Greuning & Bratanovic, 2000:158).

The need for liquidity, for banks specifically, may be classified under four headings according to Kelly (1993:352-353):

- The need by a bank to replace net outflows of funds due to retail deposits being withdrawn, or wholesale funds (deposits and loans) not being renewed.
- The need of a bank to compensate for non-receipt of expected fund inflows, due to a borrower not meeting his commitment on time.
- The need by a bank to obtain further funds when contingent liabilities actually arise, as when existing overdraft facilities or lines of credit are suddenly more fully utilised, or when commitments resulting from endorsement of bills or promissory notes have to be met when the latter are dishonoured.
- The need of a bank to be able to undertake new desirable transactions, such as when an important customer requests further funds.

A balance between too little and too much liquidity must be achieved, as both could cost the bank money over a period of time. Too little liquidity may force the bank into the market at a time when rates are high and too much liquidity will cost money when the bank has to fund a cash position with long-term deposits at a higher interest rate (Falkena & Kok, 1991:85).

Liquidity management is the continuous process of raising new funds, in the case of a deficit, or investing excess resources when there are excesses of funds (Bessis, 1998:127). Bank management can reduce liquidity risk by

avoiding undue concentration of maturities and by monitoring its exposure to certain clients. The basic funding principle is to control the amount of funds that have to be raised on any given day by currency, country and source.

For a large bank it is almost always possible to attract more funds in the money market by simply increasing its deposit rates relative to what is being offered in the market. For a smaller bank the upward adjustment of its deposit rates may have a positive result at first, but if the rates it is offering are too far out of line with those being offered by the rest of the market, this will be interpreted as an indication of a liquidity problem and will then have the opposite effect, with a possible run on the bank's deposits (Falkena & Kok, 1991:86).

2.5.3 Interest rate risk

The interest rate risk is the risk of declines of earnings due to the movements of interest rates (Bessis, 1998:8; Gardner & Mills, 1994:146). Most of the balance sheet items of banks generate revenues and costs which are indexed to interest rates. Since interest rates are unstable, so are earnings. Interest rate risk also compares the sensitivity of interest income to changes in asset yields with the sensitivity of interest expense to changes in the interest costs of liabilities (Koch & Macdonald, 2003:124).

Anyone who lends or borrows is subject to interest rate risk. The lender earning a variable rate has the risk of seeing revenues reduced through a decline in interest rates. The borrower paying a variable rate has higher costs when interest rates increase. Both positions are risky since they generate revenues or costs indexed to market rates. The other side of the coin is that they present opportunities for gains as well (Bessis, 1998:8).

An interest rate determines a bank's cost of funds as well as the "selling price" of its funds (Styger & Van der Westhuizen, 2000). Interest rate exposure is a characteristic of any financial company and stems from assets and liabilities maturing or repricing at different times. The risk here lies in the fact that

interest rates may rise and that these more expensive funds have to be used to fund assets that are yielding lower returns.

In principle, the sound management of interest rate risk requires systematic and adequate oversight by senior management. Also needed are risk management policies and procedures that are clearly spelled out and commensurate with the complexity and nature of a bank's activities and the level of its exposure to interest rate risk. This risk should be monitored on a consolidated basis, including the exposure of subsidiaries (Van Greuning & Bratanovic, 2000:179).

According to Van Greuning and Bratanovic (2000:179) the bank's board of directors has ultimate responsibility for the management of interest rate risk. The board approves the business strategies that determine the degree of exposure to risk and provides guidance on the level of interest rate risk that is acceptable to the bank. The board should systematically review risk to fully elucidate the level of risk exposure and to assess the performance of management in monitoring and controlling risks in compliance with board policies.

Banks should also have an adequate system of internal controls to oversee the interest rate risk management process. A fundamental component of such a system is a regular, independent review and evaluation to ensure its effectiveness and, when necessary, make appropriate revisions or enhancements. The goal of interest rate risk management is to maintain risk exposure within the bank's self-imposed limits and at levels consistent with its internal policies (Van Greuning & Bratanovic, 2000:180).

2.5.4 Market risk

Market risk is the risk of adverse deviations of the mark-to-market value of the trading portfolio during the period required to liquidate the transactions (Bessis, 1998:9; Koch & Macdonald, 2003:124). It is also the sensitivity of an asset's returns to factors affecting the entire financial system (Gardner & Mills,

1994:146). Market risk exists for any period of time. Earnings for the market portfolio are profits and losses arising from transactions. Any decline in value will therefore result in a market loss for the corresponding period equal to the difference between the beginning and the ending mark-to-market values.

For banks, market risk arises if financial instruments are held to the trading book or if a bank holds equity as some form of collateral. Market risk comes in many different forms. For the banking sector, however, two are of the greatest concern namely (Heffernan, 2000:194):

- Variations in the general level of interest rates
- The relative value of currencies

Most banks will try to estimate the impact of these risks on performance, attempt to hedge against them and thus limit the sensitivity to variations in undiversifiable actions.

By its very nature, market risk requires constant management attention and adequate analysis. Prudent managers should be aware of exactly how a bank's market risk exposure relates to its capital. In recognition of the increasing exposure of banks to market risk, and to benefit from the discipline that capital requirements normally impose, the Basel Committee amended the 1988 Capital Accord in January 1996 by adding specific capital charges for market risk (Van Greuning & Bratanovic, 2000:190).

Market risk management policies should specifically state a bank's objectives and the related policy guidelines that have been established to protect capital from the negative impact of unfavourable market price movements. Policy guidelines should normally be formulated within the restrictions provided by the applicable legal framework (Van Greuning & Bratanovic, 2000:191).

2.5.5 Foreign exchange risk

The currency risk is that of observing losses due to changes in exchange rates (Bessis, 1998:10). This change in exchange rates affects the values of

assets, liabilities and off-balance sheet activities (Koch & Macdonald, 2003:124). Most banks view activity in the foreign exchange market as beyond their franchise, but some are active participants. The former will take virtually no principal risk, no forward open positions and have no expectations for trading volume. Within the latter group, there is a clear distinction between those that restrict themselves to acting as agents for corporate and/or retail clients and those that have active trading positions (Santomero, 1997:19).

According to Falkena and Kok (1991:90) currency risk is regarded as having three sides:

- Transaction risk – this represents the price impact of an exchange rate change on foreign receivables and foreign payables.
- Economic or business risk – this relates to the impact of exchange rates on a bank's long-term competitive strength.
- Translation risk – this arises from the periodic consolidation of the financial statements of a parent and its affiliates for the purpose of uniform reporting to shareholders.

Currency risk can be managed in the following ways:

- There must be written policies in which the exposures that must be hedged over a specified time horizon as well as the derivatives that must be used for the hedging should be defined. The extent to which treasury must be allowed to manage positions based on its view of foreign exchange rates must also be specified.
- The foreign exchange position must be marked-to-market frequently and a combination of risk measures, for example value-at-risk, sensitivity analysis and stress-testing must be used to gain insights into the risk of the foreign exchange position that is being managed.
- Foreign exchange accounting practices must be uniform throughout the banking group (Wallace, 1998:2).
- Hedging that uses forward agreements, futures, currency swaps and/or currency options is also a solution (Falkena & Kok, 1991:103).

2.5.6 Solvency risk

Solvency risk is the risk of being unable to cover losses, generated by all types of risks, with the available capital. Solvency risk is therefore the risk of default of the bank. It is also identical to the credit risk incurred by the counterparties of the bank (Bessis, 1998:11). This risk also refers to the potential decrease in the market value of assets below the market value of liabilities, indicating that economic net worth is zero or less (Koch & Macdonald, 2003:126). Solvency is the end result of available capital and of all risks taken: credit, interest rate, liquidity, market or operational risks.

The fundamental issue of capital adequacy is to define what level of capital should be associated with the overall risk in order to sustain an acceptable solvency level. The principle of capital adequacy follows and sets up the major orientations of risk management. These can be summarised by the following principles (Bessis, 1998:11):

- All risks generate potential losses.
- The ultimate protection for such losses is capital.
- Capital should be adjusted to the level required to make it capable of absorbing potential losses generated by all risks.

The implementation of this principle requires the following (Bessis, 1998:11):

- All risks should be quantified in terms of potential losses.
- A measure of aggregated potential losses should be derived from the measurement of potential losses generated by the different risks.

A major challenge of solvency risk management is to implement these principles and define quantitative measures required to obtain the adequate capital, or derive which levels of risk are sustainable given the capital constraints (Bessis, 1998:11). Solvency management requires a combination of daily monitoring, periodic analysis and long-term planning. On a daily basis, banks need the infrastructure to accumulate positions, measure economic and regulatory capital needs and manage liquidity. Long-term

planning requires analysis of the overall capital structure as well as modelling of the growth and capital needs of each company (Morisano, 2003:32).

To ensure capital adequacy and confidence in the banking system, minimum capital requirements for individual banks must thus be imposed (Koch, 1995:388). Requirements can be met when banks obtain an acceptable amount of financing in the form of qualifying equity capital and related long-term debt sources (Koch, 1995:388). Risk adjusted performance measures and capital-at-risk (CAR) can be used to measure and manage capital risks.

2.5.7 Operational risk

Defining as well as quantifying operational risk can be very difficult (Young, 1999:79) because there is no agreed upon or universal definition (Basle, 1998:3). Bessis (1998:12) define operational risk as the malfunctioning of the information systems, of reporting systems, and of the internal risk monitoring rules. Operational risk also refers to the possibility that operating expenses might vary significantly from what is expected, producing a decline in net income and firm value (Koch & Macdonald, 2003:125).

Operational risks appear at two different levels (Bessis, 1998:12):

- The technical level, when the information system, or the risk measures are deficient.
- The organisational level, reporting and monitoring of risk, and all related rules and policies.

In both cases, the consequences are similar: any deficiency potentially generates losses of an unknown magnitude given that no corrective action is taken during the time span when the risk remains ignored (Bessis, 1998:13).

To make things worse, there are many potential causes for such deficiencies.

The inherent risk in this is that, regardless of operational risk performance, all banks would be treated alike and better performers would be penalised.

However, there is an exemption to this as banks that develop models to accurately measure their operational risk can allocate just enough capital to cover their exposure.

Banks that manage this risk effectively, measure it effectively and allocate capital effectively would thus be rewarded with a smaller regulatory burden and more capital to support innovation and to expand (Bloom & Galloway, 1999:2). The capital needed to cover operational risk can also be calculated by using an add-on, based on key operational ratios such as variability in earnings, staff turnover, error rates and technology costs. Another approach that is used involves applying a base requirement reflecting the scale of a bank's activities, for example a percentage of fixed costs (IFCI Risk Watch, 2004).

2.6 CONCLUSION

This chapter dealt with the history of South African bank mergers and acquisitions. A picture of unsuccessful mergers had been sketched and if it succeeds it is costly and time consuming and results in thousands of people losing their jobs. With this, the first research objective, namely to give a brief history of the successes and failures of banking mergers and acquisitions in South Africa, has been achieved (objective 1.4.2.1, page 3).

The recent success of the Barclays-Absa acquisition is refreshing and quite new to the banking industry in South Africa. This history ultimately creates an ideal platform from which to investigate the success of this acquisition. The question on everyone's lips is what is setting Absa and Barclays apart from the other banks and their attempts to successfully merge across-border.

In any merger or acquisition there are certain risks involved and the banking industry is no exception. Knowing how often and how easily a banking merger can fail, this chapter also dealt with the risk considerations with regard to mergers and acquisitions in the banking industry specifically. Discussing these risks was essential to this study and to be able to determine the

fundamentals of the Absa-Barclays success story, one had to identify the risks first.

The art of risk management is to strike a balance between compliance with risk-limiting rules and the ability to develop business, between the disclosure of risks and the management incentives in force within the organisation. In the end, the efficiency of risk monitoring is highly dependent upon the respective roles and influences of the business units and the risk control unit.

In ensuring that a bank moves in a certain direction that is consistent with the bank's objectives, a bank must not only use general strategic risk management principles, but must also identify, measure and manage all the various bank risks by means of the current risk management system. In this system there are different methods available for the measurement and management of risks. The combination of methods that suits the bank best must be used, given the objectives of the bank and other constraints. With this the second research objective has been achieved (objective 1.4.2.2, page 3).

In the following chapters a mergers-specific application of the theory discussed in this chapter will be made. It will show that a merger or acquisition in the banking sector can be realised successfully if the general merger and acquisition principles are integrated with the strategic risk management framework of banks discussed in this chapter.

CHAPTER 3

THE POTENTIAL DRIVING FACTORS OF MERGER AND ACQUISITION SUCCESS

3.1 INTRODUCTION

A merger involves the coming together of two companies – the acquirer and the acquired. In each company there is a range of stakeholders, managers, employees, consumers and the community at large (Sudarsanam, 2003:64). Each of these groups wants the merger to succeed and to gain from it but the interests of these groups do not always coincide. One group can benefit at the expense of the others. For example, a takeover can lead to high shareholder returns, but loss of managerial jobs.

Acquisitions require capital investment decisions that are considerably larger than typical spending decisions. Enormous amounts of money have been lost as the result of poor acquisition decisions and the factors driving a successful transaction have eluded the industry for quite a long time.

In this chapter the potential factors that drive the success of merger and acquisition transactions will be analysed and discussed (objective 1.4.2.3, page 3). Characteristics of bidders, targets and the merger transaction will be identified, which have explanatory power for bidder returns, target returns, and the combined effect of both bidder and target.

3.2 FACTORS EXPLAINING MERGER AND ACQUISITION SUCCESS

Ten potential driving factors of merger and acquisition success will be analysed and researched in this chapter. The results of these factors' impact on the success of the Absa-Barclays merger transaction will be shown in Chapter five.

3.2.1 The product/activity focus of a transaction

The ratio of the net interest income of a target to the total operating income of a target is analysed as a proxy for the *product focus* of a transaction. The higher this ratio of net interest income to the total operating income of a target, the more focused a transaction of a bank, bidding for another bank is. In the banking industry a ratio above 40% is considered a reasonable high ratio. A transaction with a financial services provider that has a provisional rather than interest-related income is considered as being a transaction without product focus (Beitel *et al.*, 2003:4).

With a cross-border banking merger, banks, however, may also be involved in more activities than lending and therefore the measure may have some weaknesses. DeLong (2001) analysed 280 bank mergers and acquisitions from 1988 to 1995, studying effects for the combined entity of the target and the bidder. She found that an increased product/activity-focus has a significantly positive effect on merger and acquisition success of banks.

Also a related study of 423 bank mergers and acquisitions between 1988 and 1995 by Cornett *et al.* (2000) concluded that the product/activity-focus has a significantly positive impact on the value creation of bank mergers and acquisitions.

It can therefore be concluded that bidding banks are more likely to be successful in transactions which are product/activity focused and that the product/activity focus has a significant impact on value-creation in bank mergers and acquisitions.

3.2.2 The geographic focus of a transaction

To measure the *geographic focus* of a transaction and to take into account the differences between Europe and South Africa, a distinction is used to reflect whether a transaction is domestic or cross-border in character. It is expected that domestic transactions provide for a higher synergy potential (e.g., more

cost savings) than cross-border transactions thus being able to create value easier and more understandable for capital markets (Beitel *et al.*, 2003:4).

