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Research Report

The application of theory of constraints in mergers and acquisitions

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I, Unathi Mntonintshi, herewith declare that the language of this report has been edited by Carol Waterston

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1. EXECUTIVE SUMMARY

Over the decades mergers and acquisitions have been utilised by many businesses as a means of expanding their businesses and growing their profits. However, research done over the last few decades indicates that most of these mergers or acquisitions do not yield the expected or intended results. Many reasons have been bandied about for such a high rate of failure in mergers and acquisitions. Some of the reasons deal with the mechanics of the merger or acquisition, including implementation, whilst other reasons doubt the strategic decision to acquire or merge with a specific company.

The aim of this research report is to determine whether the application of the theory of constraints can assist companies to make better decisions or choices as to which companies to acquire or merge with.

In the case study of Nedcor 's acquisition of BoE, the contents of the research report will add value and be utilised in practice. In the end, the contribution of this research report should be to reduce the failure rate of mergers and acquisitions.

1.1 Literature review

Mergers and acquisitions have been utilised as a business growth tool for many decades. There are sound reasons for engaging mergers and acquisitions as strategic tools for business growth. These reasons range from acquiring capabilities to diversifying for exchange rate risk. However, other reasons are described as either dubious or strategically flawed. In most of these cases, mergers and acquisitions are utilised to conceal deep-seated problems within organisations. Inevitably such mergers and acquisitions never yield the publicly stated results. Generally, mergers and acquisitions are met with hype generated by executives involved in such deals. The hyping of the mergers or acquisitions creates high expectations from investors.

There is a school of thought that begins to question the wisdom of utilising mergers and acquisitions as a tool for growth. Alliances are provided as an alternative to mergers and acquisitions. Alliances have their own advantages and disadvantages depending on the specific situation.

The banking industry has been besieged by a consolidation process throughout the world, in both developed and developing markets. In Japan the number of banks was reduced from 21 to 8 within the space of a year. There is a school of thought that the banking industry in South Africa should be consolidated further to reduce costs.

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As with any marriage, there should be some sort of “fit” between the two marrying parties. Taking mergers and acquisitions as strategic tools, strategic fit is therefore an integral part of mergers and acquisitions. However, strategic fit is a broad concept. For the purposes of this research strategic fit means linking the constraint of an organisation with a competence of another organisation.

Core competence is a concept developed by Prahalad and Hamel (1990). Core competence is believed to bring a competitive advantage to an organisation as it is not easily copied, gives access to new markets and makes a significant contribution to the perceived customer benefits.

Due diligence is an important process in mergers and acquisitions. Johnson (1999) defines it as the process of ensuring that an individual or entity is an appropriate and suitable partner for any business transaction. Johnson attempts to define the process as broadly as possible through a checklist. The process of identifying means of elevating a constraint could be part of the due diligence process.

Theory of constraints was developed by Eliyahu Goldratt. The concept has been widely and successfully applied within the manufacturing environment. However, it has not been widely applied within the professional services industry. It is based on the cause and effect approach. The concept is largely underpinned by the premise that any system is as strong as its weakest link. Goldratt (1990) suggests that the improvement process should be based on identifying what to change, what to change to and how to cause the change. Goldratt further suggests five focusing steps, which are as follows:

- Identify the system’s constraint.
- Decide how to exploit the constraint.
- Subordinate everything else to the constraint.
- Elevate/break the system’s constraint.
- Refocus on the next constraint and avoid inertia.

The five focusing steps are more widely used in the application of the theory of constraints.

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1.2 Description of the two businesses

Both Nedcor and BoE are old companies in the financial services industry. BoE has more regional presence than Nedcor. BoE has presence in the Western Cape and the KwaZulu-Natal provinces. Nedcor is more of a national bank but with less presence in small towns.

The two companies offer similar types of services to business and to individuals, both directly and indirectly. These services range from business banking, property and asset finance, wealth management, treasury and capital markets. Nedcor has a special division of technology solutions within the banking industry and has utilised this part of the business with reasonable success.

Nedcor's strategy is influenced by the view that the financial services industry needs to be consolidated and that the leading bank will be the lowest cost producer. BoE, on the other hand, believed in specialised services and operated as a medium-sized bank. BoE tried relentlessly to partner as global financial services industry company as the company could not sustain itself as a medium-sized bank. Both BoE and Nedcor favoured a multi-brand strategy as they embarked on an acquisition trail in order to grow their businesses. However, there is a difference in that BoE tended to keep the names of the businesses the company acquired as opposed to Nedcor, who formed new brand names. This had significant financial implications regarding the building of the brands.

The financial results of the two companies were contrasting. Nedcor was continually showing poor results as the business struggled with non-core investments in Dimension Data and the stronger currency. Nedcor showed declining financial performance in all operations.

On the other hand BoE showed improving financial results, despite not declaring an interim dividend. Both the corporate banking and investment management divisions of the bank showed improved financial performance with a 25% growth in earnings from the corporate banking division. However, BoE's existence was influenced by the liquidity crisis that arose from the dramatic collapse of the rand and declining depositor confidence in smaller banks.

Nedcor's acquisition of BoE was influenced by the following factors;

- Consolidation within the banking industry.

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- International banks entering the South African market.
- Lack of corporate banking skills.
- Geographical presence in Western Cape and KwaZulu-Natal provinces.
- Declining profits for Nedcor.
- Economies of scale.

1.3 Application of the theory of constraints

The five focusing steps of theory of constraints are utilised as the means of applying theory of constraints in mergers and acquisitions. The first step in the five focusing steps is to identify the constraint. Generally three problems were identified as facing Nedcor as a company. These problems relate to the multi-brand strategy, image and leadership. The multi-brand strategy and image are symptomatic problems within the company. Collins (2001) implicitly alludes to the fact that leadership is the key for business to continuously produce results. Leadership is found to be the constraint of the company as the bank invested in non-core investments that yielded unprecedented losses at Nedcor. However, leadership is viewed more in a collective approach as opposed to looking specifically at the individual leading the company.

The constraint could not be exploited as the second step of the five steps suggests. This view supports the assertion of Motwani *et al.* The nature of leadership is such that the exploitation and elevation of the constraint cannot be separated. It is important to note that the general statement that this step in the five focusing steps is not applicable in service organisations, is not entirely accurate. It is possible for service organizations to have physical constraints and such constraints can be exploited.

The step involving the subordination of everything else to leadership would have ensured that Nedcor gives priority to leadership and there is urgency in elevating the constraint.

The elevation of the constraint is more complicated in terms of leadership at Nedcor as the constraint was identified as a collective rather than just the individual leading the organisation. However, there is no evidence that the CEO did not support the share incentive scheme and there is evidence that the strategy followed by the company was the brain child of the CEO. A new leader would have to be sought for the company.

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There could be problems relating to whether the leader should come from inside (within the existing executive team) or outside the company. There are advantages and disadvantages to both approaches. The board of directors should play an important role in determining the terms of reference of the new leader. It might be that the new leader would have to deal with the board to address the broader leadership problem at the company.

1.4 Conclusions

Theory of constraints can play a significant role in reducing the number of failures in mergers and acquisitions. The five focusing steps are the key implementation features of the theory of constraints that have a direct impact on mergers and acquisitions. The application of theory of constraints in mergers and acquisitions forces the acquiring company to initially apply theory of constraints within the company in order to identify the constraint.

Mergers and acquisitions only form part of the elevation of the constraint step of the five focusing steps. Simplistically, the application of the theory of constraints in mergers and acquisition is to have a strategic fit between the acquiring organisation's constraint and the strengths or capabilities of the company being acquired.

The due diligence process plays an important role in the application of theory of constraints in mergers and acquisitions.

Strategically fit mergers and acquisitions are not sufficient to ensure the success of those mergers and acquisitions. Other issues, like the implementation of the merger or acquisition in relation to "soft" issues, are just as important. Theory of constraints reduces the number of strategically flawed mergers and acquisitions.

The application of the theory of constraints in mergers and acquisitions forces systems-thinking theory and ongoing improvement into strategic management.

1.5 Recommendations

By implication the theory of constraints approach to mergers and acquisitions forces the process to have the interests of the organisation at heart as opposed to the acquisition being a personal ambition of the leader who might be interested in settling old scores. As

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Collins (2001) indicated in his book, in those organisations that were able to move from good to great, the company was first priority before the personal ambitions of the leader. As the case study of Nedcor indicated, the company would have been able to identify the leadership constraint the company was facing. Importantly, the TOC will not exclude the leader in the process of identifying the constraint that is impeding the company from making money now and in the future.

Objectivity of the process is important. TOC, if applied correctly, brings the objectivity that is necessary not only during the strategic evolution of the process but also during the due diligence process that the organisation should conduct before the decision of whether to merge or acquire is made.

The theory of constraints is not a panacea to mergers and acquisitions. Achieving the strategic fit between the acquirer and acquiree, or between two merging companies, does not guarantee that the merger will be successful. However, strategically flawed mergers and acquisitions will almost certainly not succeed. Whilst companies operating in monopoly or near monopoly industries might afford such strategically flawed acquisitions, businesses operating in industries with strong competition can ill-afford such failures. Similarly, companies that are carrying the flag of black economic empowerment in South Africa can equally ill-afford such failures as the future of black economic empowerment and changing of stereotypes rely heavily on the success of these companies.

Therefore, the foundation of any successful merger or acquisition is laid with a strategically fitting marriage or takeover. Theory of constraints value as a revenue-focused approach to mergers and acquisitions cannot be doubted. Part of the reasons for the failure of mergers and acquisitions is the lack of focus on revenues, as companies concerned themselves with reducing costs rather than increasing sales.

However, theory of constraints will not help to ensure that the acquirer is not paying more than it should. This relates to the share price at that particular time of the transaction. Financial experts should be engaged in determining the price that should be paid. However, this should be viewed in relation to the benefits of the acquisition.

With due diligence, organisations need to be able to exactly identify the capability that they are acquiring, just as the acquiring company needs to accurately identify its constraint. In situations where such capability or core competence lies with specific

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individuals, those individuals should be identified and be made part of the acquisition process.

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2. INTRODUCTION

Over the decades mergers and acquisitions have been utilised by many businesses as a means of expanding their businesses and growing their profits. However, research done over the last few decades indicates that most of these mergers or acquisitions do not yield the expected or intended results. Many reasons have been bandit about for such a high rate of failure in mergers and acquisitions. Some of the reasons deal with the mechanics of the merger or acquisition, including implementation, whilst other reasons doubt the strategic decision to acquire or merge with a specific company.

However, the high failure rate in mergers and acquisitions has not dampened business belief in mergers as one of the best tools for organisations in search of continuous growth. In South Africa big businesses continue to merge or acquire other businesses for critical mass or other strategic reasons. South Africa has not escaped the dismal failure of mergers and acquisitions. There are numerous examples of South African businesses that have embarked on acquisition sprees both locally and internationally, with mixed fortunes. Both local and international research has been continued in the pursuit of means to alleviate the high rate of failure experienced in mergers and acquisitions.

Dr Eliyahu Goldratt developed what is today known as the theory of constraints (TOC). The theory of constraints is largely based on a cause and effect relationship. The theory involves investigating what is preventing an organisation or a manufacturing plant from achieving its goal of making profits today and in the future. The theory has been successfully implemented in the manufacturing industry. However, there has been very little application of the theory in the service-based industries. The theory seems to ask basic questions about a business and how it operates.

The theory of constraints will be applied in the acquisition of BoE by the Nedcor Group in the year 2002. Both these companies are in the banking industry. The implementation of the acquisition is still continuing as the research is conducted.

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2.1 Definition of terms

"Merger" – an acquisition in which all assets and liabilities are absorbed by the buyer, i.e. exchange of assets or exchange of stock.

"Acquisition" – a purchase of a company through cash and/or stock for the company to be wholly owned by the buying company.

"Constraints" – this is the aspect of a system that is limiting the system from achieving its goal.

"Due diligence" – a process of ensuring that an individual or entity is an appropriate and suitable partner for any business transaction.

"Acquirer" – The company or individual that is acquiring another company.

"Acquiree" – The company that is being acquired by another company or individual.

"Theory of constraints" – a process of ongoing improvement based on the premise that an organisation or any system is as strong as its weakest link.

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2.2 Statement of the problem

The theory of constraints is a concept that was developed by educator, businessman and author Dr Eliyahu Goldratt.

