

FINAL RESEARCH REPORT

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THE IMPACT OF FOOD AND BEVERAGE MERGERS

ON THE SHAREHOLDER VALUE

WITH THE SPECIFIC REFERENCE TO SOUTH AFRICA

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**“THE IMPACT OF FOOD AND BEVERAGE MERGERS ON
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AFRICA”**

**is my own work and that all the sources used have been indicated by
means of complete references.**

Pretoria, 30 November 2007

Wiseman Bellingham Wanda MYENI

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ABSTRACT

This study is aimed at investigating the effect of mergers and acquisitions on the share prices and dividends involving South African companies in the food and beverage industry.

A sample of 79 mergers from 1999 to 2005 was used. The data was analysed using the event study methodology and descriptive statistics. In addition, the paired t-test was also conducted to test the significance of the results. The results were presented using graphs, tables and charts.

The results showed that target companies obtained negative abnormal returns during the announcement of mergers while acquiring companies on the other hand received positive abnormal returns. The results imply that it can no longer be generalized that target companies always win and acquiring companies lose during the merger activity.

On the other hand, the dividends for target companies increased significantly after the merger, while the dividends for acquiring companies remained insignificantly negative after the merger.

CHAPTER 1

INTRODUCTION

1.1 Background

Generally, business organisations are made of various groups of stakeholders. One of such groups of stakeholders involves shareholders. Shareholders are the owners of the company. Ownership occurs by virtue of owning shares in the company.

Like any other business entity, the company sets itself goals and objectives. One of the main objectives of the company is to grow the value of its shareholders. The shareholder value involves capital gain and dividends. The company receives the capital gain when its share price increases. The company also declares dividends when it has made profit. However, it is possible that the company may not pay dividends but instead re-invest the company profits in new investment opportunities.

There are various ways in which a company can create and increase value for its shareholders. One such a way is through a merger or an acquisition. A merger is a combination of two companies in a stock-for-stock transaction. An acquisition is the purchase of stock or assets of a business using stock of the acquirer, cash or other securities (Hunt, 2004: 202).

In many instances, it is difficult to differentiate between a merger and an acquisition. However, a merger occurs when two relatively equal-sized companies come together to form one company. On the other hand, an acquisition occurs when a larger company buys a smaller company (Hunt, 2004).

Once the company has taken a decision to merge with or acquire another company, the challenge remains on how to accomplish the process. According to Mullins (2006) there are three options available to pursue the merger activity.

Firstly, mergers can be achieved by using the pooling of interest method. This method allows merging companies to exchange their ordinary shares based on a specific proportion.

Secondly, a merger can be achieved by purchase acquisition. Purchase acquisitions involve one company purchasing common stock or assets of another company. In a purchase acquisition, one company decides to acquire another and offers to purchase the acquisitions target stock at a given price in cash, securities or both. This offer is called a tender offer because the acquiring company offers to pay a certain price if the target shareholders surrender or tender their shares. Typically, this tender offer is higher than the stock current price to encourage the shareholders to tender their stock (Mullins 2006:2). In the case of Afgri Operations and Laeveld Korporatiewe Bellegings (LK), Afgri “made a cash offer of R5,40 a share to acquire all shares of LK in terms of the scheme of arrangement” (Smith, 2002).

The third way of merging companies is consolidation. Under consolidation, currently operating companies are closed down and a new company is established. A similar case occurred in South Africa whereby Stellenbosch Farmers Winery (SFW) and Distillers Corporation merged to form a new company called Distell in the year 2000 (Hasenfuss, 2000). This method allowed merging companies to bring their assets together. In addition, the shareholders of both companies received shares issued under the consolidated company (Mullins, 2006).

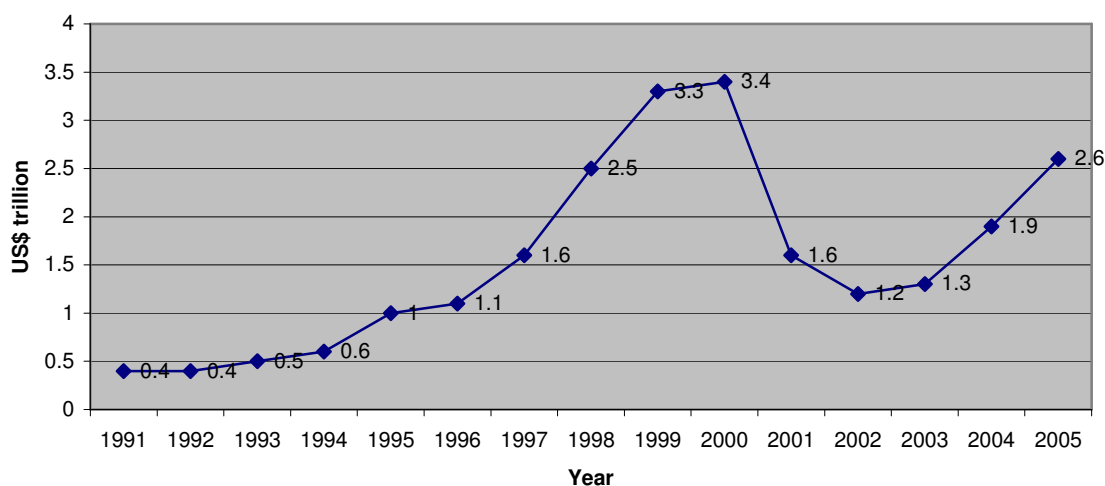
1.1.1 Mergers and Acquisitions

(a) Mergers and Acquisitions: The Global Overview

There is generally a world-wide interest in the merger and acquisition activity. This is manifested by an increase in the value of global transactions, which rose by 38,4% from \$2 trillion in 2004 to US\$2,7 trillion in 2005. Such an increase could be attributed, amongst other factors, to an increased demand for energy assets, easy access to capital and a record amount of private equity raising (Ernst and Young, 2006:5).

Figure 1.1 shows that the global trends on M & A from 1991 to 2005. From 1991 to 2000, mergers increased by annual average of 75 percent from US\$0.4 trillion to US\$ 3,4 trillion. From 2000 to 2002, the merger activity decreased by 64,7 percent (annual average of 21,6%) from US\$3,4 trillion to US\$1,2 trillion. Thereafter, Mergers and Acquisitions have since increased by 116,7% from US\$1,2 trillion in 2002 to US\$2,6 trillion in 2005 (Ernst and Young, 2006).

Figure 1.1: Global Trends on Mergers from 1991 to 2005 (US\$ trillions)



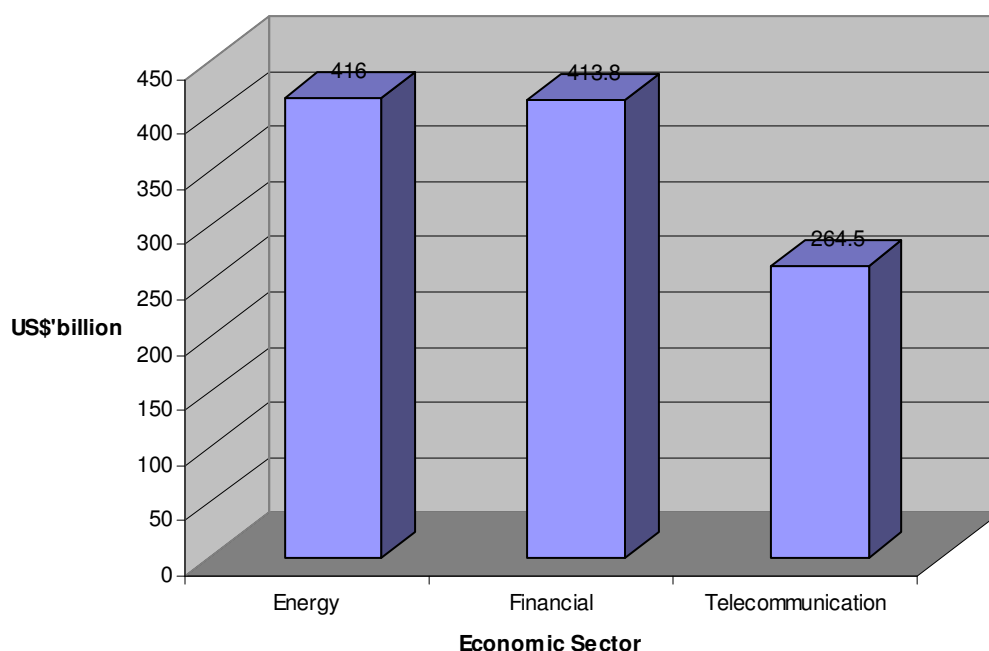
Source: Ernst and Young, 2005 Mergers & Acquisitions Review, 2006.

(i) US and Europe

Private equity played an important role in shaping the M & A activity in the US and Europe. This is manifested by US\$ 400 billion generated through M&A transactions involving private equity companies. In the US market, private equity M&A transactions amounted to US\$141,3 billion in 2005. Private equity firms also dominate merger activity in the European market. The Economist Magazine confirmed this report in its September 2005 edition. The magazine reported that about 33 percent of mergers in the continent of Europe involve private equity firms (Ernst and Young, 2006:5).

The merger activity differs from sector to sector. Figure 1.2 on global merger activity for each economic sector attests to this view. The energy and power sector attracted the highest number of merger deals valued at US\$416 billion in 2005, just over 40% increase from 2004 levels. The financial sector followed suit in the second place with merger transactions to the value of US\$413,8 billion, a 28,5% rise compared to 2004. The telecommunications sector was ranked third with merger deals valued at US\$264,5 billion, 19,4% higher than 2004 (Ernst and Young, 2006:5).

Figure 1.2: Global Merger Activity Per Economic Sector



Source: Ernst and Young, 2005 Mergers & Acquisitions Review, 2006

(ii) China

Mergers and acquisitions are not only limited to developed countries such as United States and Europe. Emerging economies such as China are beginning to take advantage of growth opportunities provided globally by mergers and acquisitions.

This is manifested by the 14,5% increase in the number of M and A transactions in China from 749 in 2004 to 857 in 2005. The aggregate value of M&A transactions amounted to US\$46,4 billion, which was a 34% rise compared to the year 2004 (Ernst and Young, 2006: 5-6).

One of the distinguishing features of the China's M&A activity is that it extensively involves cross-border transactions. However, Chinese firms are not going it alone in their (cross-border) bidding efforts—they are increasingly teaming up with foreign funders (Ernst and Young, 2006:6).

(b) Mergers and Acquisitions: The Overview of South Africa

Although South Africa experienced a 10,6% decline in the number of mergers and acquisitions transactions, as reported by Ernst and Young survey, from 832 in 2004 to 744 in 2005, the Rand value of reported transactions increased by 63% to R269,1 billion (2004:\$165,5 billion)(Ernst and Young, 2006:13). The decline in merger activity suggests that companies are no longer pursuing the merger and/or acquisition strategies as a vehicle for growth due to the availability of other growth options. The decline in merger activity may have been worsened by the fact that mergers may have become a costly exercise to finance.

Old Mutual and Skandia is one of the biggest M&A deal in 2005 valued at R38 billion, followed by Barclays-Absa group deal and Kumba Resources- Shareholders M&A deals in the second (R29,8 billion) and third place (R25,8 billion) respectively (Table1.1).

The financial sector, particularly the life assurance and banking industries rank the highest sectors (first and second) in SA M&A deals per sector. The mining sector followed in the second place with one of the expensive M&A deals in SA.

TABLE 1.1: 2005 TOP MERGERS AND ACQUISITIONS IN SOUTH AFRICA

No	Parties involved	Transaction values (R'billion)	Sector
1	Old Mutual plc and Skandia	38.0	Life Assurance
2	Barclays Bank and Absa Group	29.8	Banking
3	Kumba Resources and Shareholders	25.8	Mining
4	Vodafone and Venfin	21.0	Investments
5	Public Investment Corporation and MTN	8.6	Telecommunication
6	Old Mutual, Nedcor and Mutual and Federal	7.2	Life Assurance
7	CCMPCapital Asia and Waco International	5.4	Private Equity
8	Royal Bafokeng Holdings and Impala Platinum	5.2	Mining

Source: Ernst and Young, 2005 Mergers and Acquisitions Review

The fact that a bank like Barclays is coming back to South Africa is a signal that the banking industry is confident about the stability of South African economy. However, this may have a negative effect on the South African economy particularly the balance of payments. There would be an outflow of capital from South Africa in the form of dividends payout. This outflow of cash through dividends payments may be traded off by the capital inflow that would be obtained as a result of Old Mutual expansion to Scandinavia.

(c) General outlook

The M & A prospects do not seem to be looking good globally, according The Economist. This assertion emanates from the cautious approach exercised by global companies and dealmakers in their M & A dealings. The cautious approach is attributed amongst other things to the collapse of the large number of companies and destruction of shareholder value in the 1990s (Ernst and Young, 2006:6).