Almost all studies that cover the geographic focus of a transaction conclude that more shareholder value is created when target and bidder operate in a related geographical region. Houston and Ryngaert (1997) analysed 209 bank mergers and acquisitions between 1985 and 1992 and applied an overlap-index to determine the geographic overlap calculated following a zip-code analysis for the branches of the banks considered. These authors concluded that geographic focus has a positive impact on merger and acquisition success.

In the above mentioned research of Houston and Ryngaert (1997), opposing results for bidders and targets are observed. Bidders create value in geographically focused transactions whereas targets seem to create more value in cross-border transactions. From the point of view of the combined entity the geographic focus does not significantly determine a merger's success.

The geographic focus of a merger and acquisition transaction can therefore be seen as a significant driver of merger and acquisition success for bidding banks.

3.2.3 The size of the target

To test whether the size of a target has an impact on the merger success, the *relative asset size* of a target in relation to a bidder is analysed. Following prior research, the assumption is made that the acquisition of smaller targets is less complex. Although scale effects may be smaller, capturing existing value creation potential may be easier. However, the larger the target the larger possible synergies (through scale economies) may be. Thus the acquisition of targets that provide for sufficient synergies but still are of a manageable size should have a positive impact on value creation (Beitel *et al.*, 2003:5).

Hawawini and Swary (1990) studied the relative size of targets (in relation to bidders). They analysed 123 bank mergers and acquisitions between 1972 and 1987 and found that merger and acquisition transactions are more favourable for bidders if the targets are small relative to the bidders. They also found that smaller bidders tend to be more successful than larger bidders.

Zollo and Leshchinskii (2000) analysed 579 bank mergers and acquisitions from 1977 to 1998 and also found that the size of the acquirer has a significant impact on the acquirer's merger and acquisition success if the target is smaller than the bidder. Seidel (1995) analysed 123 bidding banks between 1989 and 1991 and showed that banks, which had obtained an optimal size after the transaction (in terms of assets) are more successful.

It can therefore be concluded that the relative asset size of a target in relation to a bidder has a significant impact on merger and acquisition success. The acquisition of small targets creates significantly higher excess returns for target shareholders. For the bidding banks, however, the relative size does not significantly drive merger and acquisition success although transactions with smaller targets seem to be more likely to create value.

3.2.4 The growth focus of a transaction

To measure the growth focus of a transaction, the growth of the total assets of a target during the year prior to the announcement year is used as measuring instrument. A transaction is considered as being growth focused if a bidder acquires a target with a strong growth rate. Merger and acquisition transactions often are considered as means for stimulating growth and thus the acquisition of a fast growing target supports the growth of a bidder even more (Beitel *et al.*, 2003:5).

DeLong (2001) studied the growth focus of transactions by looking at the product/activity focus together with the geographic focus of bank mergers and acquisitions between 1988 and 1995. She considered transactions that were

both geographic-diversifying and product/activity-diversifying as being purely growth oriented.

DeLong (2001) found that transactions, which are purely growth focused, were significantly more value creating, from a combined point of view of the bidder and the target, than transactions that focus or diversify in only one direction. Cornett *et al.* (2000) duplicated the study of DeLong (2001). These authors analysed the asset growth of the targets but could not detect any significant relationship to bidder returns and thus to merger and acquisition success.

A transaction can therefore be seen as growth focused when the target is growing at a faster rate than the bidder. This growth focused transaction is more likely to create value for the combined entity.

3.2.5 The risk reduction potential of a transaction

The *risk reduction potential* of a transaction is measured by the relationship of the market share returns of bidder and target after the transaction had been concluded. The higher the correlation between the bidder and the target's share price is, the higher the diversification/risk reduction potential of a transaction. A high correlation between the target and the bidder's share price exists when the ratio of the two share prices exceed 51,35% (Beitel *et al.*, 2003:32). It is expected that diversifying transactions smoothen earnings volatility and thus provide for more certainty in share returns (Beitel *et al.*, 2003:5).

According to popular management theories, this may have a positive impact on value creation. On the other hand, diversifying transactions may suffer from the conglomerate discount due to the share market preference for "pure play" shares (Beitel *et al.*, 2003:5-6).

Hawawini and Swary (1990) analysed the diversification/risk reduction potential of a transaction. The authors also applied the relation between

target and bidder share prices and concluded that transactions involving highly related transaction partners create more value for the bidding banks.

It can therefore be concluded that a transaction has risk reduction potential when a high correlation exists between the target and the bidder's share price and that such a transaction is more likely to create value for the bidding bank.

3.2.6 The profit efficiency of a transaction

To measure the *profit efficiency* of a transaction, a relative profitability measure is applied that is measured by the ratio of a target's return on equity (ROE) and a bidder's return on equity. ROE is also applied as it has evolved as the most important profitability measure used by capital market analysts and as it measures profit efficiency based on capital employed given that capital (as being regulated) is usually a very scarce resource in banks. The return on assets (ROA) is also analysed as a profit efficiency measure (Beitel *et al.*, 2003:6).

Return on equity (ROE) and return on assets (ROA) will be thoroughly discussed in Chapter four (paragraph 4.3.1.1 – 4.3.1.2, page 52 – 53).

Following the efficiency hypothesis (Pilloff & Santomero, 1998:37; Hawawini & Swary, 1990) it is expected that transactions are more successful if bidders are more profitable than targets. The profitability is measured by comparing the target and the bidder's ROE and ROA. In these transactions bidders may also be able to realise efficiency potentials by transferring their superior management skills to the target assets.

Profitability has also been studied by Banerjee and Cooperman (2000). They examined profitability differences between target and bidder, using ROE and ROA ratios, for 30 bidding banks and 62 target banks between 1990 and 1995 and found that bidding banks are more successful when they are more profitable than their targets.

A transaction can therefore be seen as profit efficient when the bidder is more profitable than the target ensuring that the merger and acquisition transaction will be concluded successfully.

3.2.7 The cost efficiency of a transaction

Following a similar line of argument, it is expected that transactions with a large cost efficiency similarity would have a higher value creation potential and would thus be more successful (Beitel *et al.*, 2003:6). The *cost efficiency* is measured with the relative cost-to-income ratio. This ratio compares the cost structure of a target to the cost structure of a bidder.

Pilloff (1996), studying the combined entity's returns for 48 bank mergers and acquisitions between 1982 and 1991, found that the improvement of the cost efficiency after the transaction was positively correlated to the value creation of merger and acquisition transactions in banking.

3.2.7.1 Cost-to-income ratio

According to Gattorna (2003:79) the cost-to-income ratio for the banking industry is calculated as total costs (excluding interest) divided by total income (excluding interest). An example of calculating this ratio in the banking industry is shown in Figure 3.1 below (Sudarsanam, 2003:559):

Figure 3.1: Calculating the cost-to-income ratio

- Cost-to-income ratio = Total costs / Total income, where:

<p>Total expenses</p> <p>Less:</p> <ul style="list-style-type: none"> Interest expense Life insurance expenses Goodwill amortisation Charge to provide for doubtful debts Significant expenses <p>= Total costs for purposes of cost-to-income ratio</p>
<p>Total revenue</p> <p>Less:</p> <ul style="list-style-type: none"> Interest revenue Life insurance income Significant revenue <p>= Total income for purposes of cost-to-income ratio</p>

The cost-to-income ratio calculated on this basis is a standard efficiency measure used widely across the banking industry. In the above income calculation, the bank does not include net life insurance income and the pre-tax equivalent gross up of certain structured finance transactions. The banking group usually sets a number of externally disclosed efficiency targets for the cost-to-income ratio as calculated above (Sudarsanam, 2003:560).

It can therefore be concluded that the similarity in the cost structures of the target and bidder can be linked to the value creation of merger and acquisition transactions in banking.

3.2.8 The capital market performance of the target

DeLong (2001) and Hawawini and Swary (1990) examined the share performance of targets prior to the merger and acquisition transaction. DeLong (2001) found that merger and acquisition transactions are more

successful (in terms of value creation) if targets show a poor share performance compared to their peer-group prior to a transaction. Hawawini and Swary (1990) considered the share performance of a target as a good proxy for the management quality of a target.

Hawawini and Swary (1990) found that the acquisition of targets with a bad share performance prior to a transaction creates significantly more value for the bidding banks than the acquisition of targets with a better share performance. To analyse performance as an explanatory variable, two different measures are employed which capture the *market performance of a target*: the target earnings per share (EPS) and the target share performance. They use EPS because this variable is often considered by banking analysts when judging the share performance of a firm. The performance of the target share price against its industry index can be considered as a proxy for target management quality.

3.2.8.1 Earnings per share

Earnings per share (EPS) is a traditional method used for determining corporate value and can be calculated by subtracting the dividends on preferred shares from net income, and dividing the result by the weighted average of the combination of all outstanding shares and all common share equivalents (Correia *et al.*, 2003:17-8):

$$\text{EPS} = (\text{Net income} - \text{dividends on preferred shares}) / (\text{number of outstanding common shares} + \text{common share equivalents})$$

Fully diluted EPS means that all common share equivalents (convertible bonds, preferred shares, warrants, and rights) have been included along with the common shares. The dilution represents the effective discount between the average option price and the average market price at which option holders can convert into ordinary shares (Moyer *et al.*, 2005:69).

According to Garrison *et al.* (2006:794) EPS is computed by dividing net income available for common shareholders by the average number of

common shares outstanding during the year. The formula for calculating EPS is:

$$\text{EPS} = (\text{Net income} - \text{preferred dividends}) / \text{average number of common shares outstanding}$$

Ross *et al.* (2006:26), Brigham and Erhardt (2005:97) and Moyer *et al.* (2005:6) define earnings per share as the net income (after tax) divided by the total shares that have been issued:

$$\text{EPS} = \text{net income} / \text{total shares outstanding}$$

Absa (2005d:113) includes the following factors when determining their earnings per share:

- Net income attributable to shareholders
- Net profit on disposal of property and equipment
- Net profit on disposal of available-for-sale assets and strategic investments
- Impairment of strategic and available-for-sale investments, associated companies and property
- Goodwill impaired and written off

EPS can therefore be seen as an indication of what shareholders earned by way of profit for a certain period. According to Rutterford (2001:93-94) EPS is the most widely used yardstick of management performance. EPS is therefore a very important measure in determining any bank's performance.

3.2.9 The experience of the bidding bank

Concerning the experience of a bidder, DeYoung (1997) conducted a dynamic efficiency study of 348 bank mergers and acquisitions from 1987 to 1988 and found a positive impact of bidder experience which is measured by the frequency of conducting merger and acquisition transactions. Zollo and Leshchinskii (2000) also uncovered a significantly positive correlation between a codification of experience related to merger transactions and the bidder's capital at risk.

It is expected that more active/experienced bidders have learned how to perform value-creating merger and acquisition transactions. Zollo and Leshchinskii (2000) concluded that it is not the frequency of merger and acquisition transactions, but rather the related knowledge which is important with regard to successfully conducting the transactions.

The experience of the bidding bank can therefore be seen as the knowledge gathered from having bidding experience. This experience has a positive impact on merger and acquisition transactions.

3.2.10 The method of payment

Finally, the *method of payment* has also proved to explain abnormal returns of bank mergers and acquisitions. Prior research (Travlos, 1987; Amihud *et al.*, 1990) showed that target shareholders prefer cash payments. According to the hypothesis by Myers and Majluf (1984), bidders prefer cash payments if they believe that their shares are undervalued and vice versa.

The choice of the method of payment thus reveals private information of the bidder management about the valuation of the bidder's shares and as a result share prices are affected. The method of payment is measured with the cash-ratio of a transaction. The cash-ratio equals 100% if the target is paid for with cash only and equals 0% if the bidder only pays with own shares. A cash-ratio between 1% and 99% signifies that the bidder partly pays in cash and in own shares (Beitel *et al.*, 2003:8).

The impact of the method of payment in bank mergers has been analysed by Becher (1999), Hawawini and Swary (1990) and Kaen and Tehranian (1989). All studies reported that bank mergers and acquisitions create more shareholder wealth for bidder's shareholders in cash transactions as compared to share transactions. It is expected that transactions with a higher cash-ratio are more favourable, i.e. value creating for the targets and for the bidders.

3.3 CONCLUSION

In this chapter the factors that influence announcement effects of bank mergers and acquisitions were addressed. The success of merger and acquisition transactions were separately analysed from the viewpoint of target shareholders, bidder shareholders and the combined entity of bidder and target. It turned out that successful bidders could be identified by investigating their choice of a target. Successful bidders chose smaller and faster growing targets with relative efficiency measures.

The results for the bidding banks differed somewhat from the results for the targets. Bidding banks tend to be more successful when they take over qualitatively better managed targets that at the same time provide for a sufficient synergy and profit efficiency potential. Successful bidders therefore do not search for real turnaround candidates.

With this, the third objective (objective 1.4.2.3, page 3) has been achieved namely to discuss the potential driving factors of merger and acquisition success. In Chapter four the impact of an acquisition on non-financial issues and financial performance measures will be discussed.

CHAPTER 4

THE NON-FINANCIAL AND FINANCIAL IMPLICATIONS OF AN ACQUISITION

4.1 INTRODUCTION

Mergers and acquisitions are common in the economy today as businesses restructure to compete in a global marketplace. Despite the economic logic behind them, research indicates that most mergers and acquisitions fail to achieve the synergistic results expected. Furthermore, studies repeatedly demonstrate that at best, only half of all mergers and acquisitions meet initial financial expectations (Pikula, 2003:1).

Failure is defined as not achieving the returns expected based on the investment of time, effort, money and the toll on human assets in driving the mergers and acquisitions in the first place (Glauser, 2002:1). In this chapter the factors – financial and non-financial – that are affected by the success or failure of the merger/acquisition will be discussed (objective 1.4.2.4, page 3).

4.2 NON-FINANCIAL ISSUES

In an attempt to understand the reasons behind the high failure rate, recent research has focused on the people-management activities: there is a consensus that these activities are misunderstood, poorly managed, and viewed as irrelevant to the strategic planning process.

An acquisition transaction affects management in two ways: the role they play in handling the human factor and 'syndrome' of the acquisition, and the change in the management structure. In this section the typical effects of the acquisition process on the management and people involved are described and the crucial role that management plays in ensuring acquisition success is identified.

4.2.1 The crucial role of management in ensuring acquisition success

Management should provide a realistic acquisition preview and communicate openly and regularly with employees. All employees must be aware of what the acquisition is meant to achieve, why it is important, and how they will be affected. When employees are fully aware of what to expect, they are less likely to suffer from stress or resistance of the change. Should management fail to communicate openly, they will probably experience reduced employee morale, declining productivity, and increased turnover and absenteeism (Anderson, 2005:3).

According to Anderson (2005:3) managers should be familiar with and prepared to deal with the 'merger and acquisition syndrome', in which employees initially react to the transaction announcement with denial, fear, anxiety, and anger, but learn in the end - if the transition is properly managed - to recognise new opportunities in the new organisation and become committed to it.