How can the theory of constraints be utilised in assisting companies to decide on which companies to acquire or merge with? In South Africa there has been a lot of merging and acquiring activity recently. Companies acquire what looks like a good business or enterprise, only to realise during implementation and a few years down the line that such a business was not the most appropriate business to acquire or merge with.

2.3 Hypotheses

The hypothesis of the research is that by applying the theory of constraints, the rate of failure in mergers and acquisitions can be lowered significantly. The theory of constraints adds value to mergers and acquisitions as a decision-making tool.

Theory of constraints can assist with the crafting of strategy in an organisation that seeks growth and continuous improvement, whether such growth can be achieved through mergers and acquisitions or not.

2.4 Assumptions and delimitations

2.4.1 Assumptions

The first step in the five focusing steps that Goldratt advocates as part of TOC is the identification of constraints. In an attempt to simplify the research, one is tempted to assume that the strategic decision to acquire is the correct one. However, it is clear that the identification of constraint should occur within the firm that is acquiring an acquisition or within the company that is initiating the merger. Therefore, the identification of constraint should precede the strategic decision of whether to utilise mergers and acquisitions as a means of growth. This is further entrenched by the view that you cannot elevate a constraint before it has been identified. Through the exploitation process it is possible that an acquisition is not the most appropriate answer. Therefore the assumption is that the first

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two steps of identifying and exploiting a constraint form part of the crafting of strategy within the acquiring business. Therefore, mergers and acquisitions should rather be the means of exploiting and elevating the constraint.

As means to illustrate the value of TOC, the research will not consider in detail the financial transaction of the Nedcor/BoE deal. For simplicity it is important to assume that throughout the exercise Nedcor has an open mind about the price of the BOE shares. It is, however, important to note that through the TOC teachings the acquiring business should not be willing to pay more than is necessary. Throughout the research business common sense and practise will be utilised.

It is important to emphasise that the research assumes that the legal process that is necessary and forms part of acquisitions and mergers is followed by the book and there will be no objections to the acquisition from the relevant authorities, like the Minister of Finance or the South African Reserve Bank.

The research assumes that the goal of any business is to make money now and in the future. Theory of constraints has the similar underlying principle. Whilst this assumption might seem to be linked to TOC or suggest that the acquiring organisation already implements TOC, organisations that do not have ambitions to make money now and in the future are destined to die. Organisations that embark on growth strategies have no intention to cease to exist.

2.4.2 Delimitations

One of the prime limitations of the study is the specialised nature of mergers and acquisitions as a discipline. Most companies that have this division in their portfolio of advisory services are not willing to share much of the information. However, the research is done on the premise that if the findings of the research could make a contribution with the little information available, it stands to reason that with more and better information available, the research would make an even better contribution.

The other limitation of the research is the grey area of whether the mistake or flaw was a strategic flaw or was it the right company to acquire or merge with. The research could

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also assist in making this distinction between the two phases of the mergers and acquisition process. However, where a strategic flaw exists, no amount of merging and acquisition will assist an organisation in addressing fundamental strategic problems. However, theory of constraints might be able to assist as a strategic management tool.

Another limitation to the research is the separation of the impact of TOC in relation to other related principles also advocated by Dr Eliyahu Goldratt which do not form part of the TOC as described by Goldratt himself. Every effort will be made to apply theory of constraints in its purest form as much as possible. It is a matter of debate whether such related principles are not business common sense and logic or not.

2.5 Contribution to the field

2.5.1 Research objectives

The aim of the research report is to determine whether the application of theory of constraints can assist companies to make better decisions or choices as to which companies to acquire or merge with.

In the case study of Nedcor 's acquisition of BoE, the contents of the research report will hopefully add value and be utilised in practice. In the end, the contribution of this research report should be to reduce the failure rate of mergers and acquisitions.

2.5.2 Importance of the problem

As witnessed with the rejoining of global markets by the South African economy, local businesses are being acquired by large international firms that want to invest in this country. The opposite is also true, and some South African companies like South African Breweries are acquiring international businesses.

What is also important, is that most of the successful black businesses in this country have been formed and grown through mergers and acquisitions. It must, however, be borne in mind that very few black businesses have been successful in this country. Whilst the failure of these companies cannot be attributed to one single factor (merger and acquisition mistakes), eliminating this cause could also assist with other problems as the

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theory of constraints is widely applicable in business. Mergers and acquisitions seem to be the route that is going to be taken by black businesses in this country for some time. It is therefore important that better decision-making mechanisms are investigated in the merger and acquisition field to limit the number of failures. For black business it is even more important, as such failures are normally met with sweeping conclusions about the effectiveness and the future of black empowerment and other related policy issues.

It is also important to note that appropriate decision- making is not only important for black business, but for all business. The economy of this country cannot rely only on black business making the correct choices, but also the entire business establishment.

2.6 Plan of study

The research methodology will start with a literature review of both the theory of constraints (TOC) and mergers and acquisitions. The literature review will be more on acquisitions than on mergers as the case study chosen for the research is the acquisition of BoE by Nedcor. The literature review will not include press releases about the acquisition. The research will also include interviews with four personnel members of the now defunct BoE and Nedcor.

The literature review will be followed by a description of the two businesses from a historical point of view, core business and strategic overview. This is necessary as the hypothesis for the research relates to the strategies employed by the two businesses. As indicated, the application of TOC will relate to both crafting of the strategy and contribution to mergers and acquisitions.

The next step in the research would be to evaluate or apply the five focusing steps that form the theory of constraints. It is important to remember that the application will not assume that a correct strategic decision has been made. The five focusing steps are as follows:

- Identify constraint (s).
- Exploit the constraint.
- Sub-ordinate everything to the constraint.

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- Elevate the constraint.
- Start with step one and avoid inertia.

The research will not attempt to undermine other strategic reasons for Nedcor's acquisition of BOE, but the understanding is that the goal of the business is to make money now and in the future. Therefore all strategic decisions are intended to add to the bottom line of the company now and/or in the future.

The next step after the application of TOC would be to determine whether the TOC application comes to a similar conclusion as that made by Nedcor. It is, however, important to note that the research does not include all the information and perhaps this comparison is unfair. But hopefully there will be glaring similarities or differences that would transcend the availability or lack of information.

The research will not include the evaluation of the use of TOC in implementing the acquisition in terms of integrating the two businesses. Therefore, issues like the integration of staff and other sensitive issues will not be dealt with in this research report. However, the research acknowledges the importance and the criticalness of these soft issues, even if an appropriate decision as to who to acquire or merge with has been made.

The next step will be to conclude whether the application of TOC adds value to mergers and acquisitions.

Recommendations will be made in terms of the dos and don'ts of the application of TOC in acquisitions.

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3. LITERATURE REVIEW

The literature review will constitute the following relevant topics:

Mergers and acquisitions

- Do mergers really exist?
- Merger and acquisition activity in South Africa.
- Rationale for mergers and acquisition.
- Reasons for failure of mergers and acquisitions.
- Strategic alliances as an alternative to mergers and acquisitions.
- Mergers and acquisitions in the financial sector.
- Hyping mergers and acquisitions.
- Mergers and acquisitions as strategic tools.
- Strategic fit.
- Core competence.
- Due diligence.

The research will concentrate more on acquisitions than on mergers.

Other topics, like core competency, have been pre-emptively included in the literature review due to evidence that matching the constraints of the two organisations would not assist in elevating a constraint. This would be similar to trying to match holes as opposed to matching a hole with a "fitting" protrusion.

Theory of constraints

- Characteristics of professional service companies.
- TOC as a process of ongoing improvement.
- Description of theory of constraints.

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3.1 Acquisitions

3.1.1 Do mergers really exist?

Perhaps the most important debate about mergers and acquisitions is the very existence of mergers. There is a school of thought that a merger of equals does not exist. Whilst initially this might initially be the case when the idea is conceived, this never lasts for a long period. The "merger of equals" title changes immediately after the companies combine. Inevitably one of the two companies, most probably the bigger and most powerful of the two, will "take control" through the boardroom and other important management positions within the newly formed company. The "merger" between Daimler-Benz, the German automobile manufacturer and Chrysler, the ailing American automobile manufacturer, is an example of what starts as a merger but results in a takeover. In this case Daimler-Benz reportedly took over Chrysler. Executives from Daimler-Chrysler, the newly formed company, face a lawsuit in the United States from one of their shareholders for avoiding take-over costs as the deal was reported as a merger of equals. Those submitting the lawsuit in the American courts contend that ultimately it was a takeover by Daimler as the number of executives responsible for the day-to-day running of the business from Chrysler have been reduced from eight (8) to two (2). Furthermore, the lawsuit alleges that executives from Chrysler knew that executives from Daimler-Benz could take control of the business and this was not disclosed to shareholders as a risk.

There is, however, a school of thought that suggests that the well-being of the newly formed company should be top priority. Therefore, executive positions should be filled by the best available executives, regardless of which of the two combined companies they come from. Therefore, the executive team will be chosen on merit, even if the numbers are heavily tipped towards one of the combined companies. As in the Daimler-Chrysler example, the board can still be equally representative of the two companies. The board is regarded to be the representation of a merger of equals.

It is difficult to separate the board of an organisation and its executive team. In most companies, some members of the board are the chief executive officer and other important members of the executive team. Therefore, if the key positions within the executive team are from one company, then that company has more control over the business than the company that does not fill key positions in the executive team. Therefore, a true merger of

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equals occurs when both companies are equally represented in both the executive team and the board.

Results also indicate high rates of failure of acquisitions. It is estimated that more than 60% of mergers and acquisitions do not realise their "stated" objectives (Thompson and Strickland, 2002). However, despite the overwhelming evidence of the failure of acquisitions to deliver on expected financial gains, mergers and acquisitions are still widely utilised as a means of growth within businesses.

3.1.1 Merger and acquisition activity in South Africa

Acquisitions have been widely utilised by many corporate firms as a means of expansion and growth since time immemorial. Depending on circumstances within the markets, acquisition activity tends to fluctuate over the years. Firms have utilised acquisitions to renew their competitive positions.

For decades acquisition activity was centred in the economic capitals of world in the United States of America, Europe and Asia. Most of the activity was still local, with very little "international" acquisition activity. However, with the globalisation phenomenon, more acquisition activity is on the international front. Even smaller economic centers, like South Africa have a reasonable high activity within the acquisition field. According to the *South African Ernst & Young Mergers and Acquisition Book Review* (2002) merger and acquisition activity equalled R242,4 billion in 2002 compared to R502,4 billion in 2001. This represents more than a 50% drop in merger and acquisition activity in South Africa. However, the figures are distorted by major deals involving major companies.

In South Africa where black economic empowerment (BEE) is gaining momentum, acquisitions are playing an important role. According to Thayser (2003) black economic empowerment was one of the major driving forces behind mergers and acquisitions in South Africa. In 2002 there were 104 BEE deals worth more than R12.4 billion. Most of the black owned and controlled enterprises have been obtained through mergers and acquisitions. With genuine black entrepreneurship skills heavily lacking in South Africa, the acquisition route is likely to be pursued for longer as black empowerment gains further ground.

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There is a view that the contribution made by mergers and acquisitions within black economic empowerment is not underpinned by sustainability. This view is based on the premise that these acquisitions have only led to the empowerment of a few elite and do not entrench a culture of true entrepreneurship.

However, Thayser (2003) is of the view that merger and acquisition activity will increase in black empowerment as the government embarks on a broad black economic empowerment initiative. Thayser (2003) further asserts that the lack of financial muscle in the black business community will create an artificial merger and acquisition market.

3.1.2 Rationale for acquisitions

Haspeslagh and Jemison (1991) identify three fundamental reasons for acquisitions:

- Acquiring a specific capability.
- Acquiring a platform.
- Acquiring an existing a business position.

Haspeslagh and Jemison (1991) describe acquiring a specific capability as a "rifle-shot" approach by a business to acquire a specific capability it needs to implement a business strategy. This capability seems to relate to a core competency as described by Prahalad and Hamel (1990). This suggests that a business is acquired because it has certain specific skills that are needed to implement a business strategy. However, this does not seem to refer to whether this capability could not be acquired through other means besides from acquiring another business. This rationale assumes that the capability could not be acquired internally or by utilising means other than mergers and acquisitions.