The mergers and acquisition trends suggest that there is a growing interest both globally and domestically regarding the merger activity. It is however not clear as to what the motives are behind such an interest. The next section will therefore discuss the reasons why companies merge with or acquire one another.

1.1.2 Reasons for Mergers and Acquisitions

There are various reasons why companies engage themselves in mergers and acquisitions. Some companies would like to gain economies of scale, others seek opportunities for growth, while others would like to diversify their product line, accessing new markets or acquiring the new technology. Some companies may wish to leverage joint synergies or simply acquire a competitor (Hunt, 2004:210).

(a) Gain scale

Gaining the scale is one of the commonly cited reasons for entering into mergers and acquisitions. It enables companies to rapidly grow in size, access new markets, new customers, new geographic regions or new products and services (Hunt, 2004:210-211).

(b) Growth

For a company to create value for its shareholders, it needs to grow. Growth is however not possible particularly where industries are matured or competitive. There are various ways in which companies (can) achieve growth. One such a way is through a merger or an acquisition.

Growth through M&A involves acquiring businesses that are in the same or similar industries or sectors as purchaser or acquiring companies in new industries or sectors (Hunt, 2004:211). This strategy enables companies to generate more revenue while reducing costs by gaining economies of scale and scope.

The opponents of mergers however argue differently that higher growth achieved through mergers is motivated by the desire of managers to increase their compensation and/or engage in empire building (Olson and Pagano, 2005: 2027-8).

(c) Diversification

Some companies tend to pursue mergers and acquisitions through diversification. Diversification through mergers and acquisitions is achieved by acquiring or merging with companies in industries dissimilar to that of the acquirer. This enables the acquiring firm to enter markets or offer products and services that are in industries with higher growth opportunities (Hunt, 2004:211).

Although diversification is capable of strengthening the management expertise of the acquiring firm in the new sector or industry being entered into, it may also distract the company from its core business (Hunt, 2004:211).

(d) Synergies

Synergies are a common feature of every Merger and Acquisition transaction irrespective of a reason for merger or acquisition. A synergy can be defined as leveraging the combined strengths of two parties to a transaction such that by adding the individual capabilities of the two companies, their sum is greater than their parts (Hunt, 2004: 213). Companies merge or acquire one another in order to take advantage of operating and financial synergies. Firstly, operating synergies are those synergies that come as a result of operations of two companies being consolidated (Hunt, 2004:214). They enable the company to increase its revenue, reduce both the cost of goods sold and operating expenses. In essence, operating synergies enable the merging parties to improve their financial performance.

Secondly, financial synergies are those synergies aimed at enhancing the company's capital structure or improve its ability to obtain financing on favourable terms. When the company increases its assets and cash flows through a merger of acquisition, banks and other lending institutions may be willing to provide the combined company with capital on more favourable terms because of the increased security provided by assets and cash flow (Hunt, 2004:214).

(e) Enhance Research and Development

Some companies engage in mergers and acquisitions with the main purpose of expanding their research and development capabilities. This practice is common with pharmaceutical and technology companies. Some of these companies usually do not have the existing technology, or development costs may be prohibitive, or Research and Development (R&D) funding costs are high. These R&D acquisitions enable the companies to by-pass the development stage of the product and focus on the production and marketing of the product. According to Hunt (2004: 211), buying a company that has already invested large amount of capital in developing the technology enables the acquiring company to capture earnings upside without the prior earnings dilution associated with development costs.

(f) Integration

One of the reasons why companies merge or acquire one another is because they want to integrate the company forward or backward throughout the value chain (Hunt, 2004). Integrating forward enables the acquiring firm to have access to the distribution facilities whilst integrating backward strengthens the manufacturing capability of the acquiring company.

The acquiring company can save costs during the merger and acquisition process by purchasing instead of building facilities from scratch. Integration can also provide the acquiring company with management expertise, which may be needed to successfully implement the strategy (Hunter, 2004).

Irrespective of the industry and purpose, news about mergers and acquisitions affect the prices of shares for publicly listed companies. The next section will, therefore, introduce the share prices in the merger and acquisition equation.

1.1.3 Share price

When one looks at how the stock market has performed at “the end of each trading day”, it is sometimes difficult to establish “why the share prices have either risen or fallen in value” (London Stock Exchange, 2006).

Generally, “share prices are influenced by news or information: new data on employment, manufacturing, director’s dealings, political events or even the weather, all kinds of news can influence the way share prices move” (London Stock Exchange, 2006).

(a) Factors influencing the share price

According to the London Stock Exchange (2006), share prices are influenced by various factors, amongst others, namely: the economy, , analysts’ reports, company news, press recommendations and technical influences.

(i) Economy

The state of the economy plays a significant role in influencing the share prices of publicly listed companies.

According to Funke and Matsuda (2006: 202), when the economy is experiencing strong growth (recession), higher than expected Gross Domestic Product (GDP) growth rates may lead to a fall (rise) in share prices. They argue that one possible explanation for the boom (recession) period is that it may lead to concerns (hopes) that interest rates may increase (decrease).

Furthermore, when the economy is growing (declining), the stock prices react negatively (positively) to news regarding the rising levels of unemployment. The reason is that unemployment is generally a bad (good) signal for economic growth and thus most likely also for investor growth expectations (Funke and Matsuda: 2006: 202).

(ii) Analyst Reports

Independent analysts play an important role in providing financial information necessary to make investment decisions. They do so by providing financial reports that are published in the financial news, websites, newspapers and magazines. These reports, depending on whether they recommend a 'sell', 'buy' or 'hold', tend to have a significant effect on the share price.

The share price of Biovail Corp decreased by 55 % from \$55 in 2003 to \$25 in 2006. The dramatic decline in the share price was attributed to the holding rating recommended by 90% (8 out of 9) of the stock analysts. About 10% (1 out of 9) of analysts labelled the stock as underperforming. Negative reports, like these, contribute to the fall in share price (Masters, 2006:1).

Furthermore, the share price of Overstock decreased by 63% from \$73 in 2004 to \$27 in 2006. The sharp decline in the share price occurred because 10 analysts who monitored Overstock, 60% (6 out of 10) recommended a 'holding' rating and 40% (4 out of 10) recommended the 'selling' of company shares by investors (Masters, 2006:1). Negative reports, like these, contribute to the decline in the share price.

It can therefore be concluded that negative reports by stock analyst such a 'sell' or 'hold' rating tend have a negative influence on share prices of publicly listed companies and vice versa.

(iii) Company news

The manner, in which investors, interpret the news received from companies is also a major influence on the share prices. A case in point occurs when a company sends out a caution that the business conditions are not favourable for good financial results, the share price will often fall in value. "If, however, the director purchases the shares in the company, it may be a signal to investors that the company prospects look promising"(London Stock Exchange, 2006).

The fluctuations in the stock price usually manifest themselves when a publicly listed company announces a merger or an acquisition, which subsequently leads to a change in the price of shares (Hunt, 2004:3-4). The announcement of a merger or acquisition suggests that new information can positively or negatively affect the shareholder value depending on how the stock market reacts to new information.

(iv) Press recommendations

Does media reporting have an effect on the share price? Dyck and Zingales (2003: 1) agree to this assertion. They argue that share prices tend to react to the type of earnings emphasized by the press. A working example was provided by the New York Times newspaper.

On May 3, 1998 the editor of New York Times newspaper published a story on the front page of the Sunday edition. The story involved a new idea in the development of a new cancer -cure drug by the Entremed, a biotechnology company with licensing right to the breakthrough. When the news were published the stock price quadrupled the following day (Dyck and Zingales, 2003:2).

Furthermore, newspapers, investment magazines and other media usually have financial columns that provide tips on shares. These tips tend to have a huge impact on share prices of affected companies. For example, the editor of Mirror newspaper provided a tip on the shares of the technology company. The tip resulted in the share price increasing twofold (Tran, 2000).

These cases are consistent with the view that if the journalist speaks well of the particular company's share, the share price will normally increase. Similarly, any bad publicity about the company will negatively affect the share price.

(v) Sentiment

There has been a lot of debates in financial economics regarding the possible effect of investor sentiment on share prices. There is however an agreement that irrational

sentiments of investors tend to affect the prices of shares. This is usually reflected when investors buy or sell their shares irrationally due to dramatic increases or decreases attributed to excessive bullish or bearish sentiments (Cliff and Brown, 2005:405&437).

Investor sentiment is sometimes not quite possible to anticipate and can be very upsetting. A case in point is whereby an investor has purchased shares in a company she or he thinks is a good 'buy' but the price stays is flat (London Stock Exchange, 2006).

(vi) Technical influences

Share prices can rise and fall for a variety of technical reasons that may have nothing to do with the actual outlook for an individual company or the outlook for the market.

It is, for example, a common occurrence for share prices to drop back after a strong rally. This happens because investors take profits on some of the shares that have risen in value, protecting their gains just in case the shares start to slip back. Investors often refer to this as market consolidation.

Another technical reason for share prices to rise or fall is the quarterly adjustment in the FTSE 100™ index. Shares that are expected to enter the FTSE 100™ may experience a sharper rise than one would expect in the weeks beforehand while shares that leave the index can fall more sharply. This happens because funds that simply track the index have to match the composition of the index. Some professional fund managers who hold the affected stocks also adjust their portfolios as they do not want their holding to be too far above or below the company's weighting in the index.

Share prices can also be affected by investors who use technical analyses to drive their investment techniques. Technical analysis, also known as Chartism, is the study of past share price movements and stock market index trends, which are then used to forecast how shares and stock markets will behave in future.

Marketmakers can also influence prices. If they, for example, do not own enough shares to balance their books they will have to buy more. Marketmakers also influence prices if the market is looking flat, reducing prices to attract buyers(London Stock Exchange, 2006).

It is not sufficient to discuss the shareholder value by limiting the discussion only to the share price. To ensure that the concept of shareholder is holistically investigated, dividends need to form part of the study. The next section will therefore look at dividends.

1.1.4 Dividends

Olson and Pagano (2005:1998) assert that the short-term findings reported in the finance literature point out how wealth moves from the shareholders of acquiring companies to those of target companies. These results revealed that acquiring companies tended to earn zero or negative abnormal returns and target companies receive positive abnormal returns during the merger announcement. In spite of these results, the short-term announcement of impact echoes what the investor expects with regard to the prospects of mergers at the time of announcement. Owing to the asymmetry of information between investors and management, it may be difficult to realize these expectations. Therefore, the triumph or collapse of mergers should not be judged only on the effect of the announcement but on the long the long-term performance of the acquirer's stock subsequent to the merger.

Robin (1998:1) adds that corporate dividend policy has been the focus of much attention in the finance literature. However, one aspect of dividends that has not been studied in depth relates to the effect of mergers and acquisitions on dividends.

A similar view is shared by Dube and Glascock (2006:176) who argue for the need to complement stock return studies with operating performance studies. It is in this context that this study investigates the impact of mergers on dividends.

1.2 Problem statement

The problem that will be investigated in this study relates to the uncertainty of the effects regarding how the South African companies particularly in the food and beverage industry react to mergers and acquisitions.

Studies regarding the short-term effects of mergers and acquisitions agree that mergers and acquisitions create value for company shareholders. They however concede that most of the value goes to the target firms. Research in the United States of America (USA) and United Kingdom (UK) reports that the shareholders of target firms generated positive abnormal returns between 16% and 45%. While, on the other hand acquiring firms obtained abnormal returns ranging from -1% to 7,9%(Wimberley and Negash, 2004:31). This indicates that that acquiring firms have a tendency to obtain insignificant negative stock returns to smaller positive returns compared to target firms (Wimberley and Negash, 2004:31). The same cannot be said with certainty for companies in the food and beverage industry in South Africa.

Most of the studies conducted in the past regarding the impact of mergers and acquisitions tended to concentrate on financial services sector particularly the banking industry (Kusnadi et al, 1999:109). This resulted in little attention being given to empirical studies in other industries such as food and beverage industry. The reason is that the food and beverage industry is often the neglected or ignored industry when it comes to studying the effect of mergers and acquisitions to a particular industry. This paper will therefore deal with the impact of mergers and acquisitions in the food and beverage industry.

According Dragun and Howard (2003:42), a significant number of studies have been conducted in the past to investigate the generic effects of corporate consolidations on shareholder value. They however discovered that sector scrutiny has been lacking in the previous studies. The scarcity or inadequacy of sector studies necessitated that a similar investigation regarding the impact of merger be conducted in the context of South African food and beverage industry.

However, few studies tend to concentrate on the impact of mergers on the long-term performance of the merged companies. This view is supported by Olson and Pagano (2005: 1998) who argue that prior research on bank mergers tended to focus on the short-run effects of merger announcements on both acquiring and target firms' returns. As a result, very little attention has been given regarding the effect of mergers on dividends. Dividends are part of shareholder value. However, the emphasis tends to be on one aspect of shareholder value, that is, share price. Dividends are often left out. The study will include the investigation on the impact of mergers on dividends. This will enable the study to also provide a long-term view regarding the performance of mergers, which has always been lacking.