If division managers are included in the strategic decision making, organisations gain a better understanding of the human implications of the acquisition. These managers should determine the extent to which the organisational cultures are compatible and provide recommendations for overcoming differences.

Management should help develop a new organisational structure and establish clear, well-defined reporting relationships. Most unsuccessful mergers and acquisitions have suffered from unclear relationships and a tendency to change poorly defined relationships several times during the first year. Specific short-term organisational goals should be defined to provide employees with a clear direction (Joslin, 2000:24).

According to Glauser (2002:3) there are two crucial components management should address in ensuring merger or acquisition success, namely

diagnostics/data gathering and planning. Each component is distilled into a few critical factors:

4.2.1.1 Diagnostics/data gathering

The diagnostics/data gathering component includes the following:

- Include in due diligence a culture and human resource audit for example programmes, plans, and practices.
- Collect data on each organisation's position in the "corporate life cycle". Differences between the two companies could have a significant effect.
- Understand the point of view from employees of both organisations by conducting targeted interviews and focus groups.

4.2.1.2 Planning

The following factors are part of the planning component:

- Establish a "Merger transition team" early in the process with senior managers from both companies. They will be responsible for planning, deployment and review.
- Bring in outside expertise to help manage the behavioural dynamics of the merger or acquisition.
 - Identify merger related problems and design interventions for the areas that will take the 'hardest hit'.
 - Manage the interim organisation by establishing temporary infrastructures. Provide adequate time and resources for the integration function.

4.2.2 The human impact of an acquisition

The ignorance from management with regard to the people in the organisation is increasingly being held responsible for merger and acquisition failure. This weakness is commonly found in a typical acquisition process and can be grouped as follows (Mercer, 1999:223):

- The neglect of psychological issues. The psychological effects of change on people are not given adequate consideration when companies are integrated.
- Inadequate communication throughout the process. Employees are not kept informed during the integration process. Although people fear that their jobs are at stake, they typically have very little reliable information on which to base decisions.
- Culture clashes between the two organisations. Employees with different values and work styles are frequently required to work together with no structure for resolving differences.
- Ambiguous company direction and unclear roles and responsibilities. Senior management is typically slow in articulating the vision and mission of the new merged organisation.

'Mergers and acquisitions . . . represent a significant and potentially emotional and stressful life event' (Cartwright and Cooper, 2002:34), because they can change an individual's working life significantly but fail to provide the individual with any control over the event. Some common acquisition stress factors include uncertainty, insecurity, and fears concerning job loss, job changes, compensation changes, and changes in power, status, and prestige (Schweiger & Ivancevich, 2000:40). Employees may experience job/career/life dissatisfaction, lower self-esteem, depression, and anxiety.

4.2.3 The merger and acquisition syndrome

Both people and management have relatively consistent patterns of reaction to an acquisition. The people typically become withdrawn and preoccupied with their own survival, and the management tend to withdraw into crisis management, which often involves secrecy and centralised decision making.

In most cases this response from management exacerbates the negative impact of the acquisition on employees. Executives may be optimistic about the transaction, because they have more control over the situation and better access to information (Anderson, 2005:6).

Historically, the most unsuccessful mergers and acquisitions have suffered from unclear relationships and a tendency to change already vague, poorly defined reporting relationships several times during the first year (Pappanastos *et al.*, 2004:4).

The majority of staff members, on the other hand, are typically pessimistic or angry about the change. Hunsaker and Coombs (1998:47) have provided a nine-stage sequential model of employees' emotional reactions during a merger or acquisition, which describes what has come to be known as the 'merger and acquisition syndrome':

- *Denial:* At first employees feel that the acquisition will not really happen or that it will not change their work or their organisation.
- *Fear:* As plans for the acquisition begin to unfold, employees begin to fear the unknown and to imagine the worst and rumours of mass layoffs and terminations start circulating throughout the company. This typically leads to substandard performance and a decline in productivity.
- *Anger:* Once employees feel that they have no control over the situation and that the transaction is inevitable, they begin to express anger towards those responsible for the deal. They may feel that they have been sold out after providing the company with many years of quality service.
- *Sadness:* Employees begin to grieve the loss of their corporate identity; they focus on the differences in the way the two companies operate and are managed and adopt a 'we' versus 'they' mindset.
- *Acceptance:* After a sufficient mourning period has elapsed, employees begin to realise that resisting the situation would be futile, and they start to accept reality. This may imply behavioural compliance but not necessarily renewed organisational commitment.
- *Relief:* After much of the integration has been completed, employees begin to feel more settled in the new organisation and become more accustomed to working with employees from the other company. At

this stage, they feel that things are actually better than they had expected.

- *Interest:* As people become more secure in their new positions, they begin to consider the benefits of the new organisation. They perceive their situation as a challenge and try to prove their abilities and worth in the new company.
- *Liking:* Employees recognise new opportunities and begin to like their work.
- *Enjoyment:* Employees become committed to their new organisation.

4.2.4 Organisational culture

The culture of an organisation is a set of norms, values and beliefs. These have developed over time, unplanned and evolving. However, the culture of an organisation is something that can have an enormous impact on the way in which an organisation operates, and its effectiveness. It is also something that can be assessed and, if necessary, changed over time. Organisational culture interventions are notorious for their difficulty and duration, but if culture change is needed this should not discourage an organisation from embarking on the process of change - it may be the key to its survival (Thoreau, 2003:40).

Marks and Mirvis (2001:4) define the culture of an organisation as the typical behaviour patterns and values that characterise the organisation. They also state that stakeholder groups help to shape the culture of the organisation through their expectations and interactions with the company and with each other.

Anderson (2005:7) indicates that the ease of integrating the organisations will be affected by the compatibility of the two cultures, the strength of each culture, and the type of acquisition. A corporate culture provides employees and management with identity and stability; they tend to be committed to

organisations with strong corporate cultures, which make the process more difficult.

Even without proactive intervention, organisational culture changes over time as organisations grow and progress. A merger or acquisition in any organisation demands this change of culture. Managing the new combined entity with various cultures, and achieving coherence and integration, is not a simple matter (Thoreau, 2003:46).

However, if a manager can recognise the different cultures involved in various parts of the organisation (and the need for these, or the need to change these), then at least he or she will be able to understand the nature of the task and the potential problems involved, instead of grappling in the dark with associated problems and 'solutions'.

Employees and management typically emphasise or exaggerate the differences between organisational cultures; they tend to perceive that their way of doing things is superior to the style and practices of the other company (Pikula, 2003:2). Distorted perceptions and hostile feelings toward employees from the 'other organisation' may become common, and failures are typically attributed to the other company. The result may be post-merger conflict, or 'culture clash'.

4.2.5 Leadership and management

Glauser (2002:4) indicates that in any merger or acquisition the following guidelines are essential for management in making a success of the transaction:

- Provide a clear sense of corporate direction and gain alignment on vision, strategy, and priorities.
- Appoint one well-respected top manager with formal management responsibility for combining the two entities.
- Get to know the other firm's culture – identify the personality traits of the new business partner.

- Establish priorities for the integration.
- Protect productivity and keep people focused.
- Set up sub-transition teams for integrating major lines of business and functional areas.
- Create communication exchanges with top managers and key teams from both firms to focus on common goals and strategies to meet these goals.
- Give all senior managers, from both companies, the opportunity to influence vision, strategies and policies.
- Grow leaders at all levels of the organisation to carry the message and model the behaviour.
- Ensure new leaders and new teams get off to a strong start.

4.2.6 Communication

According to DeVito (2001:152) communication is both the solution and the problem. Communication within organisations continues to be an age-old challenge, but some radical new solutions can help. Communication solutions today revolve around much greater data sharing and exchange of information among and within departments. There are also several ways in which open communication can be used to enhance employee relations and productivity for example: conducting monthly communication meetings to inform and to solve problems; to explain layoffs or videotape topics of interest to employees; to describe a particular customer's philosophy or attitude or to tell employees why a specific complaint was made.

There are barriers facing every organisation as the organisation strives to attract, motivate and retain high-quality employees, in order to achieve optimal business results. These barriers can be grouped into three categories (Douglas, 2005:1):

- *Message:* It is unclear or it is not compelling.
- *Vehicle:* The medium does not have impact or is insufficient.

- *Audience:* They are not receptive or they do not know how to act on the information.

These barriers can be overcome by creating a compelling vision for the organisation's success, by enhancing the leadership's abilities to craft and communicate the message, and by ensuring that the employees are willing and able to carry out the vision. Management should create a plan for innovatively and proactively addressing the highest leverage issues. This plan should include schedules, content and desired outcomes for the communications programme. The communications should be creative, honest, and consistent. Finally, work the plan, measure results, celebrate successes, and redirect the organisation's course when needed (Douglas, 2005:8).

Communication plays one of the most important roles in a merger or acquisition transaction. Communicating properly with employees could reduce the appearance of misunderstandings, rumours and uncertainty often observed during a takeover. Glauser (2002:3-4) describes strategies and techniques that managers could implement during a merger/acquisition phase in their company.

4.2.6.1 Strategies

The following strategies can be implemented during a merger/acquisition process (Glauser, 2002:3):

- Create internal and external communications plans.
- Assign one person to be responsible for managing the communication process.
- Managers need to take employees into their confidence.
- Explain rationale - give people reasons to make the merger or acquisition work.
- Be up front with bad news.
- Be consistent and clear on a few core messages.

- Address the needs of different stakeholder groups.
- Monitor effectiveness through feedback systems.
- Adjust or modify the plan as often as necessary.

4.2.6.2 Techniques

The implementation of the following techniques is essential during any merger/acquisition process (Glauser, 2002:4):

- Coach executives in general and for each communication event specifically.
- Conduct frequent meetings with acquired employees, including participation by top managers.
- Communicate repeatedly and redundantly.
- Use various forms of media for example face-to-face meetings, company newsletters, memos, bulletin boards, E-mail, voice mail and telephone hot line.
- Start up a specific merger/acquisition newsletter.
- Exchange literature and documentation between companies.
- Set up and use the informal "grapevine" i.e., to get and send information.
- Manage and coordinate external and internal press releases.

4.2.7 Management structures

All organisations have some form of structure, which should facilitate the implementation of strategy and the achievements of objectives. An organisation's structure can be defined as the established pattern of relationships among the individuals, groups and departments within it (Ritson & Marsden, 2004:104).

Within this organisational structure there are two more structures, namely a *vertical structure* of authority and responsibility where clear limits of financial authority exist and a *horizontal structure* of groupings of activities designed to

use the resources towards goal-attainment. Although the horizontal structures can change from time to time, the basic vertical structure of an organisation is a relatively static framework within which processes such as communication, leadership and decision making take place (Ritson & Marsden, 2004:104).

4.2.7.1 The functional management structure

In most financial institutions the functional management structure is used because this structure divides the organisation into its main functions in which all similar specialist activities are grouped together into interdependent departments. The basic principle behind this structure is that a manager/senior manager/director is placed in charge of a function. The level of management can multiply according to the size and complexity of the organisation (Gibson *et al.*, 2002:147).

The functional structure has a few potential *benefits* (Ritson & Marsden, 2004:105-106):

- Specialised resources are used efficiently.
- Quality is enhanced by other specialists from the same functional area.
- Opportunities exist for extensive division of labour.
- A career structure enables people to advance within their functional specialist field.
- It is easier to manage specialists if they are grouped together.
- It fosters communication and enhances the development of skill and knowledge.

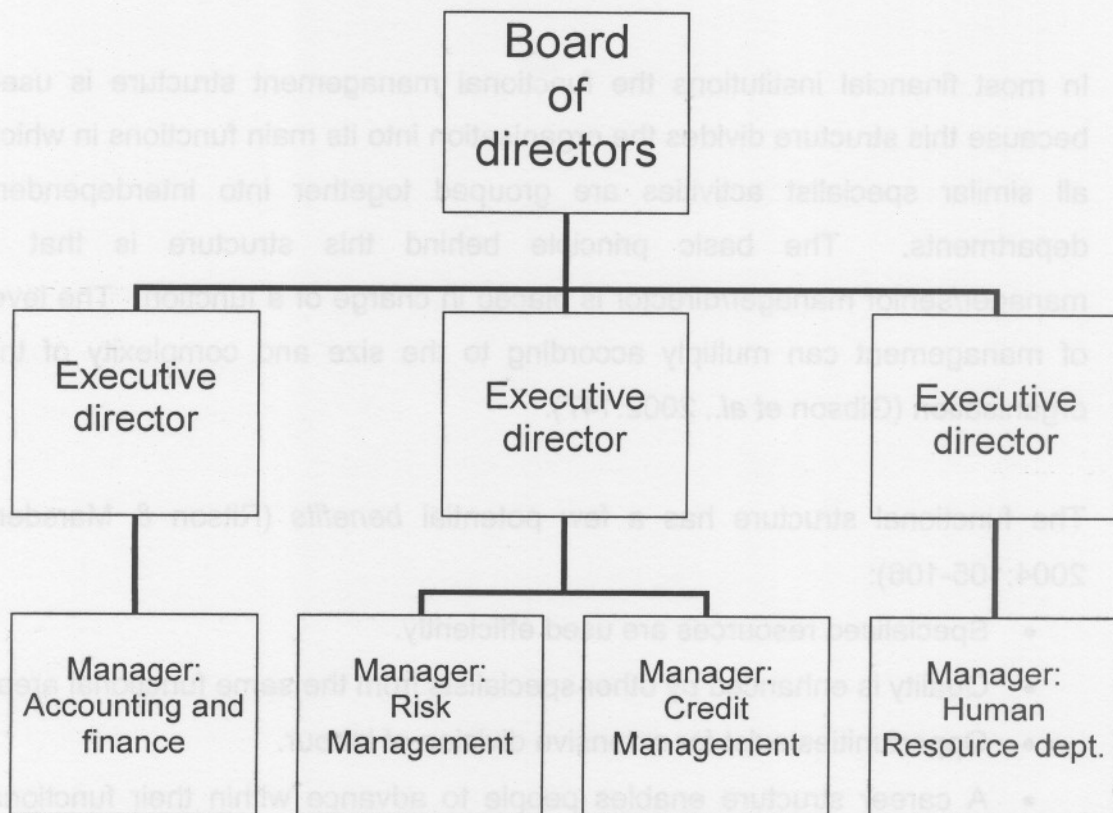
However, this structure also has a few *drawbacks* (Ritson & Marsden, 2004:106):

- Increased need for interdepartmental co-ordination and scheduling.
- Communication, co-ordination overload the vertical hierarchy.
- Inefficient co-ordination of functional departments.
- Responsibility for overall outcomes is unclear.

- Interdepartmental conflicts can occur.
- There is little creativity and innovation.

Gibson *et al.* (2002:151) illustrate an example of such a structure (Figure 4.1).