Acquiring a platform refers to acquisitions that may be viable before acquisition, but will clearly not be a part of the acquiring firm unless it commits to significant further investment. Therefore, the acquisitions represent a commitment to an investment strategy that far exceeds the initial purchase price.

Acquiring a business position is described as an acquisition that involves an existing business position. The acquisition itself almost implements the strategy.

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Haspeslagh and Jemison (1991) further indicate that other types of acquisitions are either a combination of these approaches or variations to one of these fundamental approaches. They further indicate that each of these approaches or rationales pose different challenges, both in the pre-acquisition stage and in the integration stage.

It is clear that before deciding which approach to take, it should be preceded by some soul searching by the acquiring firm. Theories like the theory of constraints and core competency are a genuine attempt for businesses to do some soul searching to find out what their business is about (Prahalad and Hamel,1990). It is also important to note that this will also largely be affected by the strategy a business is pursuing.

Brealey and Myers (2002) give what they term “sensible motives” for mergers and acquisitions and what they term “dubious” reasons for acquisitions.

Brealey and Myers (2002) give the following sensible motives for mergers and acquisitions:

- Economies of scale.
- Complementary resources.
- Surplus funds.
- Eliminating inefficiencies.

Economies of scale relate to a reduction of costs through the merger or acquisition. Interestingly, as Brealey and Myers (2002) allude, mergers and acquisitions motivated by economies of scale have been found in the banking industry. In the United States big banks bought smaller banks as regulations eroded, and communications and technology improved. However, the two authors are also convinced that some mergers that are motivated by economy of scale do not yield the expected results because the companies function as a collection of separate and sometimes competing operations with different production facilities, research efforts and marketing forces. This also relates to a multi-brand strategy where the different brands are expected to market themselves separately, despite being part of the same group of businesses.

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Bigger firms also acquire smaller firms that provide the missing ingredients necessary for the small firm's success. Therefore both the acquirer and acquiree have complementary resources that are important for the survival of the small firm. This motive for acquisition seems to relate heavily to Haspelagh and Jemison's idea of acquiring a specific capability. Although the complementary resources idea of Brealey and Myers relates to both companies needing a resource or capability from each other, in an acquisition situation this is similar to the acquiring company purchasing a capability.

Acquisitions motivated by surplus funds relate companies operating in mature industries with surplus cash, but with few profitable investment opportunities. These firms should normally distribute the cash to its owners (shareholders), but energetic managers are reluctant to pay the dividends. These managers are also not much interested in repurchasing some of the issued shares. The surplus cash is then invested in financed in cash acquisitions. However, such firms are often targeted for takeovers by other firms interested in redeploying the cash for them.

Cartwright and Cooper (1996) relate other motives for acquisitions that are non-value maximising or managerial. These motives relate to the following:

- Increased market share.
- Management prestige.
- Reduced uncertainty.
- Restored market confidence.
- Takeover defence.
- Protection of profits from taxation.
- Individual interests.

These motives seem to be as dubious as the motives articulated by Brealey and Myers (2002). Executives have embarked on acquisitions in an effort to renew credibility and restore self-confidence and the confidence of the board. These acquisitions are never in the interest of the organisation and most executives rely heavily on the fact that by the time the results of the acquisition are known and the prudence of the decision questioned, these executives have already moved on. When they have moved on it is always easy to put the blame on other people managing the merger or acquisition.

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Pratt and Urban (2000) suggest that the following are reasons for acquisitions in the banking industry:

- Allure of increased profitability.
- Greater market share.
- Better position to deal with competition.
- Reduced operating costs.

The above reasons for mergers and acquisitions are no different from the reasons advanced by Cartwright and Cooper (1996).

Click and Coval (2002) suggest that companies can also engage in an acquisition deal to "hedge" their positions from exchange risk beyond the short term. This is relevant for multi-national companies (operating in more than one country) and exporters and importers. Click and Coval (2002) further assert that "hedging" with a financial instrument is a short-term solution that buys companies time to make the necessary operating changes to their processes. Companies acquire other companies to diversify operations and counter exchange rate risk. However, such diversification is underpinned by low levels of correlation between the two currencies that the two businesses operate with.

There are other business leaders who continue to believe in mergers and acquisitions as one of the best business growth strategies. This is largely influenced by the premise that the new economy, through speed, does not allow for internal building. Therefore acquisitions are the best option most companies can choose to cope with the speed imperatives linked to the new economy. It must be added that this view is valid only if the acquisitions are strategically sound and implemented successfully.

3.1.3 Reasons for failure of acquisitions

Brealey and Myers (2002) have also given dubious reasons for mergers and acquisitions. The dubious reasons are as follows:

- Diversification.
- Increasing earnings per share: Bootstrap game.
- Lower financing costs.

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Brealey and Myers (2002) argue that diversification as an end in itself has not been proven to be a gain through mergers and acquisitions. In fact there is no evidence to suggest that investors pay a premium for diversified companies. They go further to say that diversified companies give discounts on their worth. A company that diversifies on the understanding that the sum of the individual stock prices of the independent diversified firms will be the stock price of the controlling company, is treading on untested ground. More often than not the stock price of the controlling company is less than the sum of the stock prices of the diversified companies. This is not in contradiction to the rationale advanced by Click and Coval (2002) about diversifying operations to counter foreign exchange risk.

Earnings-per-share (EPS) is another dubious reason for mergers. Assuming that the price of the share for the acquiring company stays the same, an increase in earnings per share does not represent any economic gain as the market value of the separate companies will be equal to the market value of the merged company. Moreover, as the price of stock stays the same, the price-earnings ratio will decrease due to an increase in earnings per share. It is important to note that the number of outstanding shares will increase depending on the price difference between the two companies. This further assumes that the merger is financed through shares instead of cash.

It is partly true that merged firms are able to borrow at a lower rate than the separate businesses could. In a merged firm, mutual guarantees make debt less risky and lenders tend to ask lower interest rates. Therefore, although shareholders of the merged firm gain from lower rates, they lose because they have to guarantee each other's debt. They only gain lower interest rates by giving the borrowers better protection. In a case where companies issue bonds, the bondholders gain from the merger as the bonds are guaranteed by both firms, but stockholders have little to show for the merger. Lower financing costs should not be the sole reason for a merger.

Other reasons for the failure of mergers and acquisitions relate to the following:

- Poor strategic rationale.
- Overpayment for the acquisition.
- Inadequate integration planning and execution.
- A void in executive leadership and communication.

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- A severe cultural mismatch.

Poor strategic rationale affects the results of the company even if such strategic rationale does not include mergers and acquisitions. It has become clear that mergers and acquisitions are a means to implement a strategy. What mergers and acquisitions are not capable of doing, is to improve a poor strategic rationale behind their engagement as a means to achieve those strategic goals from the strategy.

It is also possible that the business being acquired inflates its value and therefore the acquirer pays more than what the firm is really worth. Therefore, more benefits from the acquisition are needed to offset the high price paid for the acquisition. The acquisition ends up not yielding positive financial results for the acquiring firm.

The issue of adequate integration planning and execution is heavily reliant on the due diligence conducted as part of an acquisition. Information obtained from the due diligence process will determine the scope of planning needed for integration and execution of the acquisition. Clearly the quality of the due diligence is of primary importance for the integration planning of the two businesses.

Lack of communication despite all that is written about it in literature and other business journals and magazines, continues to thwart many efforts to make a success of mergers and acquisitions. The most common problem with acquisitions is the inappropriateness of communicating the proposed acquisition until it has been formally approved by the Registrar of Banks and the Minister of Finance.

Cultural mismatch is being singled out as the major cause of merger and acquisition failures. This is more so if the two organisations about to be merged together have strong but different cultures. Such cultures do not necessarily have to be directly opposed, as long as they are different.

It is important to note that a combination of the above- mentioned reasons for failures of acquisitions could occur simultaneously with a specific acquisition or merger. Perhaps the only indication of such a simultaneous occurrence of a combination would be how quickly

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the merger or the acquisition is realised to be a failure. This could be realised through the business being sold again after an acquisition.

3.1.4 Alliances as alternatives to mergers and acquisitions

Thompson and Strickland (2003) define alliances as "cooperative agreements between two firms that go beyond normal company-to-company dealings but fall short of merger of full joint venture partnerships with formal ownership ties".

Thompson and Strickland (2003) suggest that in the past 10 years companies throughout the world and in all industries have formed alliances and partnerships to complement their own strategies and strengthen their competitiveness in domestic and international markets. Thompson and Strickland (2003) further contend that the changing market conditions in relation to the globalisation of the world economy, advances in technology and untapped markets in Europe, Asia and Latin America have contributed significantly to the stronger belief in alliances and partnerships. The world's leading companies have numerous strategic alliances as part of their corporate strategies. Table 3.1 below indicates the number of strategic alliances for big American corporates

Table 3.1: Number of strategic alliances in American corporate businesses.

Number	Name of Business	Number of strategic Alliances
1	General Electric	100
2	IBM	400
3	Oracle	15 000

Source: Thompson and Strickland (2003) pp 173

It is important to note that Oracle, a company directly involved in the ICT industry, has significantly more alliances than General Electric and IBM. Thompson and Strickland (2003) further report that a recent study conducted in the United States of America indicated that the average large corporation is involved in around 30 alliances compared to less alliances more than a decade ago.

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Alliances are largely formed on the understanding and premise that there is mutual benefit for both companies, otherwise they are bound to fail. The two companies should have mutual respect for each other's skills and capabilities.

Thompson and Strickland (2003) give the following reasons for entering into alliances as strategic tools:

- Collaborate on technology or development of new products.
- Overcome deficits in technical and manufacturing expertise.
- Acquire altogether new competencies.
- Improve supply chain efficiency.
- Gain economies of scale in production and/or marketing.
- Acquire or improve market access through joint marketing.

Despite the above reasons for alliances, Thompson and Strickland (2003) reveal that in an Andersen Consulting study, 61% of all alliances were outright failures or "limping along".

However, Thompson and Strickland (2003) warn against over-reliance on strategic alliances. Companies run the danger of becoming dependent on other companies for essential expertise and capabilities over the long term. Furthermore, such alliances hold only limited potential as a partner will guard its most valuable skills and expertise (core competence).

3.1.5 Mergers and acquisitions in the financial sector

Consolidation within the banking industry is one of the reasons mentioned for mergers and acquisitions in the industry. Kawamoto (2000) suggests that the Japanese banking sector utilised mergers and acquisitions to consolidate the sector. The Japanese government assisted with the consolidation of the industry by allowing banks to fail without giving any assistance, despite a capital infusion of US $92 billion. The banking industry shrunk from 21 to 8 within the space of a year (McKinsey, Issue 4, 2000).

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Kawamoto (2000) is also convinced that mergers generally attract attention from the media and signal dramatic change. In Japan the announcement of the initial mergers had a domino effect as other banks started to follow suit. This domino effect tends to create an impression that mergers are the panacea to growth problems within the banking industry.

Kawamoto (2000) goes further to cite how economies of scale could be misleading within the banking industry as benefits of a merger. In Japan the expense ratios went down after assets reached the level of US$28 billion, but ceased to do so when the assets reached a value of US$92 billion. Coincidentally, the Japanese government infused the same amount into the industry in 1999. This suggests that there is a range for banks to benefit from economies of scale in Japan. However, Kawamoto (2000) does not suggest that this is a general phenomenon within the banking industry. Perhaps then the view that banks operate similarly regardless of whether they are in the developed world or developing world or they are faced with similar dynamics, is not true. Perhaps not explicit in the facts provided by Kawamoto (2000) is that banks should increase their assets to actually realise the benefits of the merger. This seems to suggest that mergers then provide both the increase in asset value and subsequently the benefit from economies of scale. However, Kawamoto (2000) contends that few benefits arise from economies of scale from the integration of information technology systems following a merger. In fact, more often such integration of information technology systems becomes complicated and there is a need to make further investments.

Kawamoto (2000) also alludes to the view that mergers never result in cost cutting unless it will result in a significant drop in employee numbers. Table 3.2 indicates the number of employees in banks in the United States and Japan.