1.3 Research objectives

The primary purpose of this study is to investigate the effect of mergers and acquisitions announcement on the return on share prices and dividends that involve companies in the food and beverage industry. The investigation will, firstly, assist in determining how the investors in the stock market react to the announcement of food and beverage mergers. Secondly, it will look at the long-term effect of mergers and acquisitions on dividends.

(a) Specific objectives

The following are the specific objectives of the study:

- ❖ To determine the short-term effects of food and beverage mergers and acquisitions on the stock price of both acquiring firms and target firms. This objective involves establishing whether the merger or acquisition effect is significant from the normal stock returns
- ❖ To determine the long-term effect of food and beverage mergers and acquisitions on dividends of both acquiring firms and target firms. This objective also involves testing the significance of the dividend results.

1.4 Scope of the research

The research will be limited to South African mergers and acquisitions that involve at least one publicly listed company on the Johannesburg Stock Exchange. While large sample studies enhance the confidence in the generality of results, analysis at industry level is a useful vehicle to isolate a particular issue related to mergers (Mulherin, 2004). Hence, this study will focus on the manufacturing sector particularly the food and beverage industry. The study will cover mergers and acquisitions starting from 1999 to 2005.

The research will not include the analysis regarding the size of firm, the type of merger and the payment methods used in the merger and acquisition transactions. However, these could be areas for further research.

1.5 Contribution of the study

The benefit of this study is two-fold. Firstly, the results of this study may be useful in educating the management of publicly listed companies about the consequences of pursuing mergers and acquisition strategies on shareholder value in different countries and industries. Secondly, both components of shareholder value, namely: share price and dividends may be of importance in explaining the short and long term effects of mergers and acquisition on the total shareholder return.

1.6 Outline of the study

The study consists of six chapters. After this introduction, Chapter 2 provides the profile of food and beverage industry of South Africa. Chapter 3 reviews the literature that is relevant to the effects of mergers and acquisitions on share prices and dividends. Chapter 4 presents the research design and research methodology including the data collection methods and sources of data. Chapter 5 presents, summarises and analyses the findings of the research. Lastly, Chapter 6 discusses the results and draws conclusions.

CHAPTER2

PROFILE OF FOOD AND BEVERAGE INDUSTRY IN SOUTH AFRICA

2.1 Introduction

This Chapter looks at the profile of the food and beverage industry of South Africa. It entails looking at the external environment, industry environment and company environment.

2.2 External environment

The business environment, in which companies in the food and beverage industry operate, is affected by various factors that are beyond their control. These factors involve: legal, economic, social, political and technological factors. These factors will be discussed in more detail below.

2.2.1 Legal environment

The food and beverage industry is affected by various pieces of legislations. These legislations involve, Companies Act, Competition Act, Value Added Tax Act, Security Exchange Services Act, Intellectual Property Rights and Black Economic Empowerment. The list is however not exhausted.

(a) Companies Act

Like any other company in South Africa, food and beverage companies have to comply with statutory requirements as prescribed by the Companies Act. Section 98 of the Companies Act requires the directors of a company to present company's annual financial statements containing the balance sheet, statements and reports at the annual general meeting.

Financial statements contain information (such as profits) and the announcement of this information generally tends to have an impact on the share price of listed companies, including those in the food and beverage industry.

The Companies Act also speaks about votes of members (S35). This is necessary because certain acquisitions or mergers require the approval of shareholders. Therefore, the votes of the members, as approval of or a go-ahead on merger or acquisition play an important role.

The Act also reflects on the appointment of Directors. When information, about new directors being appointed, fired or resign, is communicated to the stock market, it can have a negative or positive effect on shares of the listed company. Similarly, mergers and acquisitions give a signal about the change of new management because new directors may come in and old directors be removed. This news may have an effect on the shares of listed companies in general as well as food and beverage companies in particular.

(b) Competition Act

The South African food and beverage industry, particularly mergers and acquisitions, is also governed by the competition law. Once the companies have agreed to merge or acquire one, the deal needs the approval of the Competition Commission of South Africa. The Commission will evaluate the application if amongst other things it does not suppress competition.

(c) Value Added Tax Act

The food and beverage industry is also affected by the Value Added Tax Act (VAT). Some food products are exempted from VAT in South Africa. These products are “brown bread, maize meal, sump, mealie rice, dried beans, pilchards or sardines, milk powder, dairy powder, rice, vegetables, eggs, milk, brown wheaten meal, legumes and vegetable oil”(South African Revenue Services, 2006). These products are basic food essentials. The South African government does not charge tax on these food products to ensure that food is affordable even to people who live below poverty line.

The South African government increases tax (VAT) on alcoholic drinks every year during the Budget Speech. The alcoholic drinks include beer, spirits, wine, ciders and alcoholic fruit beverages. In the year 2006, the tax on wines was increased by 12,5% to 20% and the tax on spirits, beer and other alcoholic products was increased between 9% and 10% (Manuel, 2006:18).

The South African government does not charge VAT on certain food items in order to ensure that food products are affordable to all consumers. However, the government charges higher taxes on alcoholic beverage products. By so doing the government generates more tax revenue while on the other hand trying to discourage the use of alcoholic beverage products.

(d) Security Services Act

The securities services industry in South Africa was recently overhauled with the enactment of Securities Services Act 36 of 2004 (SS Act). The SS Act, which came into operation on 01 February 2005, repealed the custody and Administration of Securities Act 85 of 1992, the Stock Exchanges Control Act 55 of 19985, the Financial Markets Control Act 55 of 1989 (FMCA) and Insider Trading Act 135 of 1998 and consolidate their provisions into single Act (Du Plessis and Cassim, 2006:1).

The SS Act is aimed at increasing the level of confidence in the South African financial markets, promoting the protection of regulated persons and clients, reducing system risk and promoting international competitiveness of securities services in South Africa. Confidence in the financial markets will ensure that South Africa attracts more foreign companies to invest in the Johannesburg Stock Exchange (JSE).

According to Du Plessis and Cassim (2006:2), “the SS Act regulates securities services being services provided in respect of buying and selling of securities, the custody and administration of securities, the management of securities by an authorized user (member of exchange and the clearing and settlement of transactions in listed securities. The SS

Act also regulates market abuse consisting of insider trading and market manipulation”. The Act ensures that stock market investors are protected from unfair business practices.

(i) Security Exchanges

South Africa has two exchange markets, namely: The JSE Securities Exchange South Africa and Bond Exchange of South Africa (BESA). “The JSE Securities Exchange is an equity and derivatives exchange, while BESA lists loan stock (bonds). Both the JSE and BESA are licensed under the SS Act from 01 February 2005” (Du Plessis and Cassim, 2006).

(e) Intellectual Property Rights

To ensure that food and beverage companies continue to invest in research and development and develop new technologies and products, the Intellectual Property Rights legislation becomes a necessity. The legislation protects companies from anyone using their brands, idea, manufacturing procedure, products or innovation unless authorization was granted by the titleholder (Krummenacker, 1995).

The food industry is one the industries in South Africa that takes the protection provided by the intellectual property rights seriously. This is manifested by a largest number of companies holding intellectual property rights. Unilever, Procter and Gamble and Nestle are some of the important companies in this regard. They hold rights involving patented processes, products, equipment, packaging technology and trademarks (Business Monitor International, 2005).

(f) Black Economic Empowerment Act

When the African National Congress (ANC) assumed political power in South Africa in 1994, it was faced with massive inequalities. These inequalities were largely attributed to the policy of apartheid. The policy excluded black people, disabled and women from participating in the mainstream of the South African economy (Levitt, 2006).

In addressing the lack of participation by black people, women and disabled, the South African government came up with the broad-based Black Economic Empowerment (BEE) intervention. BEE is simply the policy intervention by the South African government to ensure that economic opportunities are afforded to Africans, Coloured, Indians, the disabled people and women. In January 2004, the Broad-Based Black Economic Empowerment Act 53 of 2003 was signed into law by the President of South Africa (Levitt, 2006:1).

The beverage component of the industry has started with process of correcting the economic imbalances of the past. The wine industry is one of the South African industries that has shown greater commitment to transformation by drafting the industry charter. The Charter will guide the industry on how to incorporate more black people in the operations and ownership of wine businesses. It is expected that once the public has made its comments and the Minister for Agriculture and Land Affairs has approved the wine industry charter, the document will then form part of the Agri-BEE charter for the agro-processing sector (Engelbrecht, 2006).

2.2.2 Economic environment

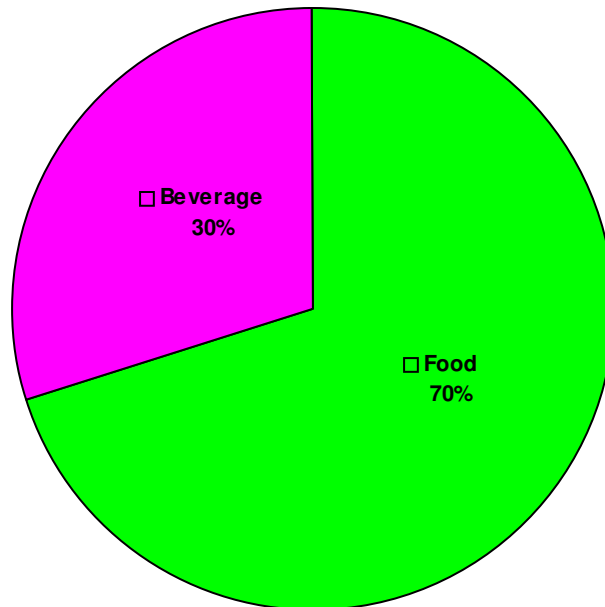
The food and beverage industry is a significant component of the South African economy. It contributed more than R27 billion (6,6%) in 2005 to the Gross Domestic Product (GDP) of South Africa (Statistics South Africa, 2006: P0441). It further provides employment to more than 211 500 people (Statistics South Africa, 2006).

(a) Market size

The South African food and beverage industry is approximately a R165 billion processing and R220 billion retail market (South Africa. National Department of Agriculture (a), 2006:107). The food industry in South Africa is partly a reflection of the country's agricultural activities" (Mbendi Information Services, 2007). It contributes about 70% of the market (See Figure 2.1). Meat accounts for 27% expenditure on food component, bread and grains for 32%, fruit and vegetables for 16%, while milk, milk

products and eggs account for 9% (South Africa. National Department of Agriculture (b), 2006:15).

Figure 2.1: Food and Beverage Market Share



Source: Department of Agriculture, South Africa, 2006

The beverage component of the industry represents about 30% of the market. It is divided into alcoholic and non-alcoholic beverage products. Alcoholic beverage products involve, amongst others, beer, wine and spirits products. They contribute about 80,6% in the beverage component. Non-alcoholic beverage products consist of juice, mageu and soft drinks. They contribute approximately 19,4% in the beverage division.

“Despite being a large exporter of alcoholic beverages, producing some of the most globally recognised brands - particularly in the premium sector - domestic consumption of alcohol is relatively low by international standards. Beer has the greatest share of the domestic alcoholic beverage market, at 47.3%, followed by sorghum beer (21.5%), natural wine (14.8%), and brandy (7.1%). Cane and grain spirit, whiskey, fortified wine

and sparkling wine account for the remaining market share”(Business Monitor International, 2005).

(b) Foreign trade

Foreign trade will be discussed under three main areas namely: exports, imports and trade balance.

(i) Exports

In its bid to increase the economic growth by raising the level of exports, South Africa exported more than R252,5 billion worth of food and beverage products in 2006. These products include sugar, including golden syrup and castor sugar, fruit and vegetables, fish and fish products and soft drinks, production of mineral waters (South Africa. Department of Trade and Industry, 2007).

“The domestic food industry exports mainly to the UK, Mozambique, Germany, Japan and the Netherlands, but new export markets, including China, Somalia, Norway, Malaysia, Thailand and Denmark, have emerged over recent years and offer the largest potential for increases in export value. South Africa is also viewed as an important entry point into other African markets due to its sophisticated economy compared with the rest of the continent”(Business Monitor International, 2005).

(ii) Imports

“Despite its agricultural expertise, the country does require imports to cater for the increased variety of products that South African consumers are demanding - particularly niche and speciality products” (Business Monitor International, 2005). Consequently, South Africa imported more than R381,8 billion food and beverage products. These products include vegetable and animal oils and fats; production, processing and preserving of meat and meat; grain mill products and soft drinks, production of mineral waters (South Africa. Department of Trade and Industry, 2007).