Figure 4.1: Example of a functional structure



4.3 PERFORMANCE MEASURES

Performance measurement is the ongoing monitoring and reporting of programme accomplishments, particularly progress towards pre-established goals. Performance measures may address the type or level of programme activities conducted (process), the direct services delivered by a programme (outputs), and/or the results of those services (outcomes). A 'programme' may be any activity, project, function, or policy that has an identifiable purpose or set of objectives (Artley & Stroh, 2001:3).

Performance measures quantitatively tell the organisations something important about their services and the processes that produce them. These measures serve as a tool to help understand, manage, and improve what the organisations do. Effective performance measures can let the organisation know (Artley & Stroh, 2001:3):

- how well it is doing;
- whether it is meeting its goals;
- whether the customers are satisfied;
- whether the processes are in statistical control; and
- if and where improvements are necessary.

Performance measures provide the organisation with the information necessary to make intelligent decisions. A performance measure is composed of a number and a unit of measure. The number gives us a magnitude (how much) and the unit gives the number a meaning (what). Performance measures are always tied to a goal or an objective (Sudarsanam, 2003:560).

The essence of managing any organisation is making good decisions. Correct decision making depends on accurate information and proper analysis. Common financial information and performance measures frequently used by financial analysts to evaluate a bank's financial health and make risk management decisions, will be discussed in the following paragraphs. By conducting regular checkups on financial condition and performance, banks are more likely to treat causes rather than address merely the symptoms of problems (Purdy & Langemeier, 2005:1).

4.3.1 Selection of the performance measures that are most relevant for the banking industry

According to Neal *et al.* (2005:5) the most popular performance indicators in the banking industry are considered to be the innovative performance indicators namely residual income (RI) and economic value added (EVA) and

traditional accounting performance indicators namely net income, return on equity (ROE) and return on assets (ROA).

Peterson and Peterson (2003:471-479) also analysed traditional and innovative measures of performance. According to their findings measures such as ROE and ROA should definitely be used as means for evaluating performance in the banking industry. They also insist on the importance of the use of measures such as EVA and RI. They note that since these value added measures focus on economic rather than accounting profit, they play an important role in evaluating performance because managers will aim towards value creation rather than mere manipulation of short-sighted accounting figures.

Garvey and Milbourn (2000:241) assessed the declared superiority of economic value added (EVA) and residual income (RI) in the banking industry. They also initially criticised the traditional accounting measures such as return on equity (ROE) and return on assets (ROA).

Garvey and Milbourn (2000:244) then found that these traditional accounting measures continue to explain changes in the bank's performance and compliment the use of EVA and RI. They concluded their study by insisting that banks should adopt the use of EVA and RI in their performance evaluation models.

Although there are a tremendous number of financial indicators, it is not possible to discuss everyone in this particular study because of the scope of the study and relevancy to the title. According to the studies mentioned above, four performance measures have been identified because of their specific relevance to the banking industry and the creating of shareholder value. These measures will be discussed in the following paragraphs:

4.3.1.1 Return on equity

Correia *et al.* (2003:5-17), Moyer *et al.* (2005:103) and Brigham and Erhardt (2005:454) define the return on equity (ROE) as the ratio of net profit after interest and taxes to ordinary equity. This ratio can be calculated as follows:

$$\text{ROE} = \text{earnings after tax} / \text{total shareholders funds}$$

Return on equity (ROE) represents the return on the owner's share of capital invested. This capital is the funds shareholders provide for the firm whenever it offers a new issue of shares, or when the firm keeps some of the profits it earns to use in the business as retained earnings, rather than paying those profits out to shareholders as dividends. A higher return on equity is preferred to a lower return. Caution should be used when interpreting this measure for an organisation with a low net worth. In this situation, the return on equity is not meaningful (Purdy & Langemeier, 2005:2).

According to Ross *et al.* (2006:65) return on equity (ROE) is a measure of how shareholders performed during the year. Since increasing shareholders' wealth is mainly any organisation's goal, ROE is, in an accounting sense, the true bottom-line measure of performance. ROE is usually measured as:

$$\text{ROE} = \text{net income} / \text{total equity}$$

According to Neal *et al.* (2005:16) the ROE of a bank can be calculated by dividing net income (NI) obtained over a year by a bank's total equity (TE) at the end of the year.

$$\text{ROE} = \text{NI} / \text{TE}$$

Essentially, ROE reveals how much profit a bank generates with the money shareholders have invested in it. Return on equity is thus an important financial performance measure because of its relevance to the bank's shareholders.

4.3.1.2 Return on assets

Return on assets (ROA) is a measure of profit per rand of assets invested in the firm. It is thus an indicator of financial performance. It is defined in the following formula (Ross *et al.*, 2006:65; Brigham & Erhardt, 2005:454):

$$\text{ROA} = \text{net income} / \text{total assets}$$

According to Purdy and Langemeier (2005:2) return on assets represents the return on both debt and equity capital invested in the business. Interest is added back to net income to obtain this measure. This makes the result independent of the type and amount of financing and what it would have been if there had been no debt capital. A higher return on assets is preferred to a lower return. A consistently low return on assets should raise a red flag to management.

Garrison *et al.* (2006:795-796) also add the interest expense back to net income and the result is an adjusted earnings figure that shows what earnings would have been if the company had had no debt. With this adjustment, the ROA can be compared for companies with differing amounts of debt or over time for a single company that has changed its mix of debt and equity. ROA is calculated as follows:

$$\text{ROA} = \text{Net income} + [\text{interest expense} \times (1 - \text{tax rate})] / \text{total assets}$$

In the banking industry specifically, the return on total assets measures the profitability of the bank as a whole in relation to the total assets employed. It is frequently referred to as the return on investment. The ratio is calculated by dividing earnings before interest but after tax (EBIAT) by total assets (Neal *et al.*, 2005:16):

$$\text{ROA} = \text{EBIAT} / \text{total assets}$$

Using the earnings before interest but after tax is conceptually the most correct approach. The reason for this is that it excludes interest, which is a cost of financing, but includes taxation that is an operating cost. ROA is thus a useful indicator of how profitable a bank is relative to its total assets and therefore important in measuring its financial health.

4.3.1.3 Residual income

Residual income (RI) is the profit earned before tax that exceeds the specified rate of return multiplied by the asset base. The asset base includes fixed and current assets. The rate can be changed to compensate for market rate fluctuations or for risk. The RI computation is as follows (Barfield *et al.*, 2003:850):

$$\text{RI} = \text{Income} - (\text{Target rate} \times \text{asset base})$$

Residual income yields a currency figure rather than a percentage.

Horngren *et al.* (2003:789) and Garrison *et al.* (2006:561) define residual income as an accounting measure of net operating income minus an amount for required return on an accounting measure of investment. This measure of investment includes long-term assets as well as current assets.

$$\text{RI} = \text{Net operating income} - (\text{Required rate of return} \times \text{investment})$$

The required rate of return multiplied by the investment is the imputed cost of the investment. Imputed costs are costs recognised in particular situations that are not usually recognised in financial accounting systems.

According to Neal *et al.*, (2005:16) residual income (RI) for banks specifically, is calculated as the difference between the net operating profit after tax (NOPAT) and a charge for invested capital, i.e. measured as the product of cost of equity (k_e) and book value of equity (BVE):

$$\text{RI} = \text{NOPAT} - (k_e \times \text{BVE})$$

A reason cited in favour of RI as a performance measure is that it is a flexible measure because different cost of capital percentage rates can be applied to investments that have different levels of risk. On the other hand, RI suffers from the disadvantage of being an absolute measure, which means that it is difficult to compare the performance of a company with other companies of a different size (Drury, 2004:801). The importance of RI is that it motivates managers to act in the best interest of the bank.

4.3.1.4 Economic value added

Currently, measures are being developed that are intended to more directly align the interests of common shareholders and managers. One of the most well-known of these measures is economic value added (EVA). EVA is a measure of the profit produced above the cost of capital (Barfield *et al.*, 2003:850; Moyer *et al.*, 2005:112). However, EVA applies the target rate of return to the market value of the capital invested rather than the book value of assets used for RI. Furthermore, EVA is calculated on net income or the after-tax profits available to shareholders. The EVA calculation is (Barfield *et al.*, 2003:851):

- $EVA = \text{After-tax profits} - (\text{market value of capital invested} \times \text{cost of capital})$

Economic value added is a specific type of residual income calculation that has recently attracted considerable attention. Economic value added (EVA) equals after-tax operating income minus the (after-tax) weighted average cost of capital multiplied by total assets minus current liabilities (Horngren *et al.*, 2003:790; Garrison *et al.*, 2006:562; Brigham & Erhardt, 2005:110):

- $EVA = \text{After tax operating income} - [\text{Weighted average cost of capital} \times (\text{total assets} - \text{current liabilities})]$

Correia *et al.* (2003:5-22) define economic value added (EVA) as a financial measure that tries to capture the true economic profit of an enterprise. EVA is also a performance measure which is linked to the creation of shareholder wealth over time. EVA was developed to help managers incorporate two basic principles of finance into their decision making. The first is that the primary financial objective of any company should be to maximise the wealth of its shareholders. The second is that the value of a company depends on the extent to which investors expect future profits to exceed or fall short of the cost of capital.

Economic value added (EVA) expresses the surplus value created by a bank in a given period, i.e. the bank's profit net of the cost of all capital (Neal *et al.*,

2005:16). This measure is computed as the product of the difference between the return on invested capital (ROIC) and its composite financing cost (i.e. cost of capital - CC) and the capital invested (CI). According to Neal *et al.* (2005:16) and Correia *et al.* (2003:5-23) EVA is calculated as follows:

$$\begin{aligned} \text{EVA} &= \text{CI} \times (\text{ROIC} - \text{CC}) \\ &= (\text{CI} \times \text{ROIC}) - (\text{CI} \times \text{CC}) \\ &= \text{NOPAT} - (\text{CI} \times \text{CC}) \end{aligned}$$

EVA substitutes the following numbers in the RI calculations (Hornngren *et al.*, 2003:790):

1. Income equal to after-tax operating income.
2. A required rate of return equal to the (after-tax) weighted average cost of capital.
3. Investment equal to total assets minus current liabilities.

Barfield *et al.* (2003:851) identified three limitations of RI and EVA, namely:

- Income can be manipulated in the short-run and depends on the accounting method selected to account for items such as inventory or depreciation.
- RI and EVA reflect the asset investment base used and it is difficult to properly measure asset investment. Some investments have value beyond the accounting period, but are not capitalised and create an understated asset base.
- Attention is directed at how well an investment centre performs in isolation, rather than relative to company-wide objectives.

Simply put, the idea behind EVA is to deduct the charge for the use of the entity's capital from the operating income/profit after tax. Generally, a positive EVA means value has been created, whereas a negative EVA means value has been destroyed. Despite certain limitations, what makes this measure so important is that it is a better way of indicating the creating of value in the company than just showing an accounting profit.

4.4 CONCLUSION

Acquisitions provide an opportunity for sweeping change. They can be used to create a stronger and more resilient company. The importance of the role that management plays in the success of a transaction has been stressed in this chapter. Management must be able to identify and manage the 'merger and acquisition syndrome', communicate openly and frequently with their employees and merge the cultures of the respective companies.

This chapter has shown that more people than only the board of directors are affected by a transaction such as an acquisition; managers and employees must now learn to cope with more immediate issues at hand. The way in which they usually conduct business, has been changed rapidly and drastically.

This chapter has also dealt with the performance measures that are affected by any change in any organisation. The four financial indicators namely ROE, ROA, RI and EVA, mentioned in the paragraphs above (4.3.1.1 – 4.3.1.4, page 52-55) specifically indicate the creating of shareholder wealth in the banking industry. With any change in a bank – especially one as extensive as an acquisition – the creation of shareholder value is of the utmost importance. The use of these indicators is therefore very relevant in showing the effect of an acquisition on a bank's financial success.

The success of the transaction depends not only on the financial and legal success, but also on the 'human' integration of the two companies. Management is hugely responsible for handling this factor and is therefore greatly affected by the successful acquisition of the company.

With this the fourth research objective (objective 1.4.2.4, page 3) has been achieved, namely to discuss the non-financial and financial implications of an acquisition. In Chapter five the results of the implementation of the theory discussed in Chapters two, three and four on the Absa-Barclays transaction will be presented, analysed and discussed.

CHAPTER 5

RESULTS

5.1 INTRODUCTION

The overall aim of this study was to show the effect of a successful acquisition on performance and management (objective 1.4.1, page 3). In the literature review a brief history of mergers and acquisition in South Africa was given, the risks with regard to the banking industry were discussed, the potential driving factors of merger and acquisition success were shown and the financial as well as the non-financial implications of a transaction were discussed (objectives 1.4.2.1 to 1.4.2.4, page 3).

In this chapter the research will be analysed and discussed under the following headings:

5.2 The research methodology

5.3 The impact of the success factors on the Absa-Barclays transaction (objective 1.4.2.5, page 3)

5.4 The impact of the Absa-Barclays transaction on non-financial issues (objective 1.4.2.6, page 3)

5.5 The effect of the Absa-Barclays transaction on Absa's financial performance (objective 1.4.2.7, page 4)

Conclusions will be drawn and recommendations for future use will be discussed in the next chapter (objective 1.4.2.8, page 4).

5.2 RESEARCH METHODOLOGY

A case study approach was used in this research. The acquisition of the Absa Group by Barclays was studied because of their recent success in closing the deal. The first part of the proposed acquisition by Barclays was a 60% interest in Absa. The second part was the partial offer to all ordinary shareholders to acquire an additional 28% of their shares.

On 27 July 2005 Absa Group and Barclays Bank PLC announced the completion of a landmark deal that sees the UK-based international banking business acquiring a majority stake of 53.96% of all ordinary shares in Absa Group Limited (Absa, 2005b:1). At a cost of nearly R30 billion (£2.6 billion), this is the largest foreign direct investment in South Africa and represents a historic deal for South Africa as well as Barclays (Absa, 2005b:2)

5.2.1 Objectives

The specific empirical objectives of this research (paragraph 1.4.2, page 3-4) are as follows:

- To analyse the impact of the success factors on the Absa-Barclays transaction (objective 1.4.2.5, page 3).
- To discuss the impact of the Absa-Barclays acquisition on non-financial issues (objective 1.4.2.6, page 3).
- To show the effect of Absa-Barclays acquisition on Absa's financial performance (objective 1.4.2.7, page 4).
- To draw conclusions and make recommendations for the future (objective 1.4.2.8, page 4).

5.2.2 Population

The Absa Group was selected as research subject for this research. The reason that only this one bank was chosen was because Absa is the only bank that has had recent success with a merger or acquisition transaction in South Africa. The financial data that were used were extracted from Absa's financial reports for the financial years ending 31 March 2004 and 31 March 2005 respectively.

The information about the impact of the acquisition on management and employees in the company was gathered from a manager in the human resource department (representative of all the managers) and ten employees representing various departments within the company. The complete detail

regarding the different measuring instruments will be discussed in the paragraphs following below.

5.2.3 Measuring instruments

This research consisted of the following measuring instruments:

- A questionnaire with a list of open-ended questions measuring how well the human aspect of the acquisition was handled as perceived by the human resource manager and employees from Absa.
- The analysis and interpretation of the financial records of the Absa Group.