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Table 3.2: Number of employees in banks in the United States of America and Japan

Number	Country	Bank Name	Number of Employees
1	Japan	Bank of Tokyo-Mitsubishi	17 937
2	Japan	Dai-Ichi Kangyo Bank	16 402
3	Japan	Sakura	16 381
4	USA	Chase	72 683
5	USA	Citicorp/Travellers	173 700
6	USA	Bank of America	170 975

Source: McKinsey Quarterly, 2000, Special Edition Issue 4, pp110

To put the above table into context, the American banks employ several times the number of employees in Japanese banks, despite comparable asset bases. Japanese banks also pay an average 1.53 times what the American banks pay on average. In contrast, South African banks do not compare with either the Japanese or American banks in terms of asset base yet they have a higher number of employees compared to Japanese banks, but significantly lower than the American banks. Therefore, compared to Japanese banks South African banks have excessive employment figures. Therefore there is room for cost-cutting benefits for mergers in South African banks. It must be noted that the comparison is superficial and does not involve deep research into the operations of South African banks compared to their Japanese counterparts.

However, Kawamoto (2000) suggests that for Japanese banks to gain any cost- cutting benefits from mergers, they have to reduce the salaries of its employees. There is no evidence to suggest that mergers have resulted in reduced salaries for employees. In South Africa the standard of living of individuals is protected by the Constitution as it prohibits the reduction of a person's standard of living after a restructuring process. Therefore South African banks cannot expect to reduce the salaries of either the company that is acquiring or the company being acquired.

There is a general decline in the number of branches in Japan through the consolidation of branches. However, it is very difficult to terminate a lease on a branch and find a non-banker for it. The space is normally fitted with hard-to-adapt features like vaults. Finding another bank to lease the space is also difficult as the number of branches declines. In banking 80% of the profits come from 20% of the customers just like any business. If those

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customers belonged to the branch that is closed they could move to another competitor close by. The merger could result in a loss of valuable customers.

Kawamoto (2000) further cautions banks that they should not utilise mergers as answers to what is strategically flawed within the banks themselves. The Japanese government protected many of the large corporations in the country, including banks. This has led to complacency within the banking industry. Mergers might be a useful tool to achieve increased profits, but it is not a panacea.

It is also interesting that in South Africa a significant number of banks have submitted their licences to the Reserve Bank instead of these banks being acquired by other banks or merging with other banks. Does this suggest that the smaller banks are generally not attractive for either acquisitions or mergers?

3.1.6 Hyping mergers and acquisitions

In his book "*Why smart executives fail*", Sydney Finkelstein (2003) suggests that within the mergers and acquisition industry, executives hype the mergers and acquisitions in order to make the big picture look good. These "hero" CEOs, as Finkelstein refers to them, want to see an immediate increase in the stock price after a deal has been announced. Some CEOs even go further and employ a public relations firm to get favourable spins in newspaper articles. Examples are given of quotes made by CEOs when the purchase was made and when the acquired companies were sold again. Table 3.3 below shows some of the quotes in the United States of America.

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Table 3.3: Quotes from CEOs on acquiring dates and sold dates:

Number	Deal	Dates sold, bought	CEO words at purchase	CEO words after sale
1	AT & T buys NCR	1991, 1995	"Ours will be a future promised fulfilled"	"The world has changed"
2	SmithKline Beecham Buys Diversified Pharmaceutical Benefits	1994, 1999	"Unique alliance positions us to win"	"We need a sharper focus"
3	Eli Lily buys PCS Health Systems	1994, 1998	"Jewel at a very attractive price"	"Business can benefit from new ownership arrangements"
4	Quaker Oats buys Snapple Risks	1994, 1997	"Tremendous growth potential"	"Remove financial burdens that Snapple brought"
5	Nedcor buys BoE	2002, 2003	"Retail banking is an industry of giants and Nedcor wants to participate"	The CEO resigned in September 2003.

Source: Finkelstein 2003

3.1.7 Mergers and acquisitions as strategic tools

Hackett (1996) suggests that whilst mergers and acquisitions can provide excellent value, sometimes they are sometimes merely ashort-term, pragmatic way of solving deep-rooted performance problems. In this instance, acquisitions tend to deal with the symptoms of the malaise affecting poor or inadequate performance rather than the cause of poor performance. Hackett (1996) goes further to say that hasty approaches to mergers and acquisitions stem from a lack of robust, effective strategic analysis and understanding of the strategic alternatives available to corporations. Companies that also pursue the acquisition approach without continuously evaluating the strategy also suffer from a lack of robust strategic plans based on a thorough understanding of strategic alternatives.

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There is also a view that other companies deliberately pursue acquisitions as the only measure of growth available. The point is that companies should not just pursue acquisitions; acquisitions should rather be the result of an extensive process including other possible ways of expanding and growing. Other companies have blindly followed the acquisition route without checking its merit. This is largely linked to the ego problems associated with mergers and acquisitions. These views are that mergers and acquisitions are the panacea of growth strategies (Anonymous, 2001, pp 4-5).

Other business leaders, like Ed Liddy,contend that mergers and acquisitions get unnecessary attention and therefore when they fail, they get all the publicity. There are internal projects within companies that have shown equal if not worse results, but get little attention due to their internal nature (Anonymous, 2001, pp 5).

Jan Leschly has alluded to the fact that for SmithKline Beecham it was more beneficial for the company to purchase products rather than companies. The products have contributed more to increasing revenues than purchasing businesses. Businesses normally come with other problems that are complex in nature and cannot be solved easily (Anonymous, 2001, pp 6).

3.1.8 Strategic fit

As a concept strategic fit has been utilised in different concepts and therefore has a different meaning to different authorities within business strategy. Strategic management as a discipline encompasses a lot of concepts. Furthermore, our understanding of what is "strategic" seems to be boundless. Therefore the concept of strategic fit can be applied in different contexts and mean different things to different people.

However, there seems to be some consensus about strategic fit being one of the most important aspects of mergers and acquisitions. Research has been conducted on how strategic fit has a bearing on creating value in mergers and acquisitions.

In the context of mergers and acquisitions combined with theory of constraints, strategic fit means the aligning of the organisation's constraints and strengths. Strengths in this context are defined in its broader terms, including concepts like core competence as

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developed by Prahalad and Hamel (1990). The basis of theory of constraints is such that what is limiting the organisation from achieving its goal should be identified and elevated. Therefore there should be a "fit" between the constraint and the means to elevate that constraint.

3.1.9 Core competence

Prahalad and Hamel (1990) suggested that the critical task for management in corporations will be to create organisations capable of infusing products and services with irresistible functionality or, better yet, creating products and services that customers need but have not yet even imagined.

According to Prahalad and Hamel (1990) it is organisations that build "core competencies" that will be able sustain growth and continuously meet the needs of investors. It is important to note that this does not suggest that organisations that have not identified such core competencies and do not have such core competencies will not have any growth. However, as with theory of constraints, the concept of core competency is underpinned by the premise that organisations do not exist so that they obtain mediocre results. In fact, the long- term existence of these businesses relies heavily on increased growth in revenues and profit.

Prahalad and Hamel (1990) utilise the analogy of a tree in their attempt to articulate the concept of core competence. The trunk and major limbs of the tree are like core products of a business. The smaller branches are business units, and the leaves, flowers and fruit are end products. The root system that provides nourishment, sustenance and stability is the core competence. Core competencies are the collective learning within the organisation.

Prahalad and Hamel (1990) suggest that three tests can be utilised to identify a core competence. These tests are the following:

- They provide potential access to a wide variety of markets.
- Should make a significant contribution to the perceived customer benefits.
- Should be difficult for competitors to imitate.

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Thompson and Strickland (2003) make a distinction between core competence and distinctive competence. "Core competence is something that a company does well relative to other internal activities". Distinctive competence is defined as "something a company does well relative to competitors".

One of the major reasons identified for the failure of mergers and acquisitions is the obsession with reducing costs linked with little regard for increasing revenues. The concept of core competence is revenue forecast as it is underpinned by a wider access to markets, perceived contribution by customers and difficulty in imitating. Intuitively during mergers and acquisitions, concepts that assist organisations to think about increased revenues become crucial if those mergers and acquisitions are to succeed.

Core competence, as articulated by Prahalad and Hamel (1990), relates well to the capability referred to by Haspeslagh and Jemison (1991). However, judging by the articulation of core competence, organisations should ideally engage in mergers and acquisitions only for capabilities that are core competencies or capabilities that contribute significantly in terms of building those core competencies. Therefore not all capabilities will be core competencies.

Moreover, it is important to pinpoint exactly where such capabilities reside. The due diligence process should be able to assist in this regard. Acquiring capabilities that reside with specific individuals who do not necessarily "approve" of the acquisition can be dangerous, especially in a relationship-based business like banking.

3.1.10 Due diligence

Johnson (1999) describes due diligence as the process of ensuring that an individual or entity is an appropriate and suitable partner for any business transaction. In mergers and acquisitions the objective of due diligence is to obtain information about the target firm, therefore enabling the acquirer to make an informed decision. The results of the due diligence process should assist the acquirer to better assess the business risks of the transaction and negotiate the transaction. According to Johnson (1999), a due diligence checklist should include the following areas of the potential candidate for acquiring:

- Financial information

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- Products
- Customer information
- Competition
- Marketing, sales and distribution
- Research and development
- Management and personnel
- Legal and other matters
- Other company information

Other company information relates to a business plan, list of board members and list of stockholders.

Johnson's (1999) checklist refers to all aspects of the business in terms of its functional structure. The impression is that with good due diligence an acquirer should be able to make an informed decision. However, concepts like theory of constraints and core competency go beyond the readily available information that can be accessed through public mediums. Furthermore these concepts force the process to look into the connection and inter-relatedness between the certain aspects of the business. It is not obvious that a constraint that is in the market for a specific company will be identified through the process of due diligence, nor is it possible to sometimes quickly determine a company's core competencies within a short space of time.

3.2 Theory of Constraints (TOC)

3.2.1 Characteristics of professional service companies

DeLong and Nanda (2003) simply define a professional service company as a company that provides a professional service to its clients. Two dimensions are utilised to characterise professional service, i.e.:

- Output
- Provider expertise

The output refers to an intangible experience and provider expertise refers to the specific expertise that the professional firm has. Delong and Nanda (2003) further allude to the fact that sometimes the intangible experience offered by professional service companies

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is accompanied by a tangible product. Banks seem to fall within this category as they offer both intangible and tangible products.

DeLong and Nanda (2003) give the following as unique characteristics of professional service companies:

- Their primary assets - knowledge, experience, and reputation of the people who work in them - are intangible.
- The service delivered is intangible and difficult to evaluate.
- The service providers are typically highly skilled people with multiple affiliations.

Banks possess all the above characteristics of a professional service company and more. Only part of the bank's activities fit the definition and characteristics of a professional service company. Corporate banking is the most suitable part of a big bank that fits the definition.

DeLong and Nanda (2003) indicate that professional service companies need to be sensitive to the following dimensions within their operations;

- Client relationship management
- Management of human capita
- Value creation

3.2.2 TOC – A process of ongoing improvement

TOC is an overall management approach that focuses on the identification and elimination of an organisation's constraints (or bottlenecks), and on the implementation of a process of ongoing improvement in order to achieve the goal of an organisation.

TOC has its roots in systems thinking. Due to a constantly changing environment, there is a need to constantly evaluate situations to check for relevance and applicability of previous solutions.

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3.2.3 Description of TOC

Goldratt and Cox (1998) argue that the only goal of an organisation should be "to make more money now and in the future". This goal was largely informed by the view that organisations frequently confuse the real goal with issues such as ensuring timely deliveries, obtaining a certain market share, achieving zero defects, being a market leader, etc. According to Goldratt and Cox (1998) the above-mentioned goals are mere necessities to achieve the real goal which is to make money now and in the future.

The TOC approach regards absolute measurements of an organisation's performance such as nett profit and return on investment as necessary to measure the extent to which the goal has been achieved. However, these measurements are not practical and relevant when local decisions (e.g. on a production line or service delivery in a service industry) are made by the factory and production people. Goldratt (1990) defines three simple measurements to judge the impact of local decisions on the goal of an organisation. These are:

- Throughput : the rate at which the system generates money through actual sales;

- Inventory : all the money the system invests in purchasing things the system intends to sell;

- Operating expense : all the money the system spends in turning inventory into throughput;

TOC is able to demonstrate that all cost calculations in a business process can be defined according to the above-mentioned measures. These measurements are intended to guide operational personnel in their decision-making. Therefore the aim of any

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organisation should be to simultaneously increase throughput and decrease inventory and operating expense.