(iii) Trade Balance

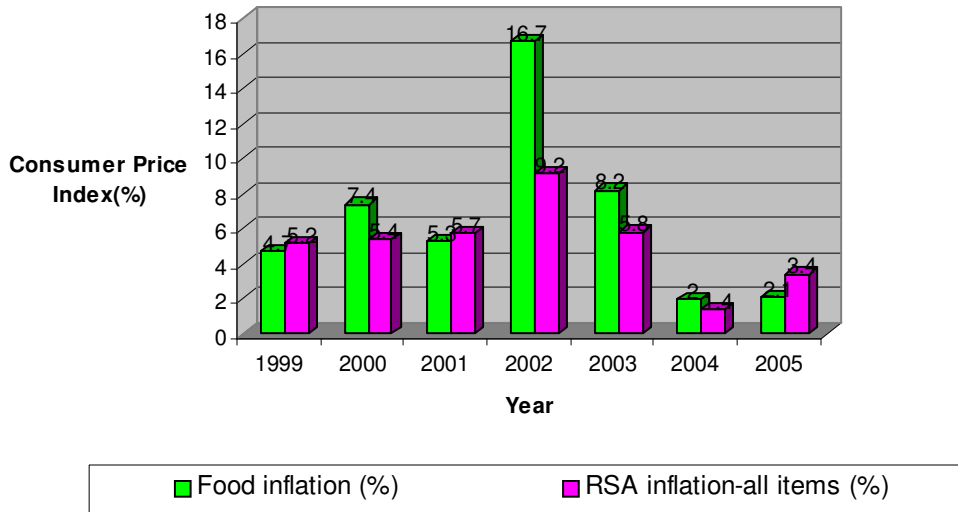
In spite of exports exceeding imports on some primary food products, South Africa is not self-sufficient in the production food and beverage products. As a result the trade balance still remains negative suggesting that food and beverage imports generally exceed exports in South Africa. The negative trade balance could be attributed to various factors. These factors, amongst others, are:

- ❖ The strength of the value of the South African currency, the Rand, which tends to be in favour of cheaper imports, while making South Africa's exports not competitive in the global market,
- ❖ Competing with countries that impose high import tariffs, while others subsidize their exports and
- ❖ The lack of export culture is cited as one of the contributing factors to the country's poor export performance

(c) Prices

South Africa is experiencing an increase in food prices. The Consumer Price Index (CPI) for food rose by 67% from 2,1% in 2004 to 3,4% in 2005 (See Figure 2.2 below) (Statistics South Africa, 2006). The price increase suggests that food was much expensive and less affordable compared to the previous year. On the other hand, it means that companies in the food industry were fetching higher prices on their products. Higher prices are generally known to have a positive impact on revenue and profits, which are necessary in enhancing the shareholder value.

Figure 2.2: CONSUMER PRICE TRENDS: 1999-2005



Source: Statistics South Africa

Although South Africa enjoyed low food prices in 2005, there were times when food products were however expensive compared to other consumer products. In the years 2000 and 2002 to 2004, food prices were higher than all other consumer items during those periods. This indicates that food prices rose faster than any other consumer products.

2.2.3 Social environment

(a) Unemployment

Mergers and acquisitions have both positive and negative social consequences on the South African economy. They have positive social outcomes when there are no job losses or more jobs created as a result of the merger. In a South African merger between Pioneer Foods and Ceres Investment in 2003, there were no job losses as result of the merger (Competition Tribunal of South Africa, 2003:4).

However, mergers and acquisitions have negative social consequences. In some cases mergers and acquisitions lead to the retrenchment of workers, which exacerbate the problem of unemployment and poverty. It was reported that the merger between Tiger Food Brands and Bromor Foods in 2006 impacted negatively on employment in South

Africa. The merger resulted in 60 job losses out 900 Bromor employees (Competition Tribunal of South Africa, 2006:7).

Although mergers do lead to job losses, it should however be noted that this phenomenon does not happen in all the merger cases.

(b) Skills Development

One of the challenges facing the competitiveness of the South African economy is the shortage of skills. In addressing the problem, the South African government established the Sector Education and Training Authorities (SETAs). The food and beverage industry has its own SETA known as FoodBev SETA. The FoodBev SETA is one of 25 SETAs in South Africa entrusted with responsibility of promoting, facilitating and incentivising skills in the food and beverage manufacturing sector (FoodBev SETA, 2006).

(c) Religion

South Africa has a number of religious denominations. These include Christianity, Muslim, and Hindu. Christianity is the dominant religion with 80 percent of South Africans following the religion. Muslim and Hindu religions follow second and third with 1,5% and 1,2% respectively (Government Communication Information System, 2007). These religions tend to prescribe what their members should or should not eat or/and drink. Some of these religious beliefs support or discourage the use of certain food products as well as beverages. For example, the consumption of pork is not allowed by some sections of Christians. Similarly, Hindu members do not eat beef, but encourage the consumption of poultry. Thus religion has an impact on the food items that people consume.

The use of alcoholic drinks is not allowed by a number of religious beliefs, whether Christian, Muslim or Hindu. This in actual fact discourages the consumption of alcoholic beverages. Therefore, religion has an influence in the consumption of food and beverage products

(d) HIV/AIDS

It is estimated that in 2005 there were about 5,5 million (8.5%) people were infected with HIV/AIDS virus in South Africa (UNAIDS/WHO, 2006). Because of their nutritional value, certain food items such as beetroot, carrot and garlic are recommended as nutritional supplement for people living with HIV/AIDS virus. This however creates more demand for these vegetable products.

From the supply side point of view, HIV/AIDS has a negative impact to the food and beverage industry particularly because it increases high levels of absenteeism, increases medical costs, reduce the level of productivity. Lastly, it largely contributes to the shortage of skills in the food and industry and the country.

Although HIV/AIDS is a deadly disease, it creates more demand for certain food products particularly vegetable products.

2.2.4 Political environment

“South Africa is a member of Codex Alimentarius and the Department of Health works closely with industry members through the Food Legislation Advisory Group (FLAG). Industry members comply with HACCP (Hazard Analysis of Critical Control Points), ISO 9000 series and SPC (Statistical Process Control) standards, which are internationally recognised ”(Business Monitor International, 2005).

2.2.5 Technological environment

The South African Association for Food Science and Technology (SAAFoST) represents the interests of the food industry and has been at the forefront in establishing the Food Advisory Consumer Services (FACS)(Business Monitor International, 2005).

Although the analysis of the external environment is important in understanding profile of food and beverage, it is however not a true reflection of competitive environment. The next section will therefore look at the competitive environment of the food and beverage industry in South Africa.

2.3 Industry environment

This section will discuss the competitive situation of the South African food and beverage industry. Five forces tool will be used to conduct the analysis. The tool involves looking at the intensity of rivalry, barriers to entry, bargaining power of suppliers, bargaining power of customers and threat of substitute products.

2.3.1 Intensity of rivalry

(a) Industry growth

The food and beverage industry has been experiencing a tremendous growth in demand over the years. From 1999 to 2005 period, expenditure on food and beverage products in South Africa increased by 70,5% (11,75% annual average) (South Africa. National Department of Agriculture (a), 2006). Such an increase in demand may be attributed amongst other things to an increase in the South African population by 9,3% from 43,054 million in 1999 to 46,888 million in 2005.

However, the strengthening of the South African rand against the British pound has reduced the export of wines to the United Kingdom (UK) which has been South Africa's largest market. The decline could have a negative effect on the beverage industry due to the loss in export revenue.

In spite of poor performance of the wine exports to the UK, the outlook for the food and beverage industry in South Africa looks bright. The reason for good prospects is that the exports to the European Union (EU) are anticipated to rise as South Africa will benefit from the Free Trade Agreement (FTA). The EU-SA FTA suggests that that the exports of South Africa to the EU market will be duty free as from 2009. 's he country will benefit from the duty-free access to the EU market from 200(Business Monitor International, 2006). The zero tariffs will enable South African products, including food and beverage, to be cheaper and more competitive in the international market.

(b) Concentration

(i) Food industry

The food industry is highly competitive in South Africa and there are over 1,800 food production companies, although ten large players dominate the industry - accounting for 68% of total turnover. Key players include Unifoods, Robertsons (Best Foods), Anglo Vaal GP, Tiger Oats GP, Anglo American, Nabisco, Nestlé and Glen Foods (Business Monitor International, 2006).

(ii) Beverage industry

South Africa also has a well-established beverage industry, which is currently experiencing considerable growth, especially in the brewing and wine sub-sectors. "The brewing industry is dominated by SABMiller with the market share of 98%. SABMiller was created through a merger of South African Breweries (SAB) and Miller Brewing Company in 2002. However, the single dominance of SABMiller actually reduces the intensity of rivalry within the brewing industry. Almost 70% of the company's income is derived from beer, and the remainder from soft drinks and sorghum beer, although the latter's market share is declining. SABMiller is one of the world's largest brewing companies (Business Monitor International, 2006).

The soft drinks business in South Africa is dominated by Cadbury Schweppes, which was bought out by The Coca Cola Company in 1999. The company sells and distributes its products domestically through Amalgamated Beverages Industries (ABI), which is the leading Coca-Cola system bottler in South Africa.

South Africa's wine industry, based almost exclusively in the Western Cape, is among the most significant, in terms of output and reputation, in the world. The sector is also growing rapidly because of the considerable attention from wine producers globally who are interested in partnerships to assist them in gaining a foothold in the profitable South African market. The top five high-priced brands all come from the Stellenbosch Farmers Winery, which merged with the Distillers Corporation in 2001 to form Distell Group Ltd. Distell Group currently has an approximate 40% share of South Africa's premium and

super premium wine markets. It has an annual production capacity of 180mn litres of wine.

2.3.2 Threat of entry

(a) Access to suppliers

The South African food processing industry has the capability of integrating backward. Backward integration enables the large publicly listed companies to expand their production capacity. It also reduces dependence on other suppliers of raw agricultural products. Anglo-Vaal Industries (AVI) and Tongaat-Hullet are examples of companies that have backward linkages. These companies produce primary raw material, which is then processed into food products (Mather, 2005).

Although backward linkages within the food and beverage industry had positive results in terms of cutting costs of sourcing the production inputs, it however created a barrier to entry for new entrants in the industry. New entrants may find it difficult to access the stock of the product with backward linkages.

(b) Access to distribution channels

The food and beverage industry is also characterized by companies that integrate forward. Forward integration allows companies to have control on their distribution channels and their sales. Tiger Brands is the case in point in this regard. The company has a major equity stake in the Spar retail group and the grain milling industry (Mather, 2005).

(c) Government policy

There are various ways in which government policy threatens the food and beverage industry in South Africa. Firstly, government may require companies to comply with the legislation. A case in point is the need for companies to comply with BEE legislation. This has led to the concern that “BEE initiatives could be costly for the new market entrants to comply with”(Business Monitor International, 2006).

Secondly, the government also limits entry in the beverage industry by requiring business licences. For instance, the liquor legislation in South Africa requires that liquor be sold only by licensed outlets. It also prohibits supermarkets from selling beer and other liquor on Sundays ”(Business Monitor International, 2006).

As a result, government policy may have unintended consequences of discouraging new companies from entering the food and beverage industry.

2.3.3. Bargaining power of customers

According to Pearce and Robinson (1997:101), individual consumers are the ultimate buyers of food and beverage products. However, wholesalers and retailers are the distributors of processed food and beverages to the end-users. Table 2.1 suggests that in 2005, more 3700 outlets were used to distribute food and beverage products. Supermarkets and convenience stores are the main customers. It also implies that supermarkets and convenience stores have more bargaining power than the others. They have the ability bring the prices down.

Table2.1: Structure Of South Africa's Food Retail Market (By Number Of Outlets)

Type of retail market	2000	2001	2002	2003	2004	2005e
Supermarkets	1,422	1,411	1439	1,461	1,495	1,540
Hypermarkets	32	32	64	71	80	88
Discount stores	19	25	28	32	36	40
Convenience stores	1,579	1,660	1793	1,860	1,950	2,070
Total mass retailers	3,052	3,128	3,324	3,424	3,561	3,738

e = BMI estimate. Source: Official statistics, BMI calculations

Source: Business Monitor International,4th Quarter Report, 2006

(a) Customer concentration

Growth prospects, in the South African food and beverage industry, look promising. Large retail companies such as Woolworth are expanding their retail outlets into

previously neglected areas. These areas include townships where retailers have not yet developed. It is expansion initiatives like these that are expected to contribute to the remarkable growth forecast for the discount sector.

According to BMI, food and beverage industry is projected to grow by 78,8% to US\$ 934 million in 2010. The substantial amount of this growth is expected to be created in those areas that do not use modern retailing. However, the price will still be a major determinant behind buying decisions in those areas (Business Monitor International, 2006).

(b) Price sensitivity of customers

There are various factors that a customer considers before making a buying decision. Price is one of these factors. According to (Business Monitor International, 2006), customers do not see the price playing any influential role in determining the purchasing decision anymore. They argue that the influence of price is declining and is being replaced by the preference for convenience and wide range of products.