5.2.4 Questionnaire

The reason for using a questionnaire is that questionnaires have a number of benefits over other forms of data collection (Wilkinson & Birmingham, 2003):

- They are usually inexpensive to administer.
- Very little training is needed to develop them.
- They can be easily and quickly analysed once completed.

Certain aspects of the questionnaire namely the objective, description, study sample, administration and analysis will be discussed next.

5.2.4.1 Objective of the questionnaire

An effective questionnaire is one that enables the transmission of useful and accurate information or data from the respondent to the researcher (Wilkinson & Birmingham, 2003:8). The objective of the questionnaire was precisely this: to gather the correct information about how well the impact of the acquisition was handled as perceived by management as well as the employees. This instrument assisted greatly in the understanding of the human aspect of the acquisition.

5.2.4.2 Description of the questionnaire

The questionnaire (Appendix A, page 96) took on the form of a list of open-ended questions. Open-ended questions impose none of the restrictions of closed and multiple-choice questions. They allow for the recording of any response to a question provided by the respondent (Williams, 2003:112). Another advantage of using open-ended questions is that it allows the respondent to answer using his/her own frame of reference, without undue influence from pre-specified alternatives. The answers to open-ended questions are in no way predetermined – this can make analysis difficult (Wilkinson & Birmingham, 2003:11). Open-ended questions were also asked to allow the respondent to elaborate and cover all relevant issues related to the question.

The questionnaire was developed based on the literature of non-financial issues in an acquisition. The questionnaire consisted of seven main questions aiming at seven aspects of management and employees during an acquisition. These seven questions were subdivided to avoid uncertainty and to allow the respondent to answer one specific question at a time. All the questions were designed to collect qualitative data as the perceptions and actions of managers and people in the organisation were being investigated.

5.2.4.3 Study sample

The study sample for the questionnaire included a manager from the Human Resource department as well as ten employees representing five departments within the company. The one manager from the Human Resource Department completed the questionnaire as representative of the department because of time constraints and the fact that they all received the same briefings on how to handle the acquisition. The perspective from both managers and employees are important to ensure the validity of the information gathered. Two employees from each of the following departments were chosen to complete the questionnaire: Risk Management, Claims, Credit Control, Information Technology and Public Relations.

5.2.4.4 Administration of the questionnaire

The questionnaire was emailed to a contact person at Absa Bank, who in return distributed the questionnaire to the various respondents in the different departments. Email-based questionnaires, because of their speed, relative cheapness and the absence of interviewer bias and data entry errors have become very popular in research (Williams, 2003:95). A time limit of one week was allowed and all ten respondents personally emailed their answers back to the researcher within the time limit. They were advised by the researcher to keep their answers confidential and not discuss it with any of the other respondents. The use of e-mail also ensured that everything was recorded correctly and that the information was made available to the organisation.

The managers and employees completed the same questionnaire to ensure the validity of the information. The employees were asked to ignore Question 1 (Appendix A, page 96) as it was directed at the managers specifically.

5.2.4.5 Analysis of the questionnaire

The data that emerged from the questionnaire were analysed by means of content analysis. Content analysis applies significance or meaning to information collected and helps identify patterns in the text (Wilkinson & Birmingham, 2003:68). The purpose was to reduce accumulated data into manageable statements. Long descriptions were summarised without losing content and meaning of the sentences.

5.2.5 Interpretation of the financial records

The objective, administration and analysis of the interpretation of the financial records will be discussed next.

5.2.5.1 Objective

The financial records of the Absa Group were examined to obtain certain information regarding the financial performance of the bank before and after the acquisition announcement in September 2004. The intention of the researcher was also to review Absa's financial data after the conclusion of the transaction on the 27th of July 2005. This was, however, not possible because Absa would not give access to this information until the end of December 2005.

5.2.5.2 Administration

The financial information was extracted from Absa's and Barclays' 2005 year end Financial Reports. These reports contained all of the financial data needed for the research and were made available on the Absa and Barclays websites respectively. These reports included the following:

- The annual financial statements (Absa, 2005d:154; Barclays, 2005b:7).
- Group salient figures (Absa, 2005d:5; Barclays, 2005b:1).
- A financial performance summary (Absa, 2005d:4; Barclays, 2005b:3).

5.2.5.3 Analysis

The following methods were used to evaluate the financial performance of Absa and the success of the Absa-Barclays transaction:

- Return on equity
- Return on assets
- Residual income
- Economic value added
- Cost-to-income ratio
- Earnings per share

5.2.6 Research method

The following steps were taken in conducting the research:

- A formal research proposal was submitted by the researcher to the study supervisors after extensive research on the subject.
- The subject for the research was identified and initial telephone contact was made with the bank.
- Certain measuring instruments for the research were identified after the completion of the literature study. The questions for the questionnaire were compiled and presented to experts for advice.
- The questionnaires were administered as described in paragraph 5.2.4.4 on page 62.
- The financial data were extracted as described in paragraph 5.2.5.2 on page 63.
- The data that were gathered by using the different measuring instruments were analysed as described in paragraphs 5.2.4.5 and 5.2.5.3 on pages 62 and 63 respectively.
- The results of the research will be discussed later in this chapter.
- Conclusions and recommendations regarding the research will be provided in Chapter six.

5.2.7 Limitations to the research

A limitation to the research was the lack of literature written about merger and acquisition success/failure factors and the effects of a merger or acquisition. This limited the amount of literature that could be reviewed. Another limitation was the lack of post-merger financial data. Absa's financial year end has moved from 31 March to 31 December. Because of the confidentiality of this data and a time constraint on the researcher's part it was not possible to obtain a true reflection of the financial impact of the acquisition.

5.3 THE IMPACT OF THE SUCCESS FACTORS ON THE ABSA-BARCLAYS TRANSACTION

In Chapter three the ten potential driving factors of merger and acquisition success were discussed. The fifth research objective will be reached (objective 1.4.2.5, page 3) when these ten factors are analysed using the Absa-Barclays transaction. Using financial and non-financial data from both Absa and Barclays, the ten potential success factors will be tested in this case study.

5.3.1 The product/activity focus of a transaction

According to the literature study done as mentioned in Chapter three (paragraph 3.2.1, page 27), the higher the ratio of the net interest income to the total operating income of the target, the more focused a transaction is. DeLong (2001) and Cornett *et al.* (2000) found that an increased product/activity-focus has a significantly positive effect on merger and acquisition success of banks.

Absa's net interest income for the 2005 financial year was R10 654 million (Absa, 2005d:70) and the total operating income was R21 195 million (Absa, 2005d:70). The net interest income/operating income ratio for Absa (Figure 5.1) is thus 49,84% [10 654 / 21 195]. This is considered a reasonable high ratio of almost 50% (paragraph 3.2.1, page 27).

Figure 5.1: Product/activity focus calculation

	Absa (2005)
Net interest income	R10 654 million
Total operating income	R21 195 million
Ratio	49, 84 %

This transaction can therefore be seen as product/activity focused because of the high net interest income to operating income ratio of the target bank, Absa. This is the first step in ensuring a successful merger.

5.3.2 The geographic focus of a transaction

Almost all the studies that covered the geographic focus of a transaction conclude that more shareholder value is created when target and bidder operate in a related geographical region (paragraph 3.2.2, page 27). Houston & Ryngaert (1997) on the other hand found that targets seem to create more value in cross-border transactions and that from the point of view of the combined entity the geographic focus does not significantly determine an acquisition's success.

The Absa-Barclays transaction is a cross-border acquisition and although cross-border transactions have proved to be less successful, it is possible when all the other factors and focuses are in place. Barclays' previous involvement in the South African banking sector could definitely be an advantage in this takeover. As the target company, Absa will also be likely to create more value from this cross-border transaction.

5.3.3 The size of the target

The acquisition of targets that are large enough to provide sufficient synergies but are still small enough to be of a manageable size should have a positive impact on value creation (paragraph 3.2.3, page 28). To test whether the size of a target has an impact on the merger success, the *relative asset size* of a target in relation to a bidder is analysed.

Absa's total assets for 2005 amounted to R348, 7 billion (Absa, 2005d:69). Compared to Barclays's R9 897,6 billion assets [£850,123 billion (Barclays, 2005b:12) x 11,6425 (rand/pound exchange rate on 24th of August 2005)] Absa can be seen as a smaller, less complex target with great value creation potential (Figure 5.2). In South Africa, though, Absa is one of the biggest

banking groups and therefore the researcher is of the opinion that Absa provide sufficient synergies for Barclays with the advantage that the merger is of a manageable size.

Figure 5.2: Size of the target and bidder

	Absa (2005)	Barclays (2005)
Total assets	R348,7 billion	R9 897,6 billion

According to the studies of Zollo and Leshchinskii (2000) and Hawanini and Swary (1990) mentioned in chapter three (paragraph 3.2.3, page 28), this transaction is likely to show a favourable outcome with great potential for success because the target is smaller than the bidder.

5.3.4 The growth focus of a transaction

To measure the growth focus of a transaction, the growth of the total assets of a target during the year prior to the announcement year is used as measuring instrument. A transaction is considered as being growth focused if a bidder acquires a target with a strong growth rate (paragraph 3.2.4, page 29). Cornett *et al.* (2000) analysed the asset growth of the targets but could not detect any significant relationship to bidder returns and therefore to merger and acquisition success. DeLong (2001) found that transactions that were both geographic-diversifying and product/activity-diversifying were purely growth oriented.

Absa's asset growth rate for the year prior to the announcement (2004) was calculated by Absa as 14.04% (Absa, 2005d:69). Absa considers this a very strong growth rate because of its consistency over the past few years (Absa, 2005d:69).

The merger with Barclays will probably stimulate Absa's growth in the future even more and this transaction can thus be labelled as a growth focused

transaction. The growth focus together with the product/activity focus and geographic-diversity there indicates that the transaction will be successful.

5.3.5 The risk reduction potential of a transaction

The *risk reduction potential* of a transaction is measured by the relationship of the market share returns of bidder and target during the estimation period of the event study. The higher the correlation between the bidder and the target's share price is, the higher the diversification/risk reduction potential of a transaction. Transactions involving these highly related partners create more value for the bidding banks ensuring acquisition success (paragraph 3.2.5, page 30).

The share prices for Absa and Barclays were R94,85 (Absa, 2005f:1) and R64,62 [£5,55 x 11,6425] (Barclays, 2005c:1) respectively on the 25th of August 2005. This indicates (Figure 5.3) a high correlation between the bidder and target share prices because the ratio of the two share prices exceeds 51,35% (paragraph 3.2.5, page 30). Barclays and Absa's ratio is 68,15% [64,62 / 94,85].

Figure 5.3: Risk reduction potential calculation

	Absa (2005)	Barclays (2005)	Risk reduction potential
Share price	R94, 85	R64, 62	
Correlation			68,15%

A high diversification/risk reduction potential for this acquisition transaction is therefore possible according to paragraph 3.2.5, page 30. This could create more value for the bidding bank i.e., Barclays and ensure the success of the Absa-Barclays transaction.

5.3.6 The profit efficiency of a transaction

The profit efficiency of a transaction is measured by the target and the bidder's return on equity (ROE) and return on assets (ROA) ratio. These two ratios were thoroughly discussed in Chapter four (paragraph 4.3.1.1 – 4.3.1.2, page 52-53). The studies, mentioned in Chapter three (paragraph 3.2.6, page 31), indicate that an acquisition transaction is likely to be more successful if the bidder is more profitable than the target.

Absa's ROE for 2005 was 25,5% (Absa, 2005d:8) and ROA was 1,68% (Absa, 2005d:8). Barclays's ROE for 2005 was 23,4% (Barclays, 2005b:5) and ROA was 1,44% (Barclays, 2005b:5). These ratios (Figure 5.4) were calculated by Absa and Barclays and extracted from their respective reports.

Figure 5.4: Profit efficiency indicators

	Absa (2005)	Barclays (2005)
Return on equity (ROE)	25,5 %	23,4 %
Return on assets (ROA)	1,68 %	1,44 %

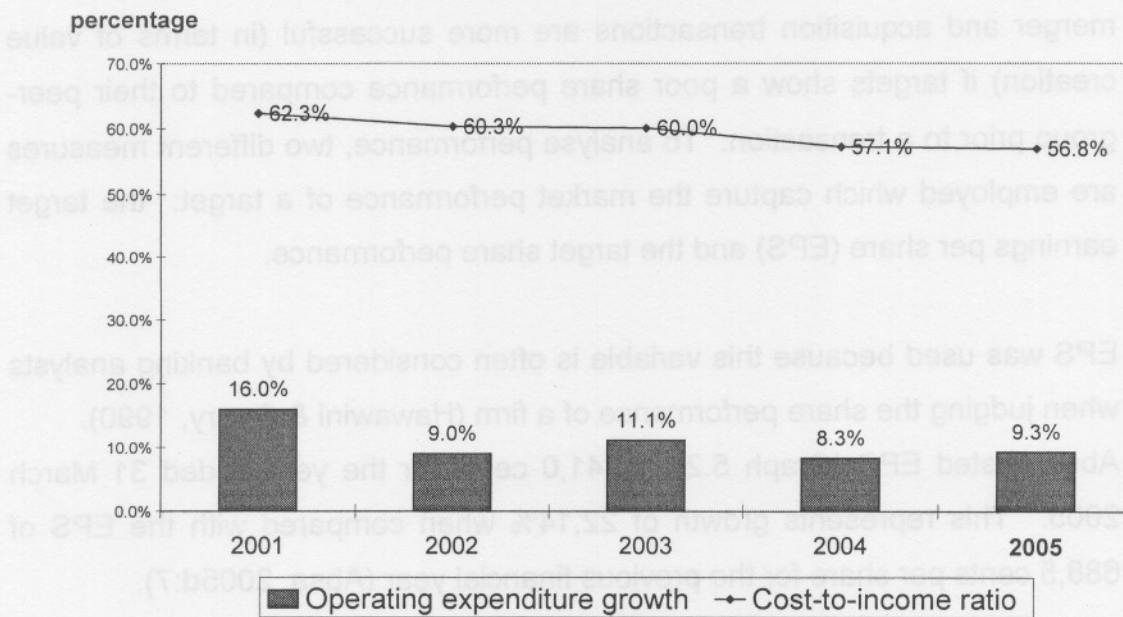
The ratios of the two banks involved are so closely correlated that it is difficult to determine whether the bidding bank, Barclays is more profitable than the target bank, Absa. The success of the Absa-Barclays transaction indicates that even though it is difficult to draw a conclusion whether Absa is more profitable than Barclays, the transaction can be profit efficient and successful.

5.3.7 The cost efficiency of a transaction

The *cost efficiency* is measured with the relative cost-to-income ratio. This ratio compares the cost structure of a target to the cost structure of a bidder. Acquisition transactions with a large cost efficiency similarity have a higher value creation potential and are thus more likely to be successful (paragraph 3.2.7, page 32).