Every production system needs some form of control point to control the flow of products through the system. If a system contains a resource that does not have the capacity to meet demand (a bottleneck), then this constraint is obviously the best place for control. According to Goldratt (1990), there are two ways to deal with a constraint:

- To maintain a buffer inventory in front of it to ensure that it always has something to work on
- To communicate upstream as to the rate of production at the bottleneck to prevent inventory from building up.

The further management of physical constraints according to TOC is based on a five focusing step approach. The five focusing steps are as follows:

- Identify the system's constraint.
- Decide how to exploit the constraint.
- Subordinate everything else to the constraint.
- Elevate/break the system's constraint.
- Refocus on the next constraint and avoid inertia.

With the goal of an organisation already identified as making money now and in the future, identifying the constraint is trying to find out what is preventing the organisation from achieving that goal. With the living systems theory profoundly articulated by Pascale, Millemann and Gioja (2000), the identification of the constraint has become even broader than perhaps initially indicated and anticipated by Goldratt. According to Goldratt a constraint can either be within the organisation or within the market. Pascale *et al* is living systems theory application in business seems to suggest that our definition of what the market is, is much broader than identified by Goldratt. The sustainability and sustainable relevance of businesses is today affected by more issues than it was more than four decades ago. It is important to note that there could be a coincidence that an organisation's constraint is another organisation's core competency. However, more research needs to be done to find out whether constraint and core competency should always be on the same aspect to achieve the required strategic fit.

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The second step in the five focusing steps is largely influenced by the empirical view that more often than not, the constraint is not used to maximum capacity. Before investments are made in the constraint, better results could be achieved by merely improving the efficiency of the constraint. More often than not this saves organisations significant investment funding as a significant improvement in financial results could be achieved through the exploitation of the constraint. "Exploit" in this context refers to getting the most out of the constraint before investment.

With the constraint already identified as that part of the system preventing the organisation from achieving its goal, it is important that it is treated with more urgency and importance. Subordinating everything else to the constraint of the system, as Cox and Spencer (1998) suggest, is the most difficult of the five focusing steps as it contrasts the most traditional managerial policies and practices and local measures. Therefore, subordinating everything else to the constraint suggests that those working with the constraint or those who have those skills should be paid more than those working with idle non-constraint activity.

It makes sense that more resources should be employed where the constraint is if it truly affects how the business achieves its goal of making a profit now and in the future. Therefore the constraint should be elevated above other activities within the system or production line. The elevation simply means an increase in capacity of the constraint. This could be done by modifying existing equipment or increasing the personnel that have the skills needed for the constraint to operate at a higher capacity. Alternatively, the personnel responsible for the constraint could be freed of their "other" duties to concentrate solely on the constraint. It is important to note that this step largely depends on how much exploitation occurred in step 2 of the process.

The last step involves not allowing inertia to set in and preventing the process of ongoing improvement from continuing. Therefore when the constraint is broken in step 4, step 1 should be engaged to identify a new constraint. Therefore, the five focusing steps have a systems-thinking underpinning that allows for the monitoring and reviewing of solutions. As indicated above, TOC is underpinned by a process of continuous improvement. It is possible that when the constraint is elevated beyond a certain level, a new constraint may appear within the system. It is important that the new constraint is rigorously engaged into the five focusing step model to achieve continuous improvement.

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Having identified the areas or the systems to be improved, Goldratt (1990) suggests the following improvement process:

- Determine **what to change**. The effect-cause-effect technique of TOC will enable participants to identify the core problems
- Determine **what to change to**. The evaporating cloud technique will assist in formulating the "ideal" situation, and prevent the creation of other undesirable side-effects as a result of the proposed solution.
- Decide **how to cause the change**. TOC suggests that the buy-in of all the people directly or indirectly involved is required before any implementation plan can be developed. The current reality tree and future reality tree techniques should be used to obtain the required buy-in of stakeholders.

There is a view that with service companies not all the five focusing steps are necessary if there is a policy constraint (Motwani, Klein, Harowitz, 1996). This seems to suggest that there is no benefit in applying steps 2 and 3 in a professional service industry. Surely there is some value in subordinating everything else to the constraint. Granted, it is not always possible to "exploit" a constraint as this becomes an elevation of that constraint as an investment is the only way to squeeze more capacity out of the constraint.

3.3 Summary of chapter: Literature review

Mergers and acquisitions have been utilised as a business growth tool for many decades. There are sound reasons for engaging mergers and acquisitions as strategic tools for business growth. These reasons range from acquiring capabilities to diversifying for exchange rate risk. However, there are other reasons that are described as either dubious or strategically flawed. In most of these cases, mergers and acquisitions are utilised to conceal-deep seated problems within organisations. Inevitably, such mergers and acquisitions never yield the publicly stated results. Generally mergers and acquisitions are met with hype generated by executives involved in such deals. The hyping of the mergers or acquisitions creates high expectations from investors.

There is a school of thought that begins to question the wisdom of utilising mergers and acquisitions as a tool for growth. Alliances are provided as an alternative to mergers and acquisitions. Alliances have their own advantages and disadvantages, depending on the specific situation.

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The banking industry has been besieged by a consolidation process throughout the world, in both developed and developing markets. In Japan the number of banks was reduced from 21 to 8 within the space of a year. There is a school of thought that in South Africa the banking industry should be consolidated further to reduce costs.

As with any marriage, there should be some sort of "fit" between the two marrying parties. Taking mergers and acquisitions as strategic tools, strategic fit is therefore an integral part of mergers and acquisitions. However, strategic fit is a broad concept. For the purposes of this research strategic fit means linking the constraint of an organisation with a competence of another organisation.

Core competence is a concept developed by Prahalad and Hamel (1990). Core competence is believed to bring competitive advantage to an organisation as it is not easily copied, gives access to new markets and makes a significant contribution to the perceived customer benefits.

Due diligence is an important process within mergers and acquisitions. Johnson (1999) defines it as the process of ensuring that an individual or entity is an appropriate and suitable partner for any business transaction. Johnson attempts to define the process as broadly as possible through a checklist. The process of identifying the means of elevating a constraint could be part of the due diligence process.

Theory of constraints was developed by Eliyahu Goldratt and has been widely and successfully applied in the manufacturing environment. However, the concept has not been widely applied in the professional service industry. It is based on the cause and effect approach. The concept is largely underpinned by the premise that any system is as strong as its weakest link. Goldratt (1990) suggests that the improvement process should be based on identifying what to change, what to change to and how to cause the change. Goldratt further suggests five focusing steps which are as follows:

- Identify the system's constraint.
- Decide how to exploit the constraint.
- Subordinate everything else to the constraint.
- Elevate/break the system's constraint.
- Refocus on the next constraint and avoid inertia.

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The five focusing steps are more widely used in the application of the theory of constraints.

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4. DESCRIPTION OF THE TWO BUSINESSES

4.1 BoE Limited

4.1.1 History and Background

The business was originally established by a trust company in Cape Town, South Africa, in 1838 by The Board of Executors and had been in operation for more than 163 years. By 1882 NBS was established as a building society in Durban. Boland Bank was established in 1900 as a regional bank in the small Western Cape town of Paarl, just over a hundred kilometres to the east of Cape Town.

There were no major activities within NBS and Boland Bank until Boland Bank was listed at the then Johannesburg Stock Exchange (JSE). BoE was itself not listed on the JSE until 1987, 18 years after Boland Bank was listed.

In 1997 NBS Holdings acquired the financial services interests in Boland Bank Holdings and the name was changed to NBS Boland Group Limited. This acquisition heralded the first step in the formation of what was the bigger group of BoE.

In 1998 there was a merger of BoE and the NBS Boland Group formed in the previous year. During 1998 BoE made further acquisitions of Claremont Life in the Isle of Man and renamed the company BoE Life International. BoE went on to acquire Cantrade Investments in the United Kingdom and the company was renamed Chiswell Associates. These acquisitions indicated BoE's strategy as a specialist bank providing innovative solutions to its clients. This further indicated BoE's first investments outside South Africa.

In the year 2000 the BoE group of companies was restructured. This included the dismantling of the pyramid control structure and control block, disposal of non-core investments, distribution of R2,4 billion in cash to shareholders, distribution *in specie* of the investment in RMB Holdings to shareholders and share buy-backs.

As a continuation of the strategy embarked on in 2000, the BoE Group further disposed of its investment in African Bank Investment Limited (ABIL). The Group then acquired the following businesses:

- Credcor.
- Cashbank.

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- Edge Investments.
- Stenham Gestinor Limited.

In 2002 the BoE Group disposed of its NBS Home Loan book and continued to buy back its shares.

4.1.2 Nature of business

BoE was a specialist provider of innovative financial solutions to businesses, and through businesses to individuals. BoE comprised three main business groupings. Business-facing divisions offered merchant banking, commercial and industrial property finance, asset-based lending to corporates, full service commercial banking and e-commerce facilities. Investment management divisions offered private banking, asset management, employee benefits, insurance and fund administration services. The retail divisions offered consumer credit, secured and unsecured lending products and savings accounts to individuals.

BoE was listed on the Johannesburg Stock Exchange (JSE) in 1987. In 1998, BoE merged with NBS Boland Group to establish of the then core of the Group. NBS was established as a building society in 1882 and Boland Bank as a regional general bank 1900.

As a South African group, BoE operated in both developed and emerging markets. The Group focused on selected market segments in which it developed high expertise. BoE's major thrust is to provide services to businesses, and through businesses to render service to individuals, whether they are owners, managers, employees or customers of these businesses.

Through a combination of high levels of client service and innovative products and ways in which products are delivered to customers, BoE sought to differentiate itself from its competitors.

4.1.3 Strategic overview

In its last few years the BoE Group followed a strategy to establish BoE as a medium-sized specialist South African banking and financial services group delivering competitive returns to its shareholders. In implementing the strategy the group did the following:

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- Disposed of or unbundled non-core businesses.
- Returned excess capital of R6 billion to shareholders through a combination of unbundling, share buy-backs and a special dividend.
- Deployed excess capital through selective but complementary acquisitions.
- Disposed of under-performing businesses.

This strategy was pursued with full cognisance of the global trend of consolidation in banking and financial services industries. A key uncertainty for BoE has been whether the South African market can sustain a medium-sized specialist banking group. To proactively manage the uncertainty, BoE continually reviewed its strategic alternatives, including the possibility of a partnership with a major local or international institution. Despite the setback with Citibank, BoE was confident of finding another global partner once things settled down after the destruction of the World Trade Centre in New York. The bank needed to invest in technology and it did not have the capital for the investment. The bank had negotiations with Citibank but these fell apart after 9/11.

The following adverse factors impacted on the banking sector in South Africa:

- A number of smaller banks were being liquidated and/or placed into curatorship.
- A dramatic collapse of the rand in the last quarter of 2001 which, *inter alia*, inflated inter- bank counter-party exposures.
- Micro- lenders and the consumer credit industry reported significant and sudden withdrawals.
- Deterioration in credit experience, resulting in a material increase in bad debts and provisions.

With the industry already adversely affected by the above-mentioned factors, the placing of Saambou Bank Limited into curatorship in mid-February 2002 became a catalyst that ignited major concerns about the entire banking system in South Africa. Immediately after the Saambou Bank episode, BoE, the sixth largest bank and the smallest of the A1 banks, experienced abnormally high levels of depositor withdrawals. A statement from the Governor of the Reserve Bank guaranteeing the deposits at BoE as it was a well-managed, sound and solvent bank, could not stop the outflow of funds from BoE.

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The future of BoE was put under further scrutiny after the bank reviewed its residential mortgage book and entered into negotiations with FirstRand Limited with the idea of selling the mortgage book to First National Bank (FNB) Home Loan.

The Minister of Finance also added weight to the depositor problem by issuing a statement guaranteeing depositor's cash at BoE. However, the damage had already been done and the bank could not normalise its liquidity position, despite receiving the proceeds of the sale of the Mortgage Book to FirstRand to the tune of R7 billion.

Due to the above problems, it was then incumbent upon the directors of BoE to review, as a matter of urgency, the Group's stand-alone strategy. The directors of BoE were convinced that all parts of BoE would benefit from being part of a larger group. Whilst the directors were convinced that the Group could not sustain itself on its own, it is not clear whether they had the Nedcor acquisition in mind. Although it was explicitly so, the directors of BoE seemed to favour a merger with a larger bank as opposed to an acquisition by another bank.