There is a threat that the downturn in the economic situation of South Africa may see consumers instantly going back to discount stores as well as reducing on non-essential products.

2.3.4 Bargaining power of suppliers

(a) Supplier concentration

Agriculture is a very diverse economic sector. Its diversity is reflected in the different industries that are processing food in South Africa. According to the latest Census for Agriculture conducted in 2002, the South African agricultural sector has more than 45 000 commercial farmers (Statistics South Africa, 2004). These farmers supply food and beverage industry with primary agricultural products. These products are used in the production of food and beverage products.

The large number farmers, who supply the food and beverage industry, is a clear indication that the bargaining power of suppliers is very low. This was also manifested in the milk industry whereby milk producers receive low prices per litre and were unable to influence the price increase with the dairy processors.

(b) Importance of product

(i) Shortage of Maize

However, there are instances where suppliers have more power than food and beverage processors. Maize is an important commodity in South Africa particularly because it is a staple food in South Africa for Black people. A shortage of maize tends to have positive effect on prices of suppliers. South Africa is expected to harvest less maize than was initially projected. This may negatively affect staple food. The decline in the yellow maize may also negatively affect the animal feed industry, particularly ASTRAL. But the producers of these agricultural products are expected to charge high prices, which could lead to high profits for maize farmers.

(ii) Shortage of carbon dioxide

In October 2006, South Africa experienced a shortage of carbon dioxide. The shortage meant that highly demanded soft drinks like Coca-Cola, Sprite and Fanta would be in short supply because of the shortage of carbon dioxide (CO₂), the key ingredient needed to put bubbles in fizzy drinks (Business Report, 2006).

Coca Cola South Africa was mostly affected because CO₂ supplier namely AFROX was struggling to get sufficient stock from the primary CO₂ sources in the industry.

The fact that AFROX is a single supplier of carbon dioxide to the soft drink industry in South Africa suggests that the supplier in this case has a strong bargaining power.

2.3.5 Threat of substitution

Soft drinks compete with a wide variety of substitute products. These products include coffee, beer, milk, tea, bottle water, juices, powdered drinks, wine distilled spirits and tap

water (Ghemawat, 1999). The large number of substitute products enables buyers to have a wider choice when selecting an alternative product.

The soft drink industry uses a wide variety of chemical compositions in their products. The carbonate is one of the dominant chemical products utilized by the soft drink industry. “However, in line with global shifts towards health consciousness, other product sub-sectors that are considered healthier than carbonates, such as fresh juices and bottled waters, are increasing in popularity. Despite this, and unlike in many markets where the same trend has been witnessed, carbonates remain a long way ahead, with other product categories still having a lot to do in terms of mounting serious competition in the sector”(Business Monitor International, 2006).

2.4 Company environment

The company environment involves looking at the analysis of the five companies’ market position, strategy, financial data and investment potential. These companies involve: Tiger brands; Illovo; Pioneer Foods; Distell and SABMiller. All companies, except Pioneer Foods, are listed the Johannesburg Stock Exchange.

Table 2.2: Tiger Brands

(a) Market Position

(b) Company Data

Tiger Brands is the company that dominates the food industry with its leading brands. The company has business interests in a wide variety of industries. These industries include milling, baking, confectionery, rice, pasta, fruit and vegetable industries and pharmaceutical. However, grain products still dominate its business operations.

Turnover up 9% for the six months ended March 31, 2006 to ZAR8bn (US\$1.18bn)
 Revenue up 7% to US\$1.2bn
 Operating income up 54% to US\$230.8mn
 Food division contributes 63% to total group revenue

(c) Strategy

The company adopted a core business strategy. This strategy enabled the company to unbundled its noncore activities with Retail SPAR and keep its market position. The company also tries to raise the level of innovation culture and enhance the growth of its brands. Lastly, the company is also focusing its efforts on growing its exports.

(d) Investment Potential

It is not easy to grow in a saturated market. However, Tiger Brands is expected to pursue the acquisition strategy by buying more food companies. There is a possibility that the company may acquire those food companies that would generate profits in the short-run. In addition, the company may buy companies with brands that would supplement its current assortment of brands. The company is also expected to invest more financial resources in developing new products and marketing campaigns to assist with the launch of new products. It is however still early to conclude whether the company would commit itself to this high level of investment.

Source: Business Monitor International, 2006

Table 2.3: Illovo Sugar Limited

a) Market Position

(b) Company Data

Illovo Sugar is a global leader and low cost producer of sugar in Africa and the rest of the world. The company is also the manufacturer of high-value downstream products. The company has operations involving both the agricultural and manufacturing sectors. The company operations are based in the following countries, namely: South Africa, Malawi, Zambia, Swaziland, Tanzania and Mozambique.

Produced 1.8bn tonnes of sugar in 2005
 2005 revenue of ZAR5.14bn (US\$756mn)
 12.5% of production sold to the US and EU
 Annual Cane production is 5,5 tons

(c) Strategy

The company pursues a low cost strategy in every country where it conducts business. The company is also involved in social investment related programmes such as supplying water and sanitation, access to health care, delivery of education and participation in community outreach programmes. It also contributes to the development of farmers by providing them, amongst other things, with extension services and training.

(d) Investment Potential

Trade restrictions placed on the volume of sugar that EU countries are allowed to produce and lower prices make it difficult for the European sugar companies to generate profits from raw sugar. Both these factors, "combined with the duty-free access to the EU market from 2009, should ensure a strong performance for Illovo in the coming years".

Source: Business Monitor International, 2006

Table 2.4: Pioneer Foods

(a) Market Position

Pioneer Foods is a South African company. The company is the domestic franchisee owned by PepsiCo. In addition to the franchising right, the company manufactures and distributes different products such as instant meals, beverages, condiments, cereals and spreads.

(b) Company Data

2005 revenue of ZAR8.45mn (US\$1.25mn) up 11.3%
 9mth Operating Profit - US\$104.97mn
 Growth of 23%
 2004 Revenue - US\$1.2bn

(c) Strategy

The company's strategy for the next financial year is to cut down on its latest string of investments and align its broad portfolio with its production capacity and with current consumer demand. Pioneer is also pursuing a BEE scheme, under which it intends to transfer 10% of its shares to its employees.

(d) Investment Potential

After making few acquisitions in 2005 and obtained the franchise right for PepsiCo, the company intends to bring down the varied nature of its investments before it can engage in any growth activities in the future. If the company does not cut down on its investments, there is a possibility that it might lose focus due to the diversified nature of portfolio of investments. Nevertheless, it is expected that the company will generate more funds from the current business transactions to finance current projects and future acquisitions.

Source: Business Monitor International, 2006

Table 2.5: Distell Group Ltd**(a) Market Position**

Distell is the South African company that produces, markets and distributes alcoholic beverage products including fine wine, spirits and ready-to-drink alcoholic beverages. The company is partly owned by SABMiller, a global company in alcoholic beverages. The company was established in the year 2000 through the merger between Stellenbosch Farmer's Winery (SFW) and Distillers Corporation, also South African wine export leader.

(c) Strategy

Distell's strategy puts more emphasis on major competitive advantages, growing its exports as well as mergers and acquisitions amongst other things.

(d) Investment Potential

In spite of existing competition in the South African wine industry and large volumes of cheap locally produced wine, Distell needs to focus on growing its exports to maintain its solid financial results. To implement its export strategy, the company needs to aggressively market and advertise its products internationally.

Source: Business Monitor International, 2006

(b) Company Data

2005 Turnover - US\$949.6mn Growth of 7%
 Headline earnings up by 34.5% to ZAR482.2mn (US\$71.5mn)
 19.8% increase in trading income
 Profit before tax up 38.5% to ZAR672.8mn (US\$99.7mn)
 Sales volumes up 1.8%
 Employees - 4,000+

Table 2.6: SABMiller**(a) Market Position**

SABMiller is the leader in the brewing industry in South Africa. The company controls about 97.5% share of the country's beer market through its 11 brands and a 51% share of the country's flavoured alcoholic beverage market. In addition to having 30% equity stake at Distell, the company is operating seven breweries. The company also has an equity stake at the Amalgamated Beverage Industries Ltd (the country's largest carbonates distributor and licensee of the Coca-Cola brands) and Appletiser South Africa (the manufacturer of sparkling fruit juice).

(c) Strategy

To sustain its market share, SABMiller continues to use marketing and promotional strategies. To protect its premium brands from competition, the company uses the unique differentiation strategy. To expand internationally, the company relies on Greenfield investments as well as mergers and acquisitions.

(d) Investment Potential

Given its beer market dominance, it is expected that any future investments by SABMiller will be aimed securing market position instead of trying to increase further growth. The company may also upgrade its production facilities to meet the needs of increasing demand. More investments may be allocated to marketing and innovating packaging to bring awareness of their brands to the attention of their customers.

Source: Business Monitor International, 2006

(b) Company Data

2006 Group revenue up 19% to US\$15.3mn
 EBIT in SA rose 11% year-on-year to US\$1.06bn
 Domestic Figures 04-05 (YE31Mar05) Turnover - US\$2,522mn Growth of 28%
 Operating profit - US\$708mn
 Volume beer sales - 25,912,000hl Growth of 3%
 South Africa contribution - 29% Revenue 17% Beer volume sales
 Employees - 5,773

2.5 Conclusion

The economic, legal, social, political and technological factors are some of the factors that were considered under the external environment. The intensity of rivalry, the threat of entry, bargaining power of suppliers, bargaining power of customers, and threat of substitute products were analysed under industry environment. Lastly, the market position, strategy, financial performance and investment were some of the areas that were considered regarding the analysis of the company.

CHAPTER 3

REVIEW OF THE LITERATURE

3.1 Introduction

A number of studies have been conducted in the past regarding the effects of mergers and acquisitions on the total shareholder return. This chapter will, therefore, review previous work of other researchers regarding the impact of mergers and acquisitions on the shareholder value. It will put more emphasis on the share price and dividends. Lastly, it will focus on the abnormal returns and dividend changes received by the shareholders of both the acquiring and target firms.

3.2 Short-term impact of mergers and acquisitions on share price

This section will firstly look at the literature focusing more on target firms and later deal with studies emphasizing acquiring firms.

3.2.1 Target firms

Under target firms, the literature that involves positive and negative abnormal returns will be reviewed.

(a) Positive returns

Various studies show that shareholders of target firms tend to earn positive abnormal returns, when the merger or acquisition is announced.

Becher (2000) conducted a study on the 558 mergers in the banking industry during 1980 to 1997 period. The study was aimed at determining how bank mergers affected the wealth of shareholders of target firms. The findings of the study showed that shareholders of target firms earned significant positive abnormal returns (+22%). Although, the large sample of bank mergers was used, findings of this study can only be limited to the short-term mergers as reflected by the 36-day event window period. The results of the study

may have differed if the pre-merger was reduced to -5 days or post-merger announced was increased to +30 days.

Dragun and Howard (2003:42-46) carried out a similar study regarding the effects of 26 mergers and acquisitions on shareholder value covering 1997-2001 period. The study, however, focused on the retail sector in Europe. The findings of the study revealed that shareholders of target firms, in the retail sector, generally earned significant abnormal positive returns during the merger activity. Although the scale of abnormal returns received in the retail sector in Europe is smaller (16%) than the banking sector (22%), the results show that retail mergers and acquisitions are not much different from those in the banking sector. This is manifested by positive abnormal returns generated through the merger activity.

Scholtens and De Wit (2004) did a study using 98 bank mergers during 1990 to 2000 period. The study examined the impact of mergers and acquisitions of large banks in Europe and US. The findings of the study discovered that target firms obtained positive abnormal returns during the merger announcement. However, the US target firms received more positive abnormal returns compared to the European banks. The results are, however, limited to a short-term event window period of 35 days. The results may differ in the long run.

In South Africa, Mushidzhi and Ward (2004:17-32) did a study involving 64 acquisitions between 1998 and 2002. The study found that the shareholder of target firms generated significant positive abnormal returns.

A similar study on forced bank mergers was conducted in Malaysia. The study looked at both forced and voluntary mergers. The results indicated that when mergers are not forced but take place voluntarily, target firms generate positive abnormal returns (Chong, Liu & Tan, 2006). The results however only covered 16 companies, which may seriously be challenged on the basis of a small sample. As a result, the generalisation of the findings cannot be extended to other industries and/or countries.

(b) Negative returns

Contrary to the earlier findings that target companies are winners during mergers and acquisitions announcement, some researchers do not agree with these findings that the shareholders of target firms earn positive returns during mergers activity. Instead they argue that the shareholders of target firms receive significant negative abnormal returns.

This view is in line with the findings of Loughran and Vihh (1997:1765) who found that shareholders of target firms obtained negative abnormal returns during the merger and acquisition activity. The results are however applicable to stock-for-stock mergers and should also be limited to a long- term context.