It was Absa's long-term objective to achieve a cost-to-income ratio in the mid-fifties. Absa has reduced this ratio from 64,7% in 1998 to the current 56,8% (Graph 5.1). This decline was achieved despite substantial investments made in the delivery footprint and regulatory compliance initiatives (Absa, 2005d:12).

Graph 5.1: Cost-to-income ratio



The cost-to-income ratios for Absa and Barclays in 2005 were 56,8% (Absa, 2005d:8) and 57% (Barclays, 2005b:7) respectively (Figure 5.5). These ratios were also calculated by Absa and Barclays and extracted from their respective reports as already calculated percentages.

Figure 5.5: Cost efficiency indicators

	Absa (2005)	Barclays (2005)
Cost-to-income ratio	56,8 %	57 %

These ratios imply that the cost structures of Absa and Barclays are very similar and have a high value creation potential. Because of the similarity in cost structures this acquisition transaction has great potential for success (Beitel *et al.*, 2003:6).

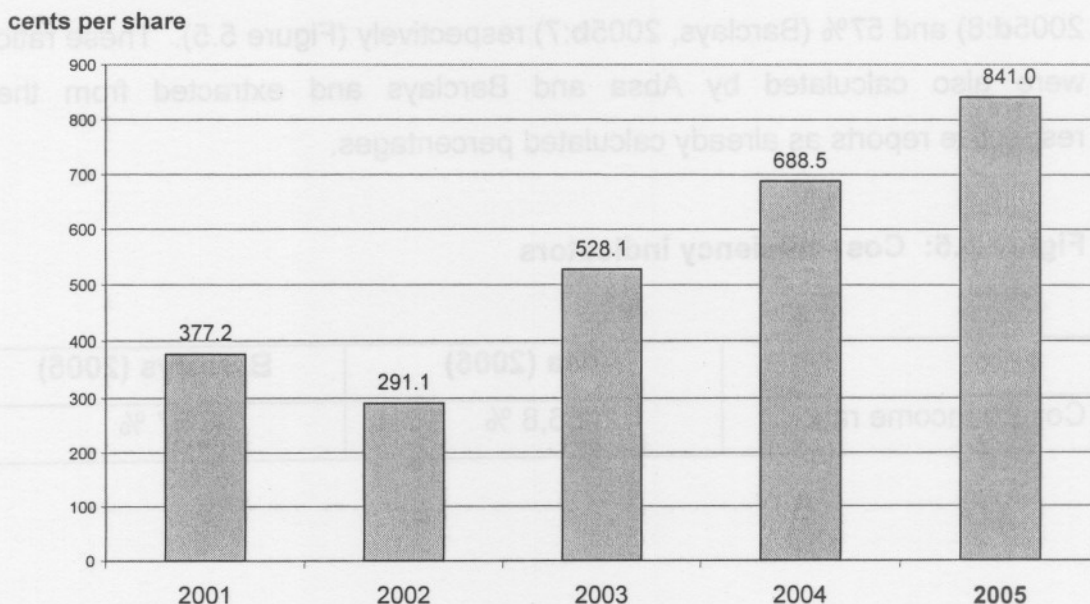
5.3.8 The capital market performance of the target

The studies mentioned in Chapter three (paragraph 3.2.8, page 33) found that merger and acquisition transactions are more successful (in terms of value creation) if targets show a poor share performance compared to their peer-group prior to a transaction. To analyse performance, two different measures are employed which capture the market performance of a target: the target earnings per share (EPS) and the target share performance.

EPS was used because this variable is often considered by banking analysts when judging the share performance of a firm (Hawawini & Swary, 1990).

Absa posted EPS (Graph 5.2) of 841,0 cents for the year ended 31 March 2005. This represents growth of 22,14% when compared with the EPS of 688,5 cents per share for the previous financial year (Absa, 2005d:7).

Graph 5.2: Earnings per share (EPS)



Absa's EPS in March 2004, prior to the acquisition announcement, was 697,5c (Absa, 2005d:8) as indicated in their report and their share price was R46,64 (Absa, 2005f:170). Compared to Absa's peer-group, Absa showed a very strong market performance in 2004 (Absa, 2005d:103). The increase of over 100% [from R46,64 in 2004 to R94,85 in 2005 (Absa, 2005f:1) in the share price since the announcement and completion of the transaction, also illustrates a very significant market performance by Absa.

Although Absa did not show a weak share performance compared to its peer-group the transaction was still successful. The share performance of a target is also considered a good proxy for the management quality of a target (paragraph 3.2.8, page 33). According to this theory and Absa's incredible share performance, the management quality is exceptional which could also contribute to the success of this transaction.

5.3.9 The experience of the bidding bank

According to the studies mentioned in Chapter three (paragraph 3.2.9, page 35) it is expected that more active/experienced bidders have learned how to perform value-creating merger and acquisition transactions. This related knowledge is important with regard to successfully conducting any merger or acquisition transaction.

Barclays Bank is the fourth largest bank in the United Kingdom. The bank can trace its routes back to 1690 in London (Figure 5.6, page 73). Today the bank is a global financial service provider operating in the UK, Europe, United States of America, and Africa. The history of Barclays Bank mergers and acquisition transactions are as follows (Barclays, 2005a:1):

Figure 5.6: Experience of Barclays as a bidding bank

1905-1916:	Acquisitions of small English banks extended the branch network
1918:	Barclays amalgamated with the London, Provincial and South Western Bank
1969:	Acquisition of Martins Bank
2000:	Acquisition of Woolwich Plc
2005:	Acquisition of Absa Group

This history demonstrates that Barclays has a history of having been a bidding bank since 1905 and their knowledge and experience has definitely contributed to the success in acquiring the Absa Group.

5.3.10 The method of payment

Prior research (paragraph 3.2.10, page 36) showed that the target and the bidder's shareholders prefer cash payments. All studies reported that bank mergers and acquisitions create more shareholder wealth in cash transactions as compared to share transactions. The method of payment is measured with the cash-ratio of a transaction. The cash-ratio equals 100% if the target is paid for with cash only and equals 0% if the bidder only pays with own shares (paragraph 3.2.10, page 35).

The Absa-Barclays merger's cash ratio is 100% as the target was paid for with cash only. Barclays offered R82.50 per share, payable in cash, representing a total consideration for the scheme and partial offer of R33 billion, acquiring a majority stake of 53.96% of all ordinary shares in Absa Group Limited (Absa, 2005c:1).

In this cash-only transaction more shareholder wealth was created for both Absa and Barclays. Creating this wealth is the most important factor in this acquisition transaction and essential in ensuring success.

5.4 THE IMPACT OF THE ABSA-BARCLAYS TRANSACTION ON NON-FINANCIAL ISSUES

There is so much more to any merger or acquisition transaction than merely the financial and legal aspects of the transaction. In the first part of Chapter four (paragraph 4.2, page 38) these aspects were discussed. Non-financial issues impacting an acquisition transaction (objective 1.4.2.6, page 3) include: the crucial role that management plays in ensuring acquisition success (paragraph 4.2.1, page 39), the importance of the human factor and managing the acquisition syndrome (paragraphs 4.2.2 - 4.2.3, page 40-41), the merging of the organisational cultures and how management should take the lead (paragraphs 4.2.4 - 4.2.5, page 43-44) and the importance of communication and defining an organisational structure (paragraphs 4.2.6 – 4.2.7, page 45-47). According to the information extracted from the questionnaire (Appendix A, page 96), Absa's management and employees have highlighted the following best practices regarding the non-financial aspects:

5.4.1 Managing the syndrome

The employees' reactions can be summarised as follows:

- All of the employees felt personal anxiety about what the future held for them when the acquisition was initially announced; they wanted to know more details about the acquisition adjustment programme: for example, if there were going to be any job losses (Appendix A, Question 2, page 96).
- All the employees confirmed that they were informed about the acquisition plans prior to or at the same time as the general public (Appendix A, Question 2, page 96).
- Eight out of the ten employees felt that they were kept informed about the progress of the transaction after the initial announcement. The other two employees felt that the communication could have been more frequent and detailed after the announcement had been made. They all agreed that the amount of communication definitely had an impact on

their morale whether it was positive or negative (Appendix A, Question 3, page 96).

Based on information obtained from the questionnaire completed by the human resource manager, the syndrome was handled in the following ways:

- The division managers were included in the strategic decision making, and the organisation gained a better understanding of the human implications of the acquisition (Appendix A, Question 1, page 96).
- The division managers also facilitated in the development of a new organisational structure and established clear, well-defined reporting relationships as soon as possible (Appendix A, Question 1, page 96).
- Management provided frequent and regular communication during and after the acquisition event. Because employees experience more stress and anxiety when they are uncertain about their future, Absa informed all their employees of acquisition plans at the same time as, or in advance of any press release in order to keep stress, rumours and uncertainty at a minimum (Appendix A, Question 2, page 96).
- Management kept employees informed about the progress of the acquisition and they understood why certain decisions were being made. These employees had a much more favourable view of the event and their morale was high after reassurance that their jobs were secure (Appendix A, Question 3, page 96).

5.4.2 Cultural Assessment

Although the acquisition made sound financial and strategic sense, both the managers and the employees recognised the importance of assessing the human implications, especially since the acquisition involved the integration of all aspects of the banking business (Appendix A, Question 4, page 96). From a management perspective, this acquisition was one of the more difficult to implement, since both banks already had knowledge of and expertise in their business and thus had to consolidate operations to avoid redundancy.

All of the employees felt insecurity to some degree and confusion about the details of the acquisition was commonly expressed. Employees wondered how the ownership arrangement would work and how the work force would be blended. The employees were unsure of the degree of difficulty of the transaction but all of them expressed concern about job losses because of the similar expertise in both banking groups (Appendix A, Question 5, page 97).

According to the information obtained from the questionnaire completed by the human resource manager, management identified the following steps to integrate their corporate cultures. The first step was identifying compatible differences that could be built on, incompatible differences that required resolution, and misconceptions about each other that required clarification. The two organisations planned to select and integrate the best aspects from each company, without losing the unique characteristics that made Absa so successful in South Africa (Appendix A, Question 6, page 97).

Concern was expressed by four of the ten employees over the company's motives and actions and the endurance of the company's corporate culture. Employees wondered about their corporate culture - their traditions and values. Were they still important and would they endure in the new organisation? The other six employees were not particularly concerned with the organisational culture. None of the employees had an idea or plan on how to merge the different cultures (Appendix A, Question 6, page 97).

5.4.3 Communication

According to a human resource manager of Absa bank, communication was critical to the success of the acquisition. When the transaction was announced, Absa made a commitment to their employees to share all plans and new developments with them first before releasing any details publicly. They also sought to ensure frequent and ongoing two-way communication with all employees and to ensure some consistency in the messages being received by employees at Absa (Appendix A, Question 7, page 97).

The employees all agreed that communication was of the utmost importance in ensuring the success of the acquisition. Eight out of the ten employees felt that the communication aspect was handled thoroughly and systematically before and after the acquisition announcement. The other two employees felt that communication could have been more detailed and more frequent (Appendix A, Question 7, page 97).

5.4.4 Effect on management and management structures

After the acquisition transaction had been finalised, the management structure of Absa changed in order to accommodate executives from both banks. The management structure of a bank was thoroughly discussed in chapter 4 (paragraph 4.2.7, page 60). The changes in the structure are illustrated below (Absa, 2005a:8).

Absa Group Ltd announced its new Executive Committee (Exco) on 27 July 2005. This Exco draws on the best skills and talents from both Barclays and Absa. It consists of 17 members (previously nine) and, with the introduction of two women to the team, has an employment ratio of 29%. The new team comprises (The * indicates the executives appointed from Barclays):

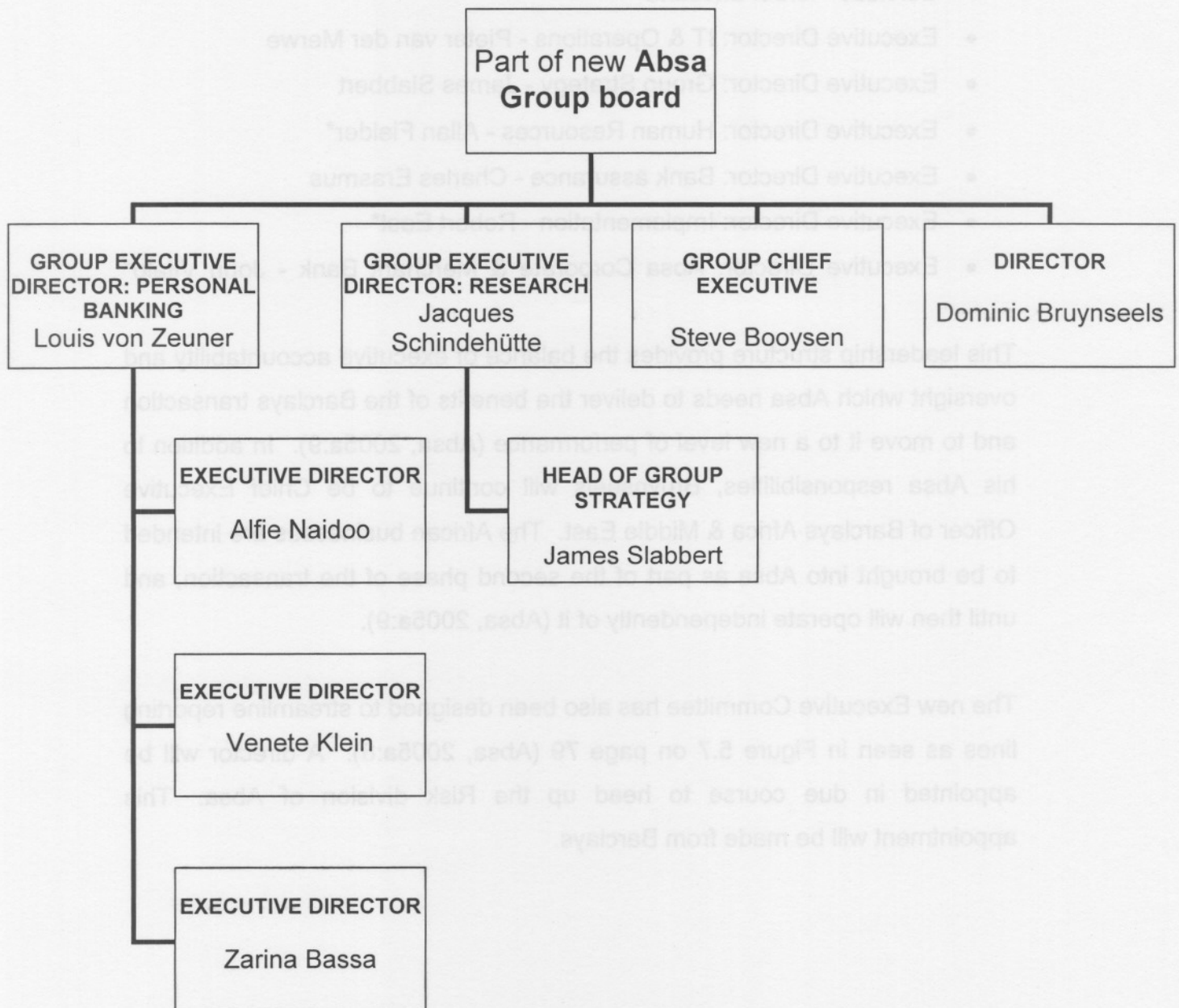
- Group Chief Executive: Steve Booyen
- Group Executive Director: Finance, Legal Services & Economic Research - Jacques Schindehütte
- Group Executive Director - Dominic Bruynseels*
- Group Executive Director: Personal Banking - Louis von Zeuner
- Executive Director: Retail Banking (Sales and Service) - Venete Klein
- Executive Director: Retail Banking (Segments) - Alfie Naidoo
- Executive Director: Private Banking - Zarina Bassa
- Executive Director: Business Banking (includes Public Sector & Agri-Business) - Robert Emslie
- Executive Director: Absa Africa & Absa Vehicle & Asset Finance - Peter Mageza

- Executive Director: Marketing and Communication and Logistical Services - Israel Skosana
- Executive Director: IT & Operations - Pieter van der Merwe
- Executive Director: Group Strategy - James Slabbert
- Executive Director: Human Resources - Allan Fielder*
- Executive Director: Bank assurance - Charles Erasmus
- Executive Director: Implementation - Robert East*
- Executive Director: Absa Corporate & Merchant Bank - John Vitalo*

This leadership structure provides the balance of executive accountability and oversight which Absa needs to deliver the benefits of the Barclays transaction and to move it to a new level of performance (Absa, 2005a:9). In addition to his Absa responsibilities, Bruynseels will continue to be Chief Executive Officer of Barclays Africa & Middle East. The African businesses are intended to be brought into Absa as part of the second phase of the transaction, and until then will operate independently of it (Absa, 2005a:9).