4.1.4 Financial results

For the period up to March 2002, the headline earnings per share, based on the lower average number of shares in issue, was unchanged at 25 cents per share. No interim dividend was declared as this was a condition of the offer by Nedcor to BoE shareholders.

Continuing their trend, the corporate banking divisions achieved a significant earnings growth of 25% and a return on equity of 25%. Profits in the Investment Management Division improved primarily due to offshore operations, enhanced by the acquisition of Stenham Gestinor. Results in the Retail Division were disappointing. Pep Bank, Cashbank, and the NBS Savings and Investment Divisions performed according to expectations, but the Credcor Division was adversely impacted on by additional provisioning for bad debts. These provisions resulted from the re-appraisal of credit risk in the micro-lending and consumer credit sectors.

Non-funded income increased by R449 million compared to March 2001, of which R270 million was attributable to the income generated by Stenham Gestinor, Edge, Cashbank,

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and Credcor. A further R112 million of the increase is attributable to foreign exchange gains from the Group's foreign operations.

Operating expenses were well controlled, with organic growth restricted to 4% over the same period in the previous year. The impact of acquisitions, some of which had relatively high cost-to-income ratios, added approximately R210 million to the cost base.

4.2 Nedcor Group

4.2.1 History and background

In 1831 the oldest bank in South Africa, Cape of Good Hope Bank, was established in St George's Street, Cape Town.

In 1834 the Syfrets Trust Company was founded. The South African Association for the Administration and Settlement of Estates, the first trust company in the world, was founded in Cape Town and later absolved into Syfrets, which was formed in 1951 by EJM Syfret. In 1841 in Kimberley, the Kimberley Permanent Mutual Building and Investment Society was formed. A number of Kimberley businessmen met to inaugurate Kimberley's third building society and first permanent one.

In 1989 Nedbank opened a representative office in Taipei, Taiwan. UAL Merchant Bank funds under administration exceeded the R10 billion mark, Syfrets R7 billion and Nedfin the R2 billion mark. Nedbank Group Limited changed its name to Nedcor Limited. Syfrets SA changed its name to Syfrets Group Limited. World Travel Agency joined NedTravel. By 1990 the Namibian Banking Corporation Limited, incorporating Nedbank's operation in Namibia, was established following Namibia's independence. Nedbank and Perm's combined ATM network became the largest in South Africa, with 944 ATMs. Nedbank, in association with the World Wide Fund for Nature (WWF), launched The Green Trust.

In 1992 Nedfin, Perm and Nedbank, together with their support divisions, became known as Nedcor Bank Limited, a wholly owned subsidiary of Nedcor Limited. NedTravel Group Holdings became the second largest travel group in South Africa and a wholly owned subsidiary of Nedcor Limited. Finansbank merged with Nedbank Financial Services Division to form Financial Services Division of Nedcor.

In 1993 UAL Merchant Bank's Founder's Room was officially opened. The Namibian Banking Corporation Limited merged with the Commercial Bank of Namibia and retained

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the latter's name, with Nedcor Bank Limited a 47% shareholder in the new Commercial Bank of Namibia. A cooperation agreement was signed with SFOM (Société Financière pour les pays D'Outre-Mer). Mr Richard Laubscher was appointed as the Group Chief Executive Officer of Nedcor.

In 1994 Nedbank opened its doors in Asia and opened a representative office in Beijing. Nedfin Bank became Nedbank Commercial Division. The Financial Services Division changed its name to Nedbank Investment Bank Division. The Sports Trust and The Arts and Culture Trust were formed. In 1995 Perm split its operations into two separate banks of equal status, namely Permanent Bank and Peoples Bank. The two banks, with new logos and corporate identities, were launched to the South African public in June 1995. Nedbank Investment Bank was selected as one of the partners in a multinational banking group appointed by the government of Ghana to handle the privatisation of National Investment Bank.

In 1997 Syfrets merged its activities with those of UAL and Nedbank Investment Bank to form Nedcor Investment Bank. Full transactional banking was made possible via the internet using NetBank. Cape of Good Hope Bank introduced credit card and cheque account facilities. By 1998 the Visa v-chip smartcard was launched in Peoples Bank.

In 1999 Nedbank Private Bank and Syfrets Private Bank were merged to create the largest private bank in South Africa. NedTravel was sold to Tourvest. In July Old Mutual, one of Nedcor's main shareholders, was demutualised and listed on the London Stock Exchange. A bid for merging with Standard Bank Limited was made in October. In 2000 Nedcor Bank acquired FBC Fidelity Bank Limited.

In 2001 Nedcor Limited and Old Mutual South Africa Limited announced the proposed merger of Permanent Bank and Old Mutual Bank to form a new banking operation focused on wealth management and financial planning.

The merged operation is a custom-built bancassurance institution focused on the retail middle market in South Africa. Nedcor and Old Mutual each own 50 percent of the new bank.

The new bank, operating as Old Mutual Bank, will initially offer a full range of deposit and investment accounts, home loans, secured loans and other wealth management products.

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On 2 July 2002, the High Court gave its approval for Nedcor to acquire all the issued shares and convertible debentures of BoE, thereby paving the way for the Nedcor - BoE merger. This final step in the approval process made the formation of one of South Africa's leading banks with assets of more than R260 billion a reality.

This merger heralded a new era in the history of BoE and Nedcor. For BoE, it offered the opportunity to continue a long and proud tradition of banking excellence and personal service. For Nedcor, the financial expertise and the quality of BoE's people will continue to further enrich its offering to the public. The High Court's ruling was lodged with the Registrar of Companies on 3 July 2002. The last day to trade in BoE shares in order to participate in the share scheme was 3 July 2002, and the operative date of the scheme was 11 July 2002.

NIB minority shares were acquired by Nedcor Limited in October 2002. NIB was delisted.

On 1 January 2003 the new Nedcor Group was formed, combining Nedcor, BoE, NIB and Cape of Good Hope Bank into one legal entity. New management structures came into effect, allowing these entities to become a fully integrated business.

The group now has banking licences for Nedbank, Peoples Bank and Imperial Bank in South Africa, Gerrard Private Bank in the United Kingdom and several licences in the rest of Africa and the Middle East.

4.2.2 Nature of business

Nedcor offers a full spectrum of banking services, either directly or through alliances with partners like Old Mutual (major shareholder in Nedcor), Imperial and Pick ‘n Pay. The bank is largely divided into three segments namely corporate banking, retail and technology operations. There are other supporting divisions within the bank.

The following services are offered by the Group:

- Treasury
- Business banking
- Property and asset finance
- Capital markets
- Retail banking

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- Wealth management
- Technology solutions

The Group has a board of directors with 25 members, influenced by a former Minister of Finance.

4.2.3 Strategic overview

The strategy of the Nedcor Group seems to have been influenced by the international trend towards consolidation in the broader financial services industry and leveraging on the technology platform. Much of this has been based largely on the belief that the banking industry is a volume-driven industry. Therefore, the lowest cost producer will ultimately be the strongest in the market. The attempted hostile takeover of Standard Bank Investment Corporation (Stanbic) was the biggest step in an attempt to not only consolidate the banking industry, but to also bring the necessary critical mass to make Nedcor the leading bank in South Africa as the lowest cost producer.

This strategy was further augmented by strategic alliances with domestic brand leaders in the middle-income, retail and technology fields. As part of this strategy, Nedcor has pursued a multi-brand strategy. The merger with BoE provided an opportunity for the bank to restructure its operations and brands. After the merger has been completed the following brands will still be operational:

- Nedbank
- Nedbank Corporate
- People's Bank
- Gerrard Bank
- BoE
- Go Banking (Pick 'n Pay)
- Old Mutual Bank
- Imperial Bank

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The technology operations division operates directly under the group brand Nedcor. Nedbank and People's Bank are the two main retail banks in the Group.

Go Banking, Old Mutual Bank and Imperial Bank represent the alliances the Group has formed to increase its market share. Despite being small these banks were reportedly growing at a fast rate.

4.2.4 Financial results

It is important to concentrate on Nedcor's latest results that were released in February 2003. However, these results also include the performance of BoE, as the merger was concluded by this time. Therefore for the purposes of this research, the results of Nedcor's core business, which excludes BoE, will be evaluated.

Nedcor has delivered continuously worsening results for the last three years. These poor results started with Nedcor losing more than R4 billion from its investment in the information technology group Dimension Data. In 2000 the investment was worth R5,3 billion and by February 2003 the investment was worth a mere R1 billion, less than the R1,5 billion initially invested. The results were dented further by a stronger rand.

Unexpected bad debt provisions continued to impact negatively on Nedcor's financial results. The bank made a provision of R656 million against bad debt on its small business lending book. The amount was much bigger than the other competing banks had provided for. However, the market seemed to be more upset about Nedcor's lack of reporting about the issue when the bank knew about the bad debt for years. An analysis of the results shows that the results were made to look better by the performance of BoE. Nedcor's core business, when analysed in isolation, indicated that the bank had a 9% drop in core earnings. Perhaps the debate should be whether BoE was a wise acquisition or whether the process BoE was also utilised to shield some of Nedcor's core business poor results.

Nedcor's commercial banking operation was down by 37%. The technology investments lost R32 million. However, retail banking was the best performer with returns of 70%, largely attributable to the old Nedbank and People's Bank. Corporate banking, excluding Nedcor Investment Bank (NIB), was down by 8%. The international outsourcing project had not yet realised any positive results.

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4.3 Nedcor's reasons for acquisition

Nedcor's decision to acquire BoE was influenced by the following issues:

- Consolidation within the banking industry.
- International banks entering the South African market.
- Lack of corporate banking skills.
- Lack of geographical presence in Western Cape and KwaZulu-Natal provinces.
- Declining profits for Nedcor.
- Economies of scale.

It might be that banks like Bank of Good Hope have a presence in areas like the Western Cape and that some of its customers take pride in banking with the bank. How much growth do these local banks have? The other important issue relates to the fact that the other banks might be winning most of the new business, as these banks struggle to market themselves locally due to the high costs of marketing for the entire group. In fact, such local banks might not be the ideal sources of growth as the larger banks tend to have more automatic teller machines (ATMs) and more branches. Clearly the South African consumer is concerned about the time he/she spends in a bank. Internet banking has increased in this country, despite its security uncertainties. How easy will it be for Nedcor to provide such technology and services through different brands? Therefore the multi-brand strategy does not seem to be the best strategy to go for.

It is argued by the CEO of Nedcor that you cannot have one size fits all. This argument is flawed, as the differentiating factor is not the name but the services offered by the bank. With the kind of aggressive marketing and range of services offered by the major one brand bank like ABSA, more customers are likely to join that bank. Berry et al (1988) allude to the fact that brands cannot make or break a company, but what matters is how well a company's goods and services meet its customers' needs. However a brand can give a company a marketing edge over its competitors. A strong corporate brand is also important for service companies, as services do not lend themselves to individual branding the way tangible products do. Moreover, banks are selling a commodity and more priority should be given to services provided than just the image. ABSA has started to advertise to the lower end of the market through the ABSA Cup soccer competition,

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More people are starting to identify with the company than before. Remember, ABSA is a consolidation of four banks, namely Allied, United Bank, Volkskas and Trust Bank.

More importantly, most of these banks have a rich history AMONG the Afrikaans-speaking population of this country. ABSA was transformed as a bank despite the rich Afrikaner history and is a truly South African bank appealing to all South Africans. It might be that Nedcor lacked leadership at crucial time. This could be attributed to denial that South Africa is a changing society and therefore corporations should start to adjust as well.

With the market already saturated by the four major banks, the fight is more for new accounts for both individuals and SMMEs. Nedcor is also likely to tighten the credit policy of BoE as the bank gave credit much more easiely than before. The competitive advantage that BoE had will diminish soon.

4.4 Summary of chapter: Description of two businesses

Both Nedcor and BoE are old companies in the financial services industry. BoE has more regional presence than Nedcor. BoE has presence in the Western Cape and the KwaZulu-Natal provinces. Nedcor is more of a national bank, but has less presence in small towns.

The two companies offer similar types of services to business and to individuals, directly and indirectly. These services range from business banking, property and asset finance, wealth management, treasury and capital markets. Nedcor has a special division of technology solutions in the banking industry and has utilised this part of the business with reasonable success.