Research work, on how the stock market reacts to the announcement of a merger, conducted by Bessler and Murtagh (2002:419) concurs with this view. This study concluded that domestic acquisitions by Canadian banks in the wealth management and retail banking sectors as well as foreign acquisitions in insurance industry earned negative returns for target firms.

This view is supported by Chong et al (2006), in their study on the impact of forced bank mergers on the creation of shareholders' wealth in Malaysia. They found that target firms earned negative abnormal returns. However, the results are limited to forced bank mergers, whereby the government forces mergers to occur through regulation.

Based on the reviewed literature, the findings of previous studies were mixed. Some studies reported positive abnormal returns, while others positive abnormal returns for target firms during mergers and acquisitions. It will be interesting to see what the findings of the previous research were regarding the effect of mergers on the shareholders of acquiring firms. The next section will therefore review the acquiring firms.

3.2.2 Acquiring firms

Under acquiring firms, previous research that includes both positive and negative abnormal returns will be reviewed.

(a) Positive returns

It is a commonly known phenomenon that shares of acquiring firms do not perform well during the announcement of the mergers. This is usually reflected in studies that conclude that many acquiring firms tend to destroy the shareholder value (Langford and Brown III, 2004:5)

This view was, however, disproved by the study conducted by Loughran and Vijh (1997). They discovered that acquiring firms generally obtained significantly positive abnormal returns during the merger announcement. But these findings were limited to mergers and acquisitions that involve cash tender offers.

Similar findings were supported by Bessler and Murtagh (2002:419). Their study looked at acquisitions conducted by Canadian Banks. The banks acquired domestic and international companies that were mainly doing business in the wealth management, retail banking and insurance industries. Their study found that Canadian banks (acquirers) obtained positive abnormal returns on foreign wealth management as well as on their domestic acquisition in the insurance industry.

The same results were obtained by Suarez (2002:401) in Spain. She did a study on the reaction of Spanish stock market regarding the formation of 72 global alliances by Spanish companies during the 1987-1997 period. She found that Spanish firms gained an average abnormal return of 0,2 percent on the day of announcement of the merger or acquisition.

The similar findings were arrived by Scholtens and De Wit (2004:217), who did a study on the “effects of large bank mergers in the European and US stock market.” They

concluded that although target firms earned higher returns than bidder banks, bidder banks still managed to earn positive abnormal returns (2,5%) in Europe.

Gleason, McNulty & Pennathur (2005: 2043) conducted a study to investigate the returns to successful bidders in privatisation acquisition of financial services firms. The study found that shareholders of acquiring firms received positive abnormal returns.

In another recent study, Rosen (2006:987) used 6259 mergers between 1982 and 2001 to determine how the stock market responds to the announcement of merger or acquisition. The study found that the share prices of bidding firms tend to rise when the merger or acquisition is announced. But the positive outcome depended on the good performance of the stock market as well as positive attitude of investors to the mergers by other companies.

Some studies do not agree with the view that acquiring firms normally receive positive returns during a merger or an acquisition. They contend that shareholders of acquiring firms tend obtain negative returns during a merger or an acquisition (Gaughan, 2001:9).

The next section will therefore look at previous research involving negative abnormal returns for acquiring firms.

(b) Negative returns

Acquiring firms generally are associated with negative abnormal returns during the merger and acquisition activity. This view was confirmed by the study conducted by Loughran and Vijh (1997:1765). They found that acquiring firms generated significant negative abnormal returns (-25,0%). The abnormal losses are however limited to stock-for stock merger transactions as well as applicable to long term results (over 5 years). Abnormal returns differ greatly when mergers and acquisitions involve cash and are of short-term in nature.

This is in line with the findings of Andrade, Mitchell & Stafford (2001). Their results showed that acquiring firms earned negative abnormal returns over a shorter period, while receiving -3,8 negative abnormal returns over a longer period. This finding suggests that although acquiring firms earned negative abnormal returns during the merger, the losses are much higher during the long term and were not statistically significant.

The similar view was confirmed by Dragun and Howard (2003:4), who also conducted a study regarding the effects of mergers and acquisitions on shareholder value in Europe. They found that acquiring firms in the retail sector earned negative abnormal returns (-4,5%) during mergers and acquisition activity.

In a study conducted by Scholtens and De Wit (2004) US bidding banks obtained significant negative abnormal returns (-1,8%). Mushidzi and Ward (2004) also agreed with the generalisation that acquiring firms have a tendency to be losers during mergers and acquisition. They found that, although acquiring companies earn negative abnormal returns (-0,55), the losses were however not significant. This actually suggests that abnormal losses are very close to zero.

Chong et al (2006) arrived at a similar conclusion in a study conducted in Malaysia that looked at both forced and voluntary mergers. The results showed that acquiring firms of voluntary mergers earned negative abnormal returns as opposed to forced mergers.

(c) Break-even (zero) returns

It is possible for shareholders of acquiring firms to obtain normal returns from a merger or acquisition. This means that the acquiring firm can earn zero return or break-even from a merger or acquisition.

In a study conducted by Becher (2000:189) to determine the effects of bank mergers from the early 1980s until the late 1990s, the findings show that acquiring firms break-even during the merger activity.

Similar results were obtained in a study carried out by Mushodzi and Ward (2004:29). The study found that the shareholder returns of acquiring firms were not affected by the merger or acquisition activity.

The shareholder value would not be complete if this study does not peruse the previous literature on dividends. The next section will therefore look at the previous research work done on the impact of mergers and acquisitions on dividends.

3.3 Long-term impact of mergers and acquisitions on dividends

There is a tendency for dividends paid by merging companies to increase after the merger. In the case of the 1960 merger between Wells Fargo Bank and American Trust Company, Wolffe (1982) discovered that dividends improved after the merger. In a study designed to investigate the impact of merger activity on economic performance and market structure in the US, Obadike (1987) found that “merged firms paid higher dividends”. The question that is continuously being asked is whether these findings are still valid today because these studies were conducted in the 1980s.

The findings that dividends improve after the merger were also confirmed by recent research. In a study conducted by Olson and Pagano (2005:2020) regarding the long-run performance of US bank mergers, it was discovered that on average during the 3 years following the mergers, the acquiring banks’ dividend pay-out ratio increased. This data portrayed that during post-merger acquiring banks are more generous with dividends than in their pre-merger days.

A similar view was echoed by the Morningstar Dividendinvestor (No date). It was reported that having successfully expanded its operations from 1995 to 2005, National City’s board of directors raised the stock’s annual dividend from \$0.72 per share to \$1.48, for an increase of 106% (10,6 % per year on average). This steady progress- reflected in the most concrete way possible through dividend- easily justifies the doubling of the stock price.”

3.4 Conclusion

The findings of various studies revealed that target firms do not always create value for their shareholders during the merger announcement, they can also destroy it. On the contrary, acquiring firms do not only destroy shareholder value during the merger activity, but they also create value for their shareholders.

In spite of sending negative information to the investors, dividend pay-outs tend to increase after the merger, according to various reports.

CHAPTER 4

RESEARCH DESIGN AND METHODOLOGY

4.1 Introduction

This chapter looks at the event of interest used in this study, how it was chosen, where and how data was collected on the chosen event of interest, and how data was analysed to determine the impact of food and beverage mergers on the share price and dividends in South Africa.

4.2 Event of interest

The event of interest for this research is the announcement of the merger or an acquisition. The analysis firstly focuses on the event period of 41 days regarding the impact of mergers and/or acquisition on the share price. This period includes 20 days before the merger announcement (pre-merger period), the day of the merger announcement and 20 days after the merger announcement (post-merger period).

The 41-day period was chosen because of its short-term nature. Shorter event windows are generally known for their ability to prevent the chances of many major events impacting on the share price compared to longer periods.

Secondly, the analysis looks at the 5-year period with respect to the impact of mergers and/or acquisition on dividends. The 5-year event window period was opted because of its long-term focus. This period also covers the final dividends declared during 1 year before the merger, the year of the merger and 3 years after the merger.

4.3 Sampling design

Although there are many mergers in the food and beverage industry, a substantial number of the food and beverage mergers in South Africa take place between private-and-private

and publicly listed-and-private companies. As a result, there are few mergers that involve publicly listed-and-publicly listed companies.

Based on the stratified probability sampling, the sample of 79 South African mergers and acquisitions was obtained. This ensured that data on merging companies is subdivided per industry (food and beverage industry), type of company (private or publicly listed) and into acquiring and/or target firms. Of the 79 companies in the sample, 53 (67%) of those companies are acquiring firms and the rest of the sample consists of 26 (33%) target firms.

The sample will, therefore, be subdivided into three categories depending on whether:

- (a) Both companies are listed on the JSE;
- (b) Only the acquiring firm is listed, and/or
- (c) Only the target firm is listed.

4.4 Data collection

The study uses secondary sources of data. Data was collected, using both the electronic and print media sources, from Standard Bank of South Africa, Competition Commission of South Africa, and the Johannesburg Stock Exchange (JSE) and Sunday Times newspaper.

The list of South African companies involved in mergers and acquisitions in the food and beverage industry were obtained from the Competition Commission of South Africa. “The Competition Commission is a statutory body constituted in terms of the Competition Act, No 89 of 1998 by the Government of South Africa empowered to investigate, control and evaluate restrictive business practices, abuse of dominant positions and mergers in order to achieve equity and efficiency in the South African economy”(Competition Commission of South Africa, 2006).

The Sunday Times newspaper, one of the biggest weekly South African newspapers, provided the names of all 18 publicly listed companies in the food and beverage industry.

The newspaper made the sorting of companies easier as the information on the companies is all grouped per industry.

Standard Financial Markets, a division of Standard Bank of South Africa, provided information on historical share prices and announcement dates for mergers and acquisitions. The information was downloaded from the company website. The use of internet in this case ensured that the process of data collection was expedited.

The Johannesburg Stock Exchange through Inet Bridge supplied electronically historical data on the JSE All Share Index. They delivered data through the electronic mail (e-mail) system at no cost.

Data on dividends was sourced from the Standard Financial Markets, a division of Standard Bank of South Africa. Final dividends declared were used for the purpose of the study. Final dividends are annual dividends necessary to measure the long-term effect of food and beverage mergers. In few cases where final dividends were not available, interim dividends were used in this regard.

Other secondary data resources such as journals articles, books, Internet, newspapers and other sources were used.

4.5 Data analysis

4.5.1 Stock price analysis

Data, on the impact of South African food and beverage mergers on the share price, will be analysed using the event study methodology. The event study methodology is the commonly used methodology in examining the stock market reactions to announcements of mergers and acquisitions and other news. It will enable the study to determine the average abnormal returns before and after the merger on share prices of merging firms as well as test the significance of the impact on returns. The results will be presented using graphs, charts and tables.

4.51.1 Market Model

(a) Background

The event study methodology relies on various models to analyse the effects of new information on the share prices. One such model is the market model. The market model is used to estimate the abnormal returns for a given stock (Kusnadi and Sohrabian: 1999).

The basic understanding on how to use the event study methodology was obtained from the previous research work conducted by Bowman (1983) and Campbell (1997).

The market model is given by the regression formula as follows:

$$R = \alpha + \beta RM$$

Where R stands for stock return on given day

α : stands for intercept (constant)

β : stands for slope (coefficient)

RM : stands for a JSE stock market return

(b) Market Model Application process

The process of analysing mergers and acquisitions in the food and beverage industry will involve the calculation of abnormal returns, average abnormal returns, cumulative and average abnormal returns and conducting of a significance testing of the abnormal returns.

(i) The calculation of Abnormal Returns

Abnormal returns can be described as “the difference between a single stock or portfolio performance with regards to the average market performance [usually] a broad index such as S & P500 or national index like Nikkei] over period of time. It is a term used by stock market traders” (Answers Corporation, 2007).

It is necessary to calculate abnormal returns because they serve as inputs in estimating the average abnormal returns. Abnormal returns are calculated by using the following formula:

$$AR_{jt} = R_{jt} - (\alpha + \beta R_{mt})$$

Where:

AR_{jt} = abnormal return of stock j on day t

R_{jt} = actual return on the jth stock on day t

R_{mt} = return on the market index, FTSE/JSE All Share Index

α , β = the market model parameters estimates used for stock j for the control period [events period -60 through -21] The coefficients estimates were used to compute the abnormal daily returns for the test period [event day - 20 to 20]where the event day [-t] represents trading day after [before]the announcement date [t=0] (Kusnadi and Sohrabian, 1999:110).