The new Executive Committee has also been designed to streamline reporting lines as seen in Figure 5.7 on page 79 (Absa, 2005a:8). A director will be appointed in due course to head up the Risk division of Absa. This appointment will be made from Barclays.

Figure 5.7: Absa's new reporting lines



5.5 THE EFFECT OF THE ABSA-BARCLAYS TRANSACTION ON FINANCIAL PERFORMANCE

The acquisition also had an impact on the financial performance of Absa Bank (objective 1.4.2.7, page 4). The success of this acquisition lies in the financial success of the transaction. In the banking industry, certain measures are essential when determining the financial performance of a bank. These

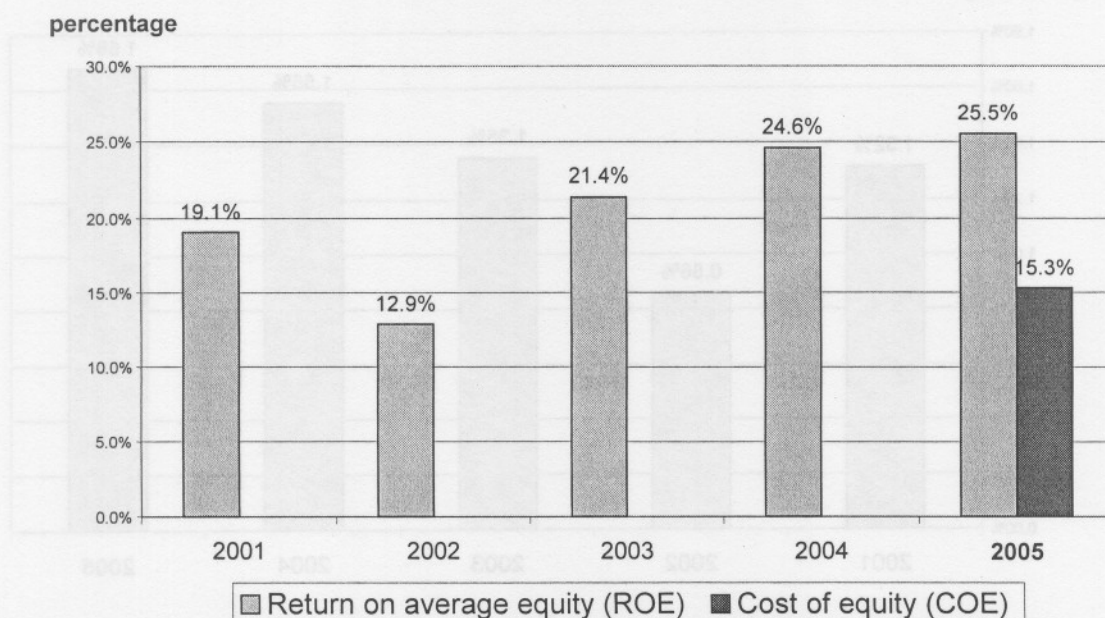
measures were discussed in detail in chapter 4 (paragraph 4.3.1, page 49). In the following paragraphs, the effect of the acquisition on these financial measures from Absa will be shown.

5.5.1. Return on average equity (ROE)

Essentially, ROE reveals how much profit a bank generates with the money shareholders have invested in them (paragraph 4.3.1.1, page 52). Return on equity is thus an important financial performance measure during this acquisition process because of its relevance to the value creation for the bank's shareholders.

Absa reported their ROE figures in their 2005 Financial Report. As seen in Graph 5.3, Absa increased its ROE from 24,6% in 2004 to 25,5% for 2005 (Absa, 2005d:9):

Graph 5.3: Return on equity (ROE)



This is comfortably higher than the Group's objective of achieving an ROE of at least 5% above the cost of equity (COE), set at 15,3% for the 2005 financial

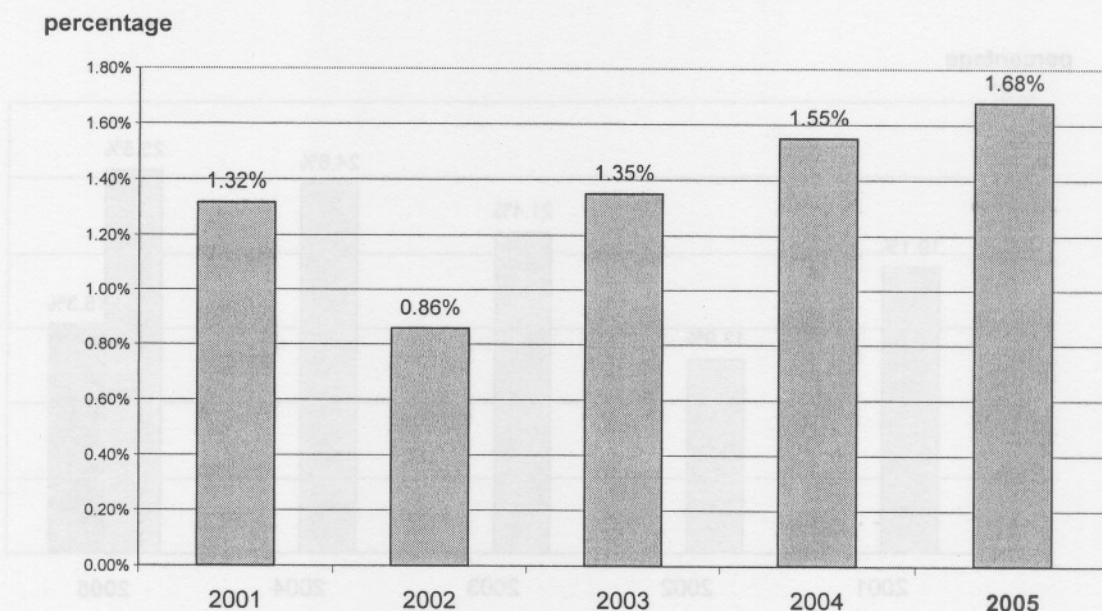
year. Despite the acquisition Absa exceeded this objective by 5,2% in the year under review, creating substantial value for shareholders (Absa, 2005d:9).

5.5.2 Return on average assets (ROA)

ROA is a useful indicator of how profitable a bank is relative to its total assets and therefore important in measuring its financial health. The ratio is calculated by dividing earnings before interest but after tax by total assets (paragraph 4.3.1.2, page 53). Using the earnings before interest but after tax is the correct approach as it excludes interest, which is a cost of financing, but includes taxation that is an operating cost.

Absa's ROA, as reported by Absa, improved from 1,55% to 1,68% indicating an increase of 8,4% (Absa, 2005d:8) for the year 2005 (Graph 5.4).

Graph 5.4: Return on assets (ROA)



Absa's ROA indicates their profitability relative to their asset size for the year prior to the announcement (2004) and after the announcement had been made (2005). This comparison indicated growth in Absa's ROA and is

important in determining the financial health of Absa after the acquisition announcement had been made in September 2004.

5.5.3 Residual income (RI)

Residual income (RI) is the profit earned before tax that exceeds the specified rate of return multiplied by the asset base. The importance of RI in this acquisition transaction is that it motivates managers to act in the best interest of the bank (paragraph 4.3.1.3, page 54). Absa's RI for the years 2003, 2004 and 2005 are calculated according to Neal *et al.*, (2005:16):

$$\text{RI} = \text{NOPAT} - (\text{cost of equity} \times \text{book value of equity})$$

Using the above-mentioned formula and the relevant amounts from Absa's financial report (Absa, 2005d:69-70), the RI for the three years respectively can be calculated as follows:

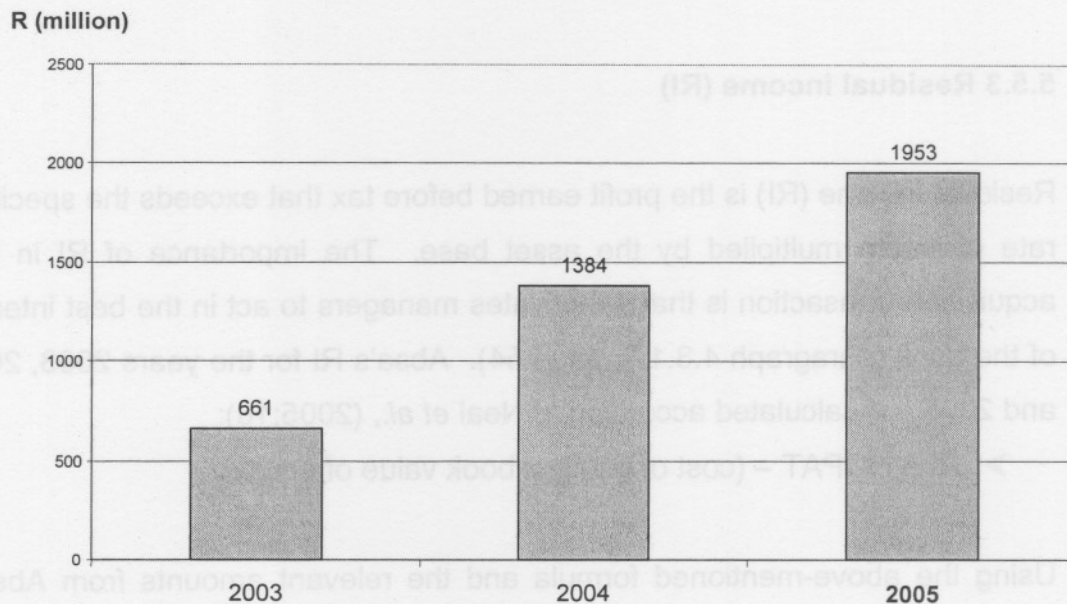
$$\begin{aligned} \text{RI for 2003} &= \text{R3 461 million} - (16,6\% \times \text{R16 866 million}) \\ &= \text{R3 461 million} - \text{R2 800 million} \\ &= \text{R 661 million} \end{aligned}$$

$$\begin{aligned} \text{RI for 2004} &= \text{R4 596 million} - (16,6\% \times \text{R19 350 million}) \\ &= \text{R4 596 million} - \text{R3 212 million} \\ &= \text{R1 384 million} \end{aligned}$$

$$\begin{aligned} \text{RI for 2005} &= \text{R5 585 million} - (15,3\% \times \text{R23 737 million}) \\ &= \text{R5 585 million} - \text{R3 632 million} \\ &= \text{R1 953 million} \end{aligned}$$

These figures can be plotted on a graph (Graph 5.5, page 83) to indicate the increase in residual income.

Graph 5.5: Residual income (RI)



Absa's RI improved from R1 384 million for the year 2004 to R1 953 million for the year 2005. This indicates an increase of 41% and should provide great motivation for managers after the acquisition transaction.

5.5.4 Economic value added (EVA)

The idea behind EVA is to deduct the charge for the use of the entity's capital from the operating income/profit after tax. What makes this measure so important is that it is a better way of indicating the creation of value in the company than merely showing an accounting profit (paragraph 4.3.1.4, page 55). According to Horngren *et al.* (2003:790) EVA is calculated as follows:

- $EVA = \text{After tax operating income} - [\text{Weighted average cost of capital} \times (\text{total assets} - \text{current liabilities})]$

Using the above-mentioned formula and the relevant amounts from Absa's financial report (Absa, 2005d:69-70), Absa's EVA for the years 2003, 2004 and 2005 can be calculated accordingly:

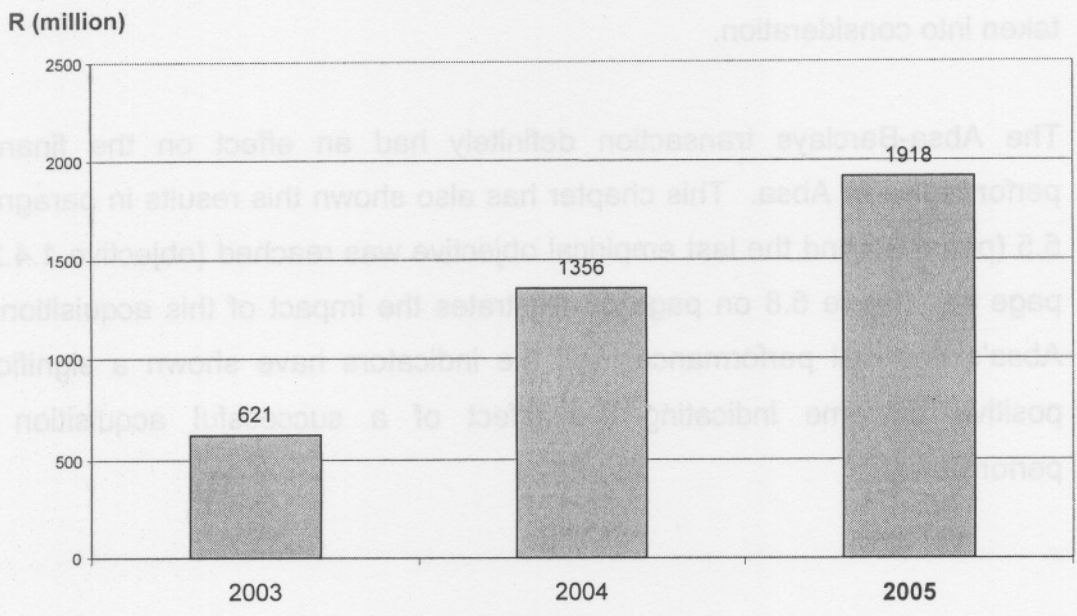
- EVA for 2003 = R3 461 million – [16,6% x (R269 064 million – R251 957 million)]
 = R3 461 million – R2 840 million
 = R 621 million

- EVA for 2004 = R4 596 million – [16,6% x (R306 848 million – R287 327 million)]
 = R4 596 million – R3 240 million
 = R1 356

- EVA for 2005 = R5 585 million – [15,3% x (R348 686 million – R324 721 million)]
 = R5 585 million – R3 667 million
 = R1 918 million

The above calculated figures can be plotted on a graph (Graph 5.6) to indicate Absa's increase in economic value added.