Nedcor's strategy is influenced by the view that the financial services industry needs to be consolidated and that the leading bank will be the lowest cost producer. BoE on the other hand, believed in specialised services and operated as a medium-sized bank. BoE tried relentlessly to partner as global financial services industry company as the company could not sustain itself as a medium-sized bank. Both BoE and Nedcor favoured a multi-brand strategy as they embarked on an acquisition trail in order to grow their businesses. However, there is a difference as BoE tended to keep the names of businesses the company acquired as opposed to Nedcor, who formed new brand names. This had significant financial implications regarding the building of the brands.

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The financial results of the two companies were contrasting. Nedcor was continually showing poor results as the business struggled with non-core investments in Dimension Data and with the stronger currency. Nedcor showed a declining financial performance in all operations.

On the other hand, BoE showed improving financial results, despite not declaring an interim dividend. Both the corporate banking and investment management divisions of the bank showed improved financial performance with a 25% growth in earnings from the corporate banking division. However, BoE's existence was influenced by the liquidity crisis that arose from the dramatic collapse of the rand and declining depositor confidence in smaller banks.

Nedcor's acquisition of BoE was influenced by the following factors:

- Consolidation within the banking industry.
- International banks entering the South African market.
- Lack of corporate banking skills.
- Lack of geographical presence in Western Cape and KwaZulu-Natal provinces
- Declining profits for Nedcor.
- Economies of scale.

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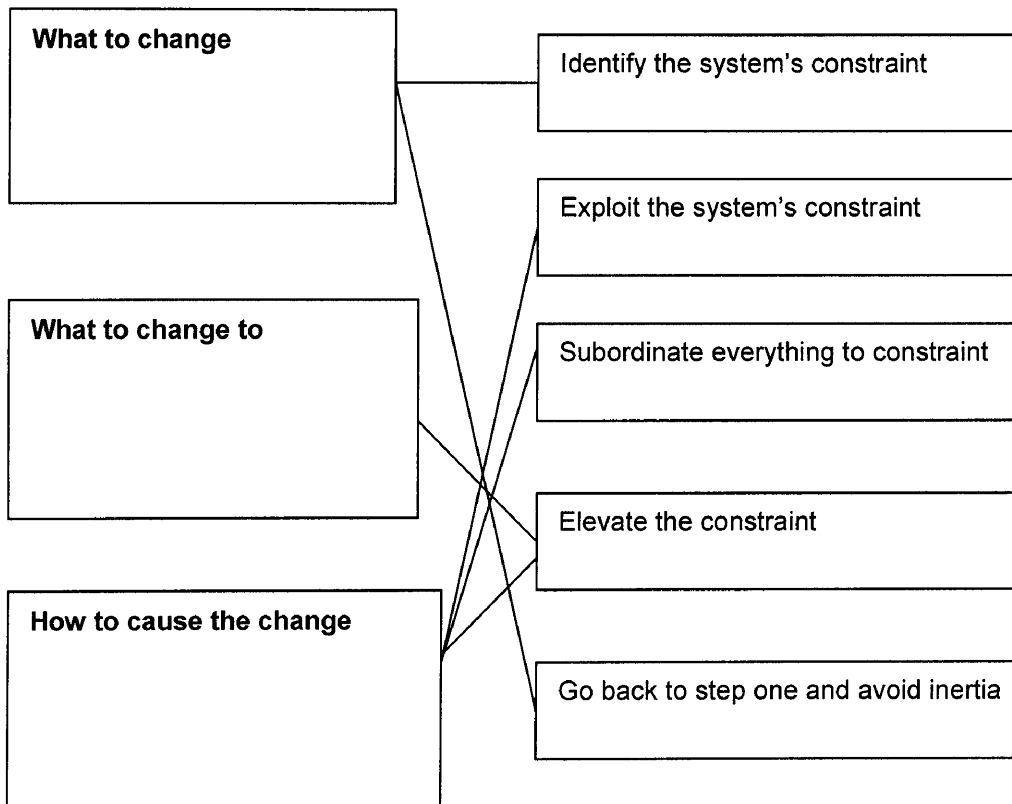
5. APPLICATION OF THEORY OF CONSTRAINTS

As indicated in the literature review, the theory of constraints is based on a systems thinking platform. It is important to find out what to change, what to change to and how to cause the change. **Figure 1** graphically shows the relationship between the three fundamental questions of TOC and the five focusing steps of TOC.

Figure 1: Relationship between the fundamental principles of TOC and the five focusing steps of TOC



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It seems logical that the actual acquisition or merger should primarily form part of step 4 of elevating the constraint. This has after all, been done without incurring too much cost. However, when the exploitation is not enough, the elevation is necessary. It must, however, be borne in mind that acquisitions could be the most expensive form of elevating the constraint. Businesses should first check other less expensive alternatives of elevating the constraint.

5.1 Identifying the constraint

Of the five focusing steps, this step is the most crucial step in constraint management. As with conventional problem-solving thinking, it is impossible to adequately address a problem if it has not been properly and accurately identified. The identification of the constraint is crucial in ensuring the success of the subsequent steps in the focusing process.

Spencer and Cox (1998) suggest that identifying a constraint should primarily involve the constraint that impacts negatively on throughput. Much of this belief is based on the premise that if any system had no constraint, it would grow boundlessly. However, in reality all systems do not grow boundlessly and therefore there is something constraining the system from achieving that boundless growth. In the case of businesses, this growth should be reflected in a company's profit or throughput according to TOC scholars.

Constraints are divided into two categories. These categories are as follows:

- Policy constraints
- Physical constraints

In the case of service organisations, there is a temptation to add behavioural constraints as another category of constraints. Leadership is an example of a constraint that does not fall in either policy constraints or physical constraints. The term behavioural constraint seems appropriate for this kind of constraint.

Furthermore, constraints can either be within the company or in the market. There is a general preference for constraints being within the company rather than in the market. If the constraints are in the market, companies tend to have less control. However, this should not indicate that constraints located in the company do not present their own challenges. Whilst the manufacturing industry has well-developed processes to identify

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physical constraints, the professional services industry is not well developed due to a lack of comprehensive application and implementation of TOC within the industry.

Furthermore, policy and behavioural constraints are less obvious when compared to physical constraints. This does not imply that service companies cannot have physical constraints, although they are likely to be less difficult to identify. However, service industries have a large component of their resources in human capital. This immediately raises the inclination that behaviour constraints are likely to be found within these companies. Perhaps this will also be influencede by the prevalent talk that people are the greatest asset to a company. However, this statement includes manufacturing companies that rely heavily on robotics to produce their final products.

Spencer and Cox (1998) allude to the fact that most constraints management researchers believe that managerial policies (behaviour and policy constraints) are more common than physical constraints as actual organisational constraints. Managers and business leaders are limited by what they believe are good policies and procedures, but only support local goals at the expense of the organisational goal. This should apply to strategic planning for companies as well. Clearly those executives that concentrate more on their egos instead of the organisational goal, are the constraint to the organisation. It seems unthinkable that a chief executive officer, an individual, could become a constraint to an organisation.

Spencer and Cox (1998) further allude to the fact that more success has been achieved in improving productivity in manufacturing than in service tasks, as service tasks often lack clearly defined activities, boundaries, ownership and detailed process diagrams. The banking industry is largely a service industry from lending to corporate banking. Perhaps the conglomerate nature of the Nedcor Group would necessitate constraint identification for each subsidiary of the mother company.

The methods identified through the manufacturing experiences will be useful for the service industry.

It is important to emphasise that the process of identifying a constraint will not by itself suggest that mergers or acquisitions are the best way to elevate the constraint.

5.1.1 Nedcor

Nedcor's pursuit of consolidation within the banking industry in South Africa seems to suggest that they believe that their constraint is in the market. However, there are

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indications that seem to refute this claim. Take Standard Bank for instance. As a bank it was struggling for a period of time. Acquisitions were not necessarily its response to clear strategic problems within the group.

It is necessary to only concentrate on the constraint for the entire Nedcor Group as opposed for each subsidiary. It will be too exhaustive for the purposes of this research and the subsidiaries will have their own constraints. Moreover, the management at Nedcor Group should be able to implement this as soon as constraint management has been applied strategically at Nedcor Group.

It is valuable that the acquiring company should be aware of the constraint of the company being acquired. The company can either exploit this constraint or at least be able to plan for such a constraint. The constraint should be identified through the due diligence process. However, in situations where the constraints of the acquiring company and the company being acquired are similar, there is no justification for acquiring or merging as there is no elevation of the constraint in the acquiring company.

5.1.1.1 Multi-brand strategy

Multi-brand strategies have been widely used in South Africa. Edgars Stores, Foschini and Jet stores all belong to one group company, yet they have their own distinctive brands. Such brand strategies have also been employed in the furniture retail industry with some measure of success.

However, whilst these stores still operate as multi-brands, there are advantages in allowing customers to purchase in any of the stores with one card from one of the stores.

This multi-brand strategy seemed to yield some success during the apartheid years when issues of corporate ownership were not public knowledge.

Nedcor's multi-brand strategy has been likened to the Bantustan- type strategy utilised by the apartheid regime to "divide and rule". This view is entrenched by facts relating to Nedbank and People's Bank. Whilst Nedbank has some black customers as the bank cannot discriminate according to colour, such clients should preferably have their accounts with People's Bank as the bank targeting the "black" market. No other bank in South Africa pursues a similar strategy. There is no evidence that poor and black customers identify less with Standard Bank and First National Bank, the traditional banks

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that have catered for the poor for long periods. These banks present one brand to all their customers and make their differentiation through products offered to clients.

Part of the logic behind the multi-brand strategy is that certain important clients have tended to identify with brands like BoE and it would be difficult to retain those clients with a different name. However, one of South Africa's leading banks, ABSA, is a consolidation of four brands from the early nineties. United Bank, Volkskas, Perm Bank and Trust Bank were consolidated in one brand. Granted, such consolidation took time to bear fruit, but today ABSA is one of South Africa's top brands. Moreover, in this context the issue has more to do with direction than time. Through its alliances with Pick 'n Pay and Old Mutual, two other important brands in South Africa, Nedcor has been forced to add more brands to its stable and there is very little evidence that neither Nedbank nor People's Bank have offered any brand equity.

Despite obvious flaws with a multi-brand strategy in the new South Africa, there is no conclusive evidence to suggest that this is the constraint that is causing Nedcor to report progressively poor results since 2000. Strategic direction is always informed by other issues within a business.

5.1.1.2 Image

Up until 1999 all seemed well at Nedcor. The company had grown from a small bank to one of the four big banks of South Africa. The bank had grown six times its size since 1994. It seemed ahead of its peers as it embarked on cost control exercise and used technology to place itself on the cutting edge of banking in South Africa.

Perhaps largely influenced by the consolidation trend around the world, Nedcor arrogantly went for a hostile takeover of Standard Bank. This much publicised hostile takeover attempt never made it past the Minister of Finance and Nedcor's public relations and communication skills were cited as one of the major reasons for the failure as Standard Bank mounted a spirited opposition. The image of the bank was heavily dented by this failed attempt, despite the market showing no signs of disapproving of such a move. The share price of Nedcor peaked late 2000 and early 2001 as Nedcor engaged in joint ventures after the failed Standard Bank hostile takeover attempt.

As the search for more growth intensified due to the failed hostile takeover, Nedcor acquired a significant stake in Dimension Data, the local information technology

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company. Dimension Data had grown from R1 billion to R5 billion within a few years and Nedcor's view was that this growth would continue unabated. However, such growth never materialised and Di Data lost more than half of its value as the technology industry generally suffered losses. In 2001 Nedcor, through its chairperson, set up an incentive scheme to reward its top executives pegged on how its information technology investments performed. Shareholders, including Old Mutual, did not take kindly to the scheme and it was aborted. However, the first signs of a decline in share price were evident as the share price had dropped to about R130 per share from R160 at the end of 2000 (*Financial Mail*, 19 September 2003, pp 21). The aborted share scheme did not escape the wrath of the market and this further dented Nedcor's image further.

In 2002 and 2003 Nedcor dented its image further through corporate governance issues relating to financial disclosures. The Group unexpectedly wrote off R650 million on a lending book and this affected the financial results adversely. Moreover, the company knew about the book years earlier, but never reported it. Further write-offs occurred and they were blamed on a changing accounting system. These further write-offs also affected the financial results and the share price plummeted to below the R100 per share mark as the market lost faith in Nedcor's financial reporting. In September 2003 the chief executive resigned, citing the need for new challenges, despite continually dismal results. The resignation announcement was accompanied by a profit warning by the company. This started rumours about whether the CE was pushed or not. This further dented the company's image.