(ii) The computation of average abnormal returns

Average abnormal return is simply the mean of abnormal returns. It is needed because it is the necessary average for the calculation of cumulative average abnormal returns. It is computed by the following formula:

$$AAR = \frac{1}{N} \sum_{j=1}^n AR_{jt}$$

Where:

AAR= average of an abnormal return for a day

N= number of securities in the sample

(iii) The estimation of cumulative average abnormal returns (CAAR)

CAAR is the sum of all average abnormal returns. The CAAR will be used for significance testing .The formula for CAAR is

$$CAAR = \sum_{t=k}^n AAR$$

Where:

K= number of event days before day

(iv) Significance Testing

Significance testing is necessary to test whether the abnormal return is statistically different from zero. A paired t-test formula was used to test the significance of abnormal returns from normal returns. For cumulative average abnormal returns, the t-test formula is:

$$CAAR_{t-stat} = \frac{CAAR}{\frac{\sigma_{pre}}{\sqrt{Nt}}}$$

4.5.2 Dividend analysis

Descriptive statistics will be used to analyse data on the impact of mergers and acquisitions on dividends. This involved amongst others things the use of averages. The following formula was used to convert dividends in their absolute form to dividends in relative (percentage form):

$$\text{Percentage dividends declared} = \frac{\text{Year 2 dividends} - \text{Year 1 dividends}}{\text{Year 1 dividends}} \times 100$$

Lastly, the results will be presented using tables.

4.6 Conclusion

The event methodology, particularly the market model, was used to analyse the effect of 79 food and beverage mergers and acquisitions in South Africa on stock prices and dividends. Secondary sources of data, including share prices of publicly listed companies, JSE All Share Index, and dividends were collected using both electronic and print media sources. In addition to the market model, significance testing and descriptive analysis tools were utilized to analyse data and present the results.

CHAPTER 5

RESEARCH RESULTS AND ANALYSIS

5.1 Introduction

This Chapter presents the results on the impact of food and beverage mergers and/or acquisitions on the total shareholder return in South Africa. It firstly looks at the short-term effect of mergers on the share price. Secondly, it deals with the long-term effect of mergers on dividends. Lastly, it provides brief comments on the findings while reserving more general comments for the next chapter.

5.2 The short-term impact of food and beverage mergers on share price

This section will be discussed under two main areas, namely: target firms and acquiring firms.

5.2.1 Target firms

Under target firms, the results on abnormal returns and significance testing will be presented and analysed.

(a) Abnormal returns

Table 5.1 shows the results on the impact of food and beverage mergers on target firms in the food and beverage industry of South Africa

Before the announcement of the merger (Day -20 to Day -1), target firms earned negative returns. This is manifested by the average abnormal loss of 0.4081 percent. The negative abnormal returns may be attributed to the declining share prices of target firms that may have occurred before the announcement of the merger or acquisition.

TABLE 5.1: IMPACT OF MERGERS ON TARGET FIRMS IN SOUTH AFRICA

Event period	AAR %	CAAR %	T-test
Day -20 to Day +20	-0.5747	-28.5402	-2.6397
Day -20 to Day -1	-0.4081	-21.9687	-2.0987
Day +1 to Day +20	-0.1273	-6.1241	-0.4274
Day -1 to Day +1	-0.1414	-1.4316	-0.2903
Day -1 to Day 0	-0.0127	-0.8555	-0.1869
Day 0 to Day +1	-0.1680	-1.0235	-0.2170

Source: Standard Financial Markets and Inet Bridge , 2006

Similarly, on the day before the announcement of the merger (Day -1 to Day 0), the target firms also obtained the negative abnormal returns of -0,0127 percent. The negative returns were however smaller on the day before the merger compared to the 20-day pre-merger period. The results suggest that the margin at which the share prices were falling was getting smaller as the day of the merger announcement got closer.

After the announcement of the merger (Day +1 to Day +20), target firms received negative abnormal returns (-0.1273%). This finding indicates that the share prices of target firms fell after the announcement of the merger or acquisition.

A similar phenomenon occurred on the day after the merger announcement (Day 0 to Day +1). Target firms also obtained negative abnormal returns (-0.1680%). But the negative abnormal returns on the day after the announcement of the merger are higher than those obtained the day before the announcement of the merger. The thirteen times increase of negative abnormal returns, involving the day before and the day after merger announcement, suggests that the announcement of the mergers and acquisitions led to a

further decline in the share prices of target firms in the South African food and beverage industry .

For the whole event period (Day -20 to Day +20), target firms earned negative abnormal returns of -0.5747 percent. The results clearly indicate that the food and beverage companies in South Africa generally (on average) earn negative abnormal returns during the merger activity. They, therefore, suggest that the shareholders of target firms react negatively to the announcement of mergers.

(b) Significance testing for target companies

Table 5.2 shows the results of the paired T-test for target companies. It depicts two variables being analysed, namely: CAAR Before Merger and CAAR After Merger.

TABLE 5.2: DESCRIPTIVE STATISTICS FOR TARGET FIRMS			
Group	n	Mean	Standard Deviation
CAAR Before Merger	20	-0.418	0.627
CAAR After Merger	20	0.017	0.811

Source: Standard Financial Markets and Inet Bridge, 2006

The difference between the means of the two groups is 0.434

Testing for differences (t test for dependent groups):

$$t = -2.482$$

$$p = 0.023$$

$$df = 19.000$$

The results show that the p value is 0.023, which is smaller than the 0.05 significance level. This suggests that there is a 95% or better probability that there is a statistically significant difference between the means of the two groups, namely: CAAR Before Merger and CAAR After Merger announcement.

It can therefore be reported that the means of the two groups-CAAR Before Merger and CAAR After Merger announcement- are statistically significantly different at the 5% level ($t=-2.48$; $df=19$; $p=0.023$) and the difference between the two means stands at 0.434.

It can be concluded from the results that target firms in the South African food and beverage industry earned statistically significant positive average abnormal returns during the announcement of mergers and acquisitions.

5.2.2 Acquiring firms

Similarly, under acquiring firms, the findings on abnormal returns and significance testing will be tabulated and discussed.

(a) Abnormal returns

Table 5.3 reports the results on the impact of food and beverage mergers and acquisitions with particular emphasis on acquiring firms in South Africa.

Before the announcement of the merger (Day -20 to Day -1), acquiring firms generated positive abnormal returns of 0.0285 percent. The positive abnormal returns may be

attributed to the increase in the share prices of acquiring firms before the merger announcement.

On the day before the merger announcement (Day -1 to Day 0), the abnormal returns remained positive at 0.7057 percent. Although the abnormal returns are positive before the announcement of the merger, they are higher on the day before the merger announcement compared to the period before merger announcement.

TABLE 5.3: IMPACT OF MERGERS ON ACQUIRING FIRMS IN SOUTH AFRICA			
Event period	AAR %	CAAR %	T-test
Day -20 to Day +20	1.9458	1.0363	0.2934
Day -20 to Day -1	0.0285	-10.5848	-2.1264
Day +1 to Day +20	1.3523	11.0276	1.9931
Day -1 to Day +1	0.2270	0.7368	0.4996
Day -1 to Day 0	0.7057	0.6220	0.4413
Day 0 to Day +1	0.0864	0.7084	0.4852

Source: Standard Financial Markets and Inet Bridge , 2006

After the announcement of the merger (Day +1 to Day +20), the impact of the merger on acquiring firms was positive. This is manifested by higher abnormal returns of 1.3523 percent compared to the period during the pre-merger. The results therefore indicate that the share prices of acquiring firms increased after the announcement of the merger or acquisition.

On the day after the announcement of the merger (Day 0 to Day +1), abnormal returns of acquiring firms were also positive at 0.864 percent. But the abnormal returns on the day after the announcement of the merger were lower than the abnormal returns on the day before the merger announcement (0.7057 percent). The results suggest that, although

abnormal returns of acquiring firms are positive, there was a slight decrease in the share prices of acquiring firms after the announcement of the merger. But the decline in the share prices acquiring firms did not contribute to negative abnormal returns.

For the whole event period (Day -20 to Day +20), acquiring firms earned positive abnormal returns of 1.9458 percent. In summary, the results show that the acquiring firms in the South African food and beverage industry, on average, earn positive abnormal returns during the merger activity. The results, therefore, indicate that shareholders of acquiring firms react positively to merger announcement.

(b) Significance testing for acquiring firms

Table 5.4 displays the findings of the paired T-test for acquiring companies. It shows two variables being analysed, namely: CAAR Before Merger and CAAR After Merger.

TABLE 5.4: DESCRIPTIVE STATISTICS FOR ACQUIRING FIRMS			
Group	n	Mean	Standard Deviation
CAAR Before Merger	20	-0.3890	0.3070
CAAR After Merger	20	0.0140	0.6090

Source: Standard Financial Markets , 2007

The difference between the means of the two groups is 0.403

Testing for differences (t test for dependent groups):

$t = -3.894$

$p = 0.001$

$df = 19.000$

The results reveal that the p value is 0.001, which is smaller than the 0.01 significance level. This suggests that there is a 99% or better probability that there is a statistically significant difference between the means of CAAR Before Merger and CAAR After Merger announcement.

It can therefore be reported that the means of the two groups-CAAR Before Merger and CAAR After Merger announcement- are statistically significantly different at the 1% level ($t=-3.89$; $df=19$; $p=0.001$). There is a difference of 0.403 between the two means.

The results suggest that acquiring firms in the South African food and beverage industry earned statistically significant positive average abnormal returns during the announcement of mergers and acquisitions.

5.3 The long-term impact of food and beverage mergers on dividends

Table 5.5 shows the results pertaining to the effect that South African food and beverage mergers and acquisitions have on dividends.

TABLE 5.5: IMPACT OF FOOD AND BEVERAGE MERGERS ON DIVIDENDS		
Type of firm	Pre-Merger %	Post-Merger %
Acquiring firms	-2.31	-0.28
Target firms	-4.51	5.34
Overall/Combined	-2.54	1.61

Source: Standard Financial Markets, 2007

5.3.1 Acquiring firms

Before the merger, the dividends of acquiring were –2.31 percent. After the merger, the negative dividends of acquiring firms were reduced to –0,28 percent. This may be attributed to two reasons. Firstly, the decrease in negative dividends declared after the merger may be due to abundant cash flow available to acquiring firms. However, management of acquiring companies does not know how to further invest the available cash. Secondly, the decline in negative dividends suggests that the South African food and beverage firms are no longer taking advantage of investment opportunities, but instead opt to give the available cash back to shareholders.

(a) Significance Testing for acquiring firms

Table 5.6 shows the findings of the paired T-test for acquiring companies. It depicts two variables being analysed, namely: Cumulative Dividends Before Merger (CUMDIVB4ME) and Cumulative Dividends After Merger (CUMDIVAFME).

TABLE 5.6: DESCRIPTIVE STATISTICS FOR DIVIDENDS OF ACQUIRING FIRMS			
Group	N	Mean	Standard Deviation
Cumulative Dividends Before Merger	53	87.689	207.105
Cumulative Dividends After Merger	53	63.451	74.247

Source: Standard Financial Markets , 2007

The difference between the means of the two groups is 24.238

Testing for differences (t test for dependent groups):

$t = 1.044$

$p = 0.301$

$df = 52.000$

The results show that the p value is 0.301, which is larger than 0.05. They suggest that there is no statistically significant difference between the means of the two groups.

The results are reported as follows:

The means of the two groups are not statistically significantly different ($t=1.04$; $df=52$; $p=0.301$).

5.3.2 Target firms

Before the merger activity, the dividends for target firms stood at -4,51 percent. The results indicate that target firms were paying little or no dividends at all to their shareholders. These types of companies have been facing two possibilities. Firstly, they may not have been profitable due to non-availability of cash to pay dividends. Secondly, target firms may have been profitable, but decided to invest all their earnings with the aim of growing shareholder value.

After the merger, the shareholders of target firms earned positive dividends of 5,34 percent. This suggests that for target firms there was growth in the shareholder value. This is manifested by the increase in dividends declared after the merger compared to the pre- merger period.

On the other hand, the increase in dividends declared after the merger suggests that the management of target companies ran out of ideas on how to invest company profits or there is a lack of investment opportunities. It also suggests that growth prospects in the future are not good. This may impact negatively on the share prices of target firms.

(a) Significance testing for target firms

Table 5.7 shows the findings of the paired T-test for acquiring companies. It depicts two variables being analysed, namely: Cumulative Dividends Before Merger (CUMDIVB4ME) and Cumulative Dividends After Merger (CUMDIVAFME) .

TABLE 5.7 : DESCRIPTIVE STATISTICS FOR DIVIDENDS OF TARGET FIRMS			
Group	N	Mean	Standard Deviation
Cumulative Dividends Before Merger	26	41.490	36.996
Cumulative Dividends After Merger	26	103.997	70.774

Source: Standard Financial Markets , 2007

The difference between the means of the two groups is 62.508

Testing for differences (t test for dependent groups):

$$t = -4.676$$

$$p = 0.000$$

$$df = 25.000$$

The results indicate that the p value is 0.000, which is smaller than 0.01. They suggest that there is a 99% or better probability that there is a statistically significant difference between the means of the two groups.