Graph 5.6: Economic value added (EVA)



Absa's EVA improved from R1 356 million for the year 2004 to R1 918 million for the year 2005 (Graph 5.6, page 84). This presents an increase of 42% and indicates that Absa has created value in the company since the acquisition announcement in September 2004.

5.6 CONCLUSION

This chapter dealt with the specific objectives by way of empirical research. Analysing the success factors with regard to the Absa-Barclays transaction has indicated the success of the acquisition and the fifth research objective was reached (objective 1.4.2.5, page 3). The Absa-Barclays transaction most likely succeeded because the acquisition was made slowly and deliberately as part of a wider company strategy. It is obvious from the results discussed in paragraph 5.3 (page 65) that Absa and Barclays had successfully created shareholder wealth.

This chapter also dealt with the impact of the Absa-Barclays transaction on non-financial issues such as communication and organisational culture (objective 1.4.2.6, page 3). Merger and acquisition deals can be a valuable tool for growing and developing a company as long as the human factor is taken into consideration.

The Absa-Barclays transaction definitely had an effect on the financial performance of Absa. This chapter has also shown this results in paragraph 5.5 (page 79) and the last empirical objective was reached (objective 1.4.2.7, page 4). Figure 5.8 on page 86 illustrates the impact of this acquisition on Absa's financial performance. All the indicators have shown a significant positive outcome indicating the effect of a successful acquisition on performance.

Figure 5.8: Summary of financial indicators

Financial indicators	Absa Group Ltd		
	2003	2004	2005
Cost-to-income ratio (Graph 5.1, page 70)	60,0 %	57,1 %	56,8 %
Earnings per share (Graph 5.2, page 71)	528,1 cent	688,5 cent	841,0 cent
Return on equity (Graph 5.3, page 80)	21,4 %	24,6 %	25,5 %
Return on assets (Graph 5.4, page 81)	1,35 %	1,55 %	1,68 %
Residual income (Graph 5.5, page 83)	R 661 million	R1 384 million	R1 953 million
Economic value added (Graph 5.6, page 84)	R 621 million	R1 356 million	R1 918 million

Because this transaction had been conducted properly, the Absa-Barclays acquisition resulted in an effective and profitable new entity. The amount of resources required to ensure that the transition will go smoothly should not be underestimated. Even with thorough planning, there will always be aspects that have been overlooked and these aspects need to be taken into account throughout the change. Ultimately, any acquisition undertaken should result in a healthier, more motivated and competitive business.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

In order to reach the final research objective (objective 1.4.2.8, page 4), a conclusion of the effect of a successful acquisition on performance and management will be drawn in this chapter. The conclusions from the specific research objectives as seen in paragraph 1.4.2 (page 3-4) will be discussed in the first section of this chapter.

Recommendations for the future and future research will be made in the last part of this chapter. These recommendations will only be made after the literature study was completed (Chapters two, three and four), the results were illustrated (Chapter 5) and the conclusions were drawn.

6.2 CONCLUSIONS

Based on the specific objectives of the research and the results obtained during the empirical study, the conclusions of this research will be discussed in this final chapter.

6.2.1 A brief history of the banking sector and bank mergers and acquisitions in South Africa

The banking sector in South Africa as well as the history of bank mergers and acquisitions (objective 1.4.2.1, page 3) was researched from the literature (paragraph 2.2 – 2.3, page 6-8). This was important in order to set the platform for the following chapters. The banking sector in our country is still highly concentrated due to the economic isolation from the rest of the world during the 1980s. Investments in information technology are large as the biggest banks in South Africa try to keep up with the sophisticated systems of the more developed countries. Keeping up with the rest of the world is also of

the utmost importance since over twenty-one foreign banks have operated in South Africa during the last eleven years.

According to the research in Chapter two, it is fair to conclude that bank mergers and acquisitions in South Africa have been unsuccessful in the past. The few mergers or acquisitions that had been successful resulted in the loss of skilled people and huge amounts of money.

6.2.2 The risk considerations with regard to banking mergers and acquisitions

What makes the merging of two banks even more difficult are the risks of banking specifically (objective 1.4.2.2, page 3). Banks must know what risks they are exposed to and understand the implications of these risks. They should also be able to identify, measure and manage them properly.

The bank risk management system (paragraph 2.5, page 12) can be used for identifying, measuring and managing these risks and can also provide a comprehensive framework that will help managers in the pursuit of any project, for example a merger or acquisition. These projects should offer the highest growth and returns in the long-term, with the ultimate result of increased shareholder value. Managing these risks can also serve as an aid in decision making and helping with the development of a competitive advantage for the bank.

6.2.3 The potential driving factors of merger and acquisition success

The ten potential driving factors of merger and acquisition success (objective 1.4.2.3, page 3) were identified and researched in Chapter three (paragraph 3.2, page 26). The success of merger and acquisition transactions was analysed from the viewpoint of both target and bidder shareholders and the combined entity of bidder and target.

Based on this analysis a number of factors (ten) were identified, which are able to explain merger and acquisition success in banking in a significant way. Although every merger and acquisition is different and has its own unique factors contributing to success, these ten factors were identified after extensive research from various sources:

- The *product/activity focus* of a transaction which has a significant positive impact on the value creation of bank mergers and acquisitions.
- The *geographic focus* of a transaction which indicates that domestic transactions provide for a higher synergy potential than cross-border transactions.
- The *size of the target* which shows that merger transactions are more favourable for bidders if the targets are small relative to the bidder.
- The *growth focus* of a transaction which indicates that the acquisition of a fast growing target supports the growth of a bidder even more.
- The *risk reduction potential* of a transaction which means that a high correlation between the target and the bidder' share price creates more value for bidding banks.
- The *profit efficiency* of a transaction which indicates that merger transactions are more successful if bidders are more profitable than targets.
- The *cost efficiency* of a transaction which indicates that transactions with a large cost efficiency similarity are more successful.
- The *capital market performance* of the target which shows that the share performance of a target is considered a good proxy for management quality.
- The *experience of the bidding bank* which indicates that the positive outcome of a merger transaction depends on the frequency of conducting merger transactions.
- The *method of payment* which shows that target and bidder's shareholders prefer cash payments because it is more value creating than share payments.

6.2.4 The non-financial and financial implications of an acquisition

Any merger or acquisition transaction will have a huge impact on a company. The financial performance of a company will be affected as well as certain non-financial issues for example, management structures, communication and organisational culture.

6.2.4.1 Non-financial

The implications of management's role in the acquisition process (objective 1.4.2.4, page 3) were discussed in Chapter four (paragraph 4.2, page 38). The research has stressed that the human aspects of mergers and acquisitions should be granted the same emphasis and attention usually devoted to financial, legal, and strategic concerns.

The management strategy must stress honesty, clarity and a feeling of involvement by employees. Carefully designed integration programmes need to deal with communication, transition management, organisational structure, cultural assessment and the development of common policies and practices.

6.2.4.2 Financial

Firstly, the importance and effect of measuring performance were discussed in Chapter four (paragraph 4.3, page 49). Performance measures quantitatively tell the organisations something important about their services and the processes that produce them and provide the organisations with the information necessary to make intelligent decisions.

The financial impact of an acquisition (objective 1.4.2.4, page 3) was also explained in Chapter four (paragraph 4.3.1, page 50). This chapter investigated the content of traditional financial performance measures (such as ROE, ROA and net income) and non-traditional measures (such as RI and EVA) in the light of creating shareholder value within the banking industry specifically.

Because of the importance of creating shareholder value during and after an acquisition transaction, these specific measures were identified as indicators of financial well-being for this research.

6.2.5 The impact of the success factors on the Absa-Barclays transaction

The effect of the ten driving factors of success on the Absa-Barclays transaction (objective 1.4.2.5, page 3) was discussed in Chapter five (paragraph 5.3, page 65). Analysing these ten driving factors of merger and acquisition success with regard to the Absa-Barclays acquisition has led to this conclusion: Eight out of the ten factors contributed to the success story of this acquisition.

The fact that two of the factors contradict the findings in the extensive research done in Chapter four, does not mean that the transaction will fail. Although the acquisition was cross-border, Absa still created value from the transaction and even though it was difficult to determine whether the target company (Absa) was growing at a faster rate than the bidding company (Barclays), this transaction was still a major success.

6.2.6 The impact of the Absa-Barclays transaction on non-financial issues

The Absa-Barclays transaction had a great impact on management and people in the organisation (objective 1.4.2.6, page 3). In Chapter five (paragraph 5.4, page 74) the effect of various non-financial issues on Absa's employees and management's ways of conducting business were discussed. This effect was determined by the completion of a questionnaire (Appendix A, page 96) by a human resource manager and employees from various departments.

The conclusion that can be drawn is that greater shareholder value was delivered during this acquisition because the human aspect had been

recognised and taken into account. Communication was open and frequent, the management structure was streamlined and both managers and employees were assured that their jobs were secure. The Absa Group emerges from this research as a good example of how the human aspects of the acquisition should be managed.

6.2.7 The effect of the Absa-Barclays acquisition on Absa's financial performance

The acquisition definitely had an impact on Absa's financial performance (objective 1.4.2.7, page 4). This impact was discussed and illustrated in Chapter five (paragraph 5.5, page 79). From the financial measures used, it can be seen that the acquisition definitely had a positive impact on Absa. All four measures, namely (ROE, ROA, RI and EVA) showed significant increase and growth since the acquisition announcement in September 2004.

This improvement in financial performance indicates that the acquisition was a financial success and that Absa has created even more value for their shareholders. This also proves that an acquisition transaction can be completed successfully with positive consequences.

6.3 RECOMMENDATIONS

To ensure the success of any merger or acquisition the following recommendations are made:

- In evaluating any proposed merger/acquisition, managers must have regard for both financial and non-financial drivers. A strategic plan for the combined entity must be developed as soon as possible. This plan should include all aspects of the business and must be reviewed frequently. The logic behind the deal must be crystal clear to everyone.

- Using the ten driving factors of success, the company should get an idea of the success potential of the merger/acquisition. Management must be clear on how growth and other critical drivers are going to be attained and must never lose sight of the strategic importance of the transaction. A clear vision, mission, goals and policies must be developed and implemented in the new combined entity.
- Integrating the different corporate cultures means more than streamlining and standardising the benefits of both organisations. It is essential to use a variety of tools, including workshops, activities and new work teams and task forces, to bring together the two cultures.
- A solid understanding of each company's workforce and the culture that surrounds it can help management develop policies and strategies that work best in the situation. This can be achieved by doing a compatibility assessment of the target company. This also allows the bidding company to do a risk analysis.
- Communicating relevant information to employees is of the utmost importance. All managers must spend time discussing the changes and how they will impact the staff. Honesty is essential and communication should be in both directions. Sessions where employees can ask questions, receive honest answers and express their concerns regarding the takeover will help to alleviate much of the anxiety and stress.
- People from different cultures must, through effective and visionary leadership, be motivated to build a new company. The future of the new company depends on the quality of its leadership.
- One of the biggest mistakes made during a merger/acquisition is to let the transaction drag on for months. It is best to move fast after the initial announcement of the acquisition so that the workforce can move

ahead and engage in meaningful work to establish the new combined entity.

- Leaving an air of uncertainty or ambiguity following the completion of an acquisition transaction could cause a newly merger firm to fail. Another pitfall after the acquisition transaction could be to bypass skilled employees for recognition or promotion. Key players in the company need to be kept informed, motivated and ready for change.
- Forming a transition committee could help to ease the process of change. This team should include members from top and middle management from both organisations to discuss what can be done in the short and long term to make a success of the transaction and the new combined entity.
- An increase in financial and operating performance should be treated as a stepping stone for further growth. The initial growth could be due to a positive reaction to the transaction. To avoid a decrease in performance after completion of the transaction, management should continue to implement new strategies to ensure continued growth.
- It is also desirable that all stakeholders who are credible must be involved from the beginning. This will ensure a good all-round understanding of the process with honest and accurate feedback on progress.

The following recommendations are made for future research:

- When another cross-border bank merger has been completed successfully, the success factors could also be identified and compared to this research.
- A model to ensure the success of a bank merger or acquisition could be compiled to assist managers in the future.

- The effect of the merger on financial and non-financial issues could be analysed a year from now to see whether the positive impact of this acquisition could be maintained.

6.4 CONCLUSION

The last research objective (objective 1.4.2.8, page 4) was reached in this chapter. Any merger and acquisition evaluation, implementation and integration require excellent management skills, speedy execution and controlling of rapid changes. The ultimate goal should be to create value for all stakeholders and to bridge the value and transition gaps.

Absa and Barclays have done all this right and was focused on success from the very beginning. The results of this acquisition have shown the positive effect on performance and management when an acquisition has been completed successfully. Cross-border mergers and acquisitions will increase in South Africa over the next couple of years as black economic empowerment gains momentum. May the answering of this research question assist in completing more successful transactions and erasing the history of failures.

APPENDIX A

LIST OF OPEN-ENDED QUESTIONS

Question 1 – Management involvement in acquisition

- 1.1 Was any other level of management – excluding top management – involved in decision-making regarding the acquisition?
- 1.2 If yes, what was the effect of including these managers in the takeover process?

Question 2 – Communication regarding the acquisition

- 2.1 How effective and frequent was communication regarding the acquisition?
- 2.2 Were employees informed about the transaction before/after/at the same time as the general public?
- 2.3 In your opinion do you think that mergers and acquisitions can have an impact on stress levels of employees?
- 2.4 If yes, do you think that efficient communication can reduce this stress?

Question 3 – Maintaining of communication

- 3.1 After the initial transaction announcement to employees, did Absa keep their employees informed about the progress of the transaction?
- 3.2 If yes, what was the impact of this frequent communication on the morale of the employees?

Question 4 – Importance of the human factor

- 4.1 In your opinion, how important was the human factor in this acquisition?
- 4.2 Why would you say it is still important even after the financial and strategic success of the transaction?

Question 5 – Difficulty of transaction implementation

- 5.1 From your perspective as a manager/employee, was this acquisition easy/difficult to implement and why?
- 5.2 Explain your previous answer with specific reference to job losses and retaining of expertise in the organisation.

Question 6 – Merging of cultures

- 6.1 When one organisation acquires another, do you think
 - a) it is possible and
 - b) it is important for their corporate cultures to merge?
- 6.2 If yes, how would you take action in merging these two different cultures?

Question 7 – Importance of communication

- 7.1 How critical was communication with employees in ensuring the success of the transaction?
- 7.2 How did your organisation handle this critical aspect of the acquisition?

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