In an effort to address corporate governance issues, the bank appointed the highly respected former public protector Selby Baqwa as the head of corporate governance in Nedcor. However, Baqwa's position is not in the high echelons of the Nedcor structure, despite the bank suffering from a serious image and corporate governance problem. This raised suspicions about Nedcor's sincerity in addressing the problem as Baqwa was not even part of the new board formed after the merger with BoE. The appointment of Baqwa as part of the board or in a senior position would have signalled Nedcor's seriousness about dealing with corporate governance issues. Moreover, most of the image problems emanated from the senior executives in the group, yet it seems Baqwa was appointed to look at everyone except the executives who caused the damage in the first place.

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The image of the bank in the fastest growing market within the banking industry in South Africa is not necessarily the best. The bank is still viewed as a "white" supremist bank that looks after the interests of rich whites.

Despite the obvious problems that bad image has caused Nedcor, the problems seem to be symptoms rather than the "root" cause of problems or constraints. Therefore image, despite being a serious problem at Nedcor, is not the constraint of the company.

5.1.1.3 Leadership

Leadership should be viewed both as a collective and the individual leader leading the organisation. This is important in the context of identifying and elevating a constraint such as leadership. This is influenced by the premise that it is not always sufficient to deal with the individual as opposed to dealing with the entire leadership collective. In the case of Nedcor, the fact that the chairman was also involved in hatching the remuneration scheme based on non-core investments and business seems to suggest that there is a broader leadership problem than just the chief executive.

Such understanding is imperative when the elevation of the constraint kicks in and will play an important role in deciding how the constraint should be elevated. Clearly, if there is a collective leadership constraint at Nedcor, replacing the CEO alone will not suffice in elevating the constraint.

Nedcor had other constraints as indicated above, but the nature of TOC is such that these constraints are prioritised in terms of how they are affecting the bottom line of the company. It is also clear that other issues, like the multi-brand strategy and image, contributed to the poor performance by Nedcor. There is a clear relationship between these aspects of the business and leadership. Collins' (2001) assertions suggest that appropriate collective leadership would have been able to identify the problems and remedy them as soon as possible or, even better, the organisation should not have had these constraints in the first place.

It is important to note that Nedcor announced on 15 September 2003 that the chief executive had resigned and would step down at the end of December 2003.

In *Good to Great*, Collins (2001) highlights the importance of leadership. Perhaps more interesting is that in all the companies that managed to make the leap from good to great, they had a similar type of leadership. "Humble and ferocious" are the adjectives

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used by Collins and his team to describe the most common leadership attributes/traits of the CEOs of the different corporations. With Nedcor rumours have surfaced about the leadership problem within that company. During the interview with John Bestbier and Mark Gilbert, Mr Gilbert continuously referred to the views of the CEO. The multi-brand strategy seems to be the brain child of the CEO and the decision to acquire BoE seems to have been largely influenced by the CEO. Reference is even made to the fact that the CEO bent over backwards to accommodate staff from BoE within the management structure of Nedcor. Collins (2001) also suggests that companies should get the right people before they decide where to take the company. Strategically this is very important. However, in organisations led by egocentric CEOs, they tend to have yes-men around them. Perhaps more confusing within the Nedcor board is that board members include a former Minister of Finance and Professor Michael Katz, both of whom are held in high regard in business circles. Granted, Mr Chris Liebenberg is a non-executive chairman, but he is still the chairman. Reports indicate that the chairman contributed much to the bad image problem.

Collins (2001), albeit subtly so, suggests that leadership is one of the most important ingredients for companies to succeed. Problems relating to strategy and image could be solved with the kind of collective leadership described by Collins as "humble and ferocious". With good leadership Nedcor would have come up with a different strategy and dealt more sincerely and swiftly with image problems.

There is reasonable evidence to suggest leadership has been the root cause of most of the problems at Nedcor. From the information available, leadership is the glaring factor from which most of the symptoms showed by the company could be addressed.

There are other respectable authors like Prahalad, Hamel, and Strickland who do not explicitly allude to the importance of leadership. However, this could be attributed to the focus and scope of literature consulted for this report. The symptomatic nature of some of the problems identified at Nedcor disqualified them from being the constraint of the business.

However, other authors like Pascale allude to the importance of leadership in organisations.

Whilst leadership is clearly a problem at Nedcor, what organisation, based on the premise of leadership as the all- encompassing competence of any organisation, would

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not ultimately point to leadership as a constraint. This is perhaps the fundamental difference between applying TOC in the manufacturing environment and the service industry. In manufacturing there is a clear distinction between operations and leadership, whereas in the service industry this distinction is not so apparent. The clear separation allows TOC to concentrate on operational issues as opposed to the entire organisation. It seems, by default, that in the service industry leadership has a very direct impact on the resources of the company in whatever occurs. Leaders therefore have a more direct impact on the statistical fluctuations that occur in a service organisation than they do in a manufacturing organisation. However, TOC principles suggest that we should look beyond leadership for constraints.

If TOC is to be applied as a strategic tool as the nature of its application in mergers and acquisitions dictates, the scope to search for a constraint is wider than was envisaged by Goldratt. The objective nature and impartiality which form the undertone of TOC are very important. It does not seem possible that a business leader would easily accept being a constraint in an organisation. There is a tendency to think that the constraint is somewhere else other than in the CEO's office.

It is important then to determine whether there is merit in identifying the exact behaviour in the leader that is significantly limiting the organisation from achieving its goals. It would be valuable if such a trait would be easily changed by the leader after the application of TOC. However, more often such behaviour has been with the leader for a long period and the leader is likely to resist the change initially. The issue is whether such an organisation can afford to wait for the leader to change. Moreover, such behaviour inevitably affects other members of the executive team and the staff. Therefore it seems plausible that to deal with the leadership problem, the leader himself should be removed from his position.

However, in elevating the constraint there is a need to identify those leadership qualities that are necessary to ensure the organisation achieves its goals. Therefore there is a need to identify the traits, despite the leader not being allowed an opportunity to develop those qualities or being dissuaded from those unwanted traits.

5.2 Exploit the system's constraint

This step in the five focusing steps largely involves taking advantage of the constraint without necessarily making any investment in the constraint itself. This step is largely

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intended to avoid unnecessary expenditure. Although the literature has already indicated that not all constraints are tangible as there are policy constraints, there seems to be another subset of constraints as leadership could hardly fit under policy constraints.

Motwani *et al* (1996) suggest that only steps 1,4 and 5 are applicable in service organisations. This seems to be a sweeping a statement, as the nature of constraint in any organisation cannot be pre-determined. Granted, evidence suggests that most of the constraints are policy related rather than physical, but there are possibilities that constraint within professional service organisations could be physical. Moreover, banks generally have a portfolio of services offered to clients at different locations. Constraints like resources and skills could be exploited, depending on their nature and level within an organisation.

5.3 Subordinate everything else to the constraint

This step in the five focusing steps is truly influenced by the view that the constraint directly affects the bottom line of the company. It is important that the company's best resources be allocated to the constraint.

With Nedcor having already identified that the constraint was internal rather than in the market, the organisation would have realised that the acquisition of BoE would never realise its intended results unless the leadership problem was solved. In a highly competitive environment like the banking industry in South Africa, organisations can ill-afford to waste time by taking too long to subordinate everything else to the constraint. This understanding of the business would have led Nedcor to first deal with the real constraint before deciding on the acquisition of BoE. This does not suggest that Nedcor would not have acquired BoE after going through a full cycle of applying the theory of constraints. It is likely that Nedcor would have still searched for an acquisition company, even if such an elevation of the constraint would have resulted in a new leader for the company.

The subordination of everything else to the constraint gives priority to the constraint. This step would lead to Nedcor giving priority to solving the leadership problem it faced.

5.4 Elevate the constraint

Clearly the leadership problem at Nedcor could not be addressed by the acquisition. There is also no guarantee that the departure of the CE would necessarily assist the

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group in addressing the image problem. However, it is clear that the CE presided over all the incidents that caused the bad image and would struggle to change the image easily by himself as he was seen as part of the problem.

The financial results were an indication that something was fundamentally wrong with the company and something drastic had to occur. It is clear in this case study that the elevation of the constraint is more complex than normal as it involved a loyal servant of the company. The CEO had been at the helm for a while and had grown through the ranks of the company to the summit. However, TOC is implicitly underpinned by the view that the interests of the business should be given high priority at all times. This is further echoed by the sentiments expressed by Collins in his book. Collins (2001) concludes that all the CEOs at the helm of the companies that made the transition from good to great acted in the interests of the company at all times. The next logical step would be to relieve the CEO of his duties. However, this would not completely suggest that the constraint has been elevated until the appropriate candidate with the required skills and who exhibits such behaviour and characteristics practically in the business was found. In the context of Nedcor this would be difficult, as a tug of war could erupt between internal and external schools of thought. The assumption that those who served under the previous CEO necessarily agreed with his views about the strategic direction of the company might not hold. An external candidate might not appreciate the history of the company and might face some internal resistance as he attempts to steer the ship in the right direction.

The board of directors should play a significant role in developing the terms of reference in appointing the new leader. Different models can be employed to deal with the constraint. An interim leader can be appointed until such time an appropriate candidate has been found.

Once the leader has been found, the new CEO could as part of elevating the constraint, also look into the composition of the board of directors and the roles of certain individuals.

5.5 Back to step one and avoid inertia

For the acquisition of BoE, Nedcor conducted a due diligence process and was advised by two international corporate finance firms, Meryll Lynch South Africa and UBS Warburg

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Corporate Finance Limited. Both these reputable companies indicated that the share scheme proposed by Nedcor was fair to both Nedcor and the shareholders of BoE.

Geographical presence was one of the reasons for the acquisition of BoE. BoE had a strong presence in the Western Cape and KwaZulu-Natal. The acquisition would allow Nedcor to expand into these areas (John Bestbier, Mark Gilbert, 2003).

Part of the problem faced by BoE was the necessary investment in technology. The technology possessed by BoE was old and disintegrated. If Nedcor had done its due diligence, perhaps this would have been picked up. The question is how much of the high costs now are linked to the oversight on this issue? Surely Nedcor will attempt to hide this, but clearly the motive of the deal from BoE's point of view also adds weight to the view that part of the problem experienced by Nedcor is due to a poor due diligence done within a short space of time. This also adds weight to the view that the acquisition was a result of egocentric executives trying to prolong their stay at Nedcor. Old Mutual seems to have different ideas though with their proposed restructuring. The rumours that the CEO is an authoritarian are also precipitated by this.

Poor strategic rationale relates to poor understanding of the strategic levers. With the kind of intellectual capital and experience at both BoE and Nedcor, poor strategic rationale is unlikely to have existed. The board of directors at Nedcor comprises a diverse group of knowledgeable individuals.

The acquisition of BoE by Nedcor could not be communicated formally to the employees of BoE before the shareholders of BoE had voted on the proposed deal.

Nedcor conducted due diligence on BoE during the uncertainty period from February to March 2002.

In the case of BoE, which was largely affected by investor confidence in small banks, Nedcor could not have easily identified its core competencies within the short period of time that the Reserve Bank had guaranteed BoE's deposits.

From the information obtained from Nedcor there seems to be a lack of a thorough due diligence process. Mr Gilbert alluded to the fact that they did a "quick" due diligence on BoE. Clearly with BoE in a predicament with deposits there was little chance that BoE's directors would have voluntarily revealed information that could have jeopardised the

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deal. And with Nedcor a hungry lion that would eat anything that has blood, they fell for the trap.

One of Nedcor's rationales for the BoE acquisition is the consolidation within the banking industry worldwide. It is important to remember that the Minister of Finance could not approve the proposed hostile takeover of Stanbic because consolidation between the four major banks is not good for South Africa. Did Nedcor then target the smaller banks like BoE due to this ruling?

Nedcor plans to close some of the BoE branches in the Western Cape. Will they still be able to realise some of the benefits if these branches are closed? As part of the due diligence process, did Nedcor identify BoE's top 20% customers? It is not clear whether BoE had a systematic way of identifying its top/lucrative customers. The 80:20 principle applies