The results also show that the cumulative dividends before and after the merger are statistically significantly different at the 1% level ($t=-4.68$; $df=25$; $p=0.000$), while the difference between the two means remains at 62.508.

5.3.3 Overall results

The overall results depict an increase in dividends from -2,54 percent before the merger to 1,61 percent after the merger. This finding may be attributed to higher dividends declared by target firms after the merger suggesting that shareholder value of South African food and beverage companies increased after the merger. However, this also suggests that the future growth prospects may not be good. It might further indicate that there is lack of investment opportunities for shareholder to grow their value/returns. This may impact negatively on the stock price of food and beverage companies.

5.4 Conclusion

Target firms in the South African food and beverage industry earned statistically significant negative abnormal returns during the announcement of food and beverage mergers. On the other hand, acquiring firms obtained statistically significant positive abnormal returns.

CHAPTER 6

DISCUSSION AND CONCLUSIONS

6.1 Introduction

This Chapter focuses on interpreting the results presented in Chapter 5 in line with the research problem and objectives of the study as outlined in Chapter 1.

6.2 Impact of food and beverage mergers on share price

6.2.1 Target firms

One of the main objectives of this study was to establish the effects of food and beverage mergers and acquisitions in South Africa on the share prices of target firms.

The results of this study do not agree with the findings of prior research that target firms generally earn positive abnormal returns during the merger or acquisition activity. The results show that target firms in the South African food and beverage industry received statistically significant negative abnormal returns during the merger activity.

The results suggest that although target firms received negative abnormal returns on the overall, there was a general increase in the number of positive abnormal returns and a decline in the number of negative abnormal returns.

The findings of this study also indicate that the share prices for target firms may have decreased during the merger period, but the decline did not have the significant negative impact. The lack of significant impact is manifested by the increase in the number of positive returns and the decline in the number of returns. This means that although the abnormal returns may have been negative generally, the news about the merger was well-received by the shareholders of target firms.

The negative returns on target firms may also suggest that some merger transactions may have been financed by stock instead of cash. Because prior research tells us that stock financed mergers tend to have negative abnormal returns, this is just pure speculation, it could however be a subject for further research.

It could also be possible that some merger transactions in the South African food and beverage industry may have been characterised as one acquiring firm going for one target firm resulting in the under-payment for a merger and/or acquisition.

The results of this study are consistent with the findings of Loughran and Vijh (1997), Bessler and Murtagh (2002) and Chong, Liu & Tan (2006) that target firms tend to earn negative abnormal returns during the merger activity.

6.2.2 Acquiring firms

This study was also tasked with the responsibility to determine the effect of South African food and beverage mergers on the share price of acquiring firms.

Acquiring firms earned statistically significant positive abnormal returns during the whole period of the merger. This finding could be attributed to higher positive abnormal returns than negative abnormal during the merger period.

The findings suggest that the share prices of acquiring firms may have increased during the whole merger period. They further do not agree with the earlier research findings that acquiring firms generally lose during the announcement of mergers and/or acquisitions.

The results of this study are in line with the findings of various studies, conducted by Loughran and Vijh (1997), Bessler and Murtagh (2002), Suarez (2002), Langford and Brown III (2004), Scholtens and de Wit (2004), Gleason, McNulty & Pennathur (2005) and Rosen (2006), that the acquiring firms tend to earn positive abnormal returns after the announcement of the merger.

6.3 The impact of food and beverage mergers on dividends

The second major purpose of this study was to look at how dividends were affected by the merger activity in the South African food and beverage industry. The overall results of this study show that dividends increased after the merger. This finding may have been caused by substantial number of dividends paid by target firms after the merger.

6.3.1 Target firms

The dividends of target firms increased significantly from negative dividends one year before the merger to positive dividends three years after the merger.

Negative dividends obtained before the merger indicate that target firms were paying little or no dividends at all to their shareholders. The target firms may have been facing two possibilities during the pre-merger period. Firstly, the target firms may not have been profitable; as a result cash flow may not have been available to pay dividends. Secondly, the target firms may have been profitable and invested all their earnings with the aim of growing their shareholder value.

Positive dividends received after the merger suggests that target firms paid higher dividends after the merger. The results imply that for target firms there was growth in shareholder value. However, positive dividends tend to have a negative effect on share prices. They may have contributed towards a decline in the share prices of target firms.

Another possible explanation for the increase in dividends declared after the merger is that the management of target companies may have ran out of ideas on how to invest company profits or there was a lack of investment opportunities. It also suggests that growth prospects in the future are not good. This may impact negatively on the share prices of target firms.

The results of this study are consistent with the findings of Olson and Pagano (2005), Morningstar Investor (No date), Obadike (1987), and Wolffe (1982)) that dividends tend to increase after the merger.

6.3.2 Acquiring firms

Acquiring firms obtained negative dividends during the five-year merger period under study, but these dividends were not significantly different from zero. The insignificant results indicate that the negative dividends may have occurred by chance and are not different from zero dividends. Negative dividends suggest that acquiring firms may have been paying little or no dividends at all.

Negative dividends for acquiring firms may be attributed to two reasons. Firstly, the decrease in negative dividends declared after the merger may be due to abundant cash flow available to acquiring firms. As a result, management of acquiring companies do not know how to invest it further. Secondly, the decline in negative dividends implies that the South African food and beverage firms are no longer taking advantage of investment opportunities, but instead opt to give the available cash back to shareholders.

One possible explanation for negative dividends could be that acquiring firms re-invested a substantial portion of their retained earnings to new growth opportunities.

6.4 Implications of the study

The findings of this study imply that it can no longer be generalised that target firms always gain and acquiring firms make losses during the mergers or acquisitions. Furthermore, the results in a particular industry and/or country should not be generalised to other industries or countries without taking into account various factors such the uniqueness and level of development.

6.5 Limitations of the study

The sample used in this study for target firms was too small. It may have contributed to negative abnormal returns. If the sample size for target firms could be increased, the results may probably differ due to the change in the number of abnormal returns.

The event window of 41 days was used in this study. The results may also differ from those of other studies if the event window (41-day period) could be increased or decreased. This could be an area for further study.

The results of this study are only limited to the food and beverage industry in South Africa. It is also possible that a similar study conducted in a different industry and country other than the food and beverage industry and South Africa could produce different results. This could be another area for further study.

The All Share Index was used for the purposes of this study. The results may also differ from those obtained in this study if specific stock indices such as food index and beverage index were used. This could also be an area which may be considered for further study in the future.

In cases where there was no data on final dividends declared was available, interim dividends or zero dividends were used depending on what data was available. This data discrepancy may have understated or overstated the results regarding the impact of food and beverage mergers on dividends.

6.6 Conclusion

The South African food and beverage mergers had a negative effect on the share prices of target firms and a positive effect on the share prices of acquiring firms. Although similar mergers had a positive effect on dividends on the overall, they however had a negative effect on dividends of acquiring firms and a positive effect on dividends of target firms. The negative effect on share prices was traded off by the positive effect on dividends and vice versa.

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APPENDIX

Appendix 1: Database of mergers and acquisitions in the South African food and beverage industry from 1999 to 2005

APPENDIX1: DATABASE OF MERGERS AND ACQUISITIONS IN THE SOUTH AFRICAN FOOD AND BEVERAGE INDUSTRY FROM 1999-TO-2005		
ACQUIRER	TARGET	ANNOUNCEMENT DATE
Empowerment Consortium	ICS Holdings(35%TigerBrands)	1-Apr-99
Tiger Brands	Empresas Carozzi	19-Aug-99
Tiger Brands	Langeberg Foods	19-Oct-99
Tiger Brands	Adcock Ingram	6-Oct-99
Imperial Holdings	Cold Chain(o/b TigerBrands)	5-Jun-00
Bidvest	SA Bulk Terminals(o/b TigerBrands)	29-Jun-00
TigerBrands	Natchix	22-Sep-00
TigerBrands	Sea Harvest	23-Oct-00
Novartis	Lagap Pharmaceuticals(o/b TigerBrands)	2-Apr-01
MassMart	Rebhold (TigerBrands)	31-May-01
Nestle SA	Dairymaid (50% TigerBrands)	18-Jan-02
TigerBrands	Robertsons Home Care & Robertsons (Pty) Ltd	17-Sep-02
TigerBrands	Enterprise Foods	3-Apr-03
TigerBrands	Parke-Med	16-May-03
AVI	I&J	11-Oct-99
Willards(o/b AVI)	Baker Street Snacks	9-May-00
McCain	I & J (AVI)	5-Jun-00
Management Consortium?	Nedan Oil Mills(AVI)	27-Sep-01
Mast Fishing (Pty) Ltd	Siphumelele (AVI)	4-Dec-03
AVI	Denny Mushroom	2-Jun-04
AVI	Owens-Illinois	12-Oct-04
Rainbow Farms (pty) Ltd	Vector Logistics(AVI)	2-Dec-04
AVI	A & D Spitz (Pty) Ltd	4-Apr-05
Astral	Natchix	3-Apr-02
Astral	Early Bird (50% Afgri)	5-Mar-04
Afgri	Premier Group (Clark Cotton)	13-Jan-99
Afgri	SOK	24-Mar-99
Afgri	Falcon Equipment	19-May-99
Afgri	Foodcorp	10-Jan-00
Umanyama	Afgri	23-Mar-01
Pride Milling	Afgri	23-May-01
Afgri	Laeveld Korporatiewe Bellegings	6-Nov-02
Afgri	T & H Walton	30-Jan-03
Afgri	Natal Agricultural Co-operative	19-Dec-03
Afgri	Bester Feed and Grain	2-Jun-04
Agri Sizwe Empowerment Trust	Afgri	24-Nov-04

APPENDIX1: DATABASE OF MERGERS AND ACQUISITIONS IN THE SOUTH AFRICAN FOOD AND BEVERAGE INDUSTRY FROM 1999-TO-2005

ACQUIRER	TARGET	ANNOUNCEMENT DATE
Afgri	Daybreak Farms	7-Nov-05
Afgri	Nedan Oil Mills (Pty) Ltd	23-Feb-05
Scandinavian Building Systems	Tongaat-Hullet	10-May-01
ILLOVO	Monitor Sugar Company (US co)	25-Mar-99
ILLOVO	Maragra Sugar Mill (Moz)	11-Oct-99
ILLOVO	Tate & Lyle (Zambia Sugar)	16-Feb-01
-	Mon Tresor and Mon Desert (ILLOVO)	6-Apr-01
Grand Bridge	Gledhow (ILLOVO)	17-May-01
Michigan Sugar Company	Monitor Sugar((ILLOVO)	6-Aug-04
Umvoti Transport	Umfolozi Sugar Mill (ILLOVO)	11-Feb-05
PIC	Oceana	12-Mar-03
Conafex	Cape Natural Tea Products	16-May-01
Conafex	Grassroots Group (Pty) Ltd	12-Oct-04
SA Wine Industry Trust	KWV	11-Feb-04
Phetogo Investments	KWV	9-Nov-04
Distillers Corporation SA	Stellenbosch Farmers Winery (SFW)	18-Jun-03
WIPHOLD Beverages (Pty) Ltd	Distell Group	12-Oct-05
Distillers Corporation SA	Hyraces Holdings	4-Apr-00
SABMiller	Zambian Breweries	14-May-99
SABMiller	Pilsner Raquel	7-Oct-99
Brands Investments	SABMiller	3-Apr-01
SABMiller	China Resources Brewery	31-May-01
SABMiller	My sore Breweries Ltd	28-Jun-01
SABMiller	Beer Timisoreana	7-Aug-01
Liberty	SABMiller	27-Sep-01
SABMiller	Coca Cola Bottling Luanda	1-Nov-01
SABMiller	Rochees Breweries Ltd	7-Nov-01
SABMiller	Cervecerla Hondure\$a SA (CHSA)	29-Nov-01
SABMiller	Euoro Dongxihu Breweery	3-Dec-01
SABMiller	Zambia Bottlers Ltd	12-Feb-02
SABMiller	Miller Brewing Company	30-May-02
SABMiller	Rheem	28-Jan-03
SABMiller	Birra Peroni	14-May-03
SABMiller	Harbin Brewery Group	30-Jun-03
SABMiller	Aurora SA	10-May-04
China Resources(SABMiller)	Anhui Longjin Group	18-May-04
China Resources(SABMiller)	Lion Nathan	15-Sep-04
SABMiller	Santo Domingo Group	19-Jul-05
SABMiller	BevCo Ltd	21-Nov-05
Key Matrix	Khululeka Cash Loans(Awethu Breweries)	30-Aug-00
Intetrading	Agrilink	19-Feb-99
Intetrading	Skysrevice (Pty) Ltd	29-Aug-02
Katope International	Intetrading	29-Apr-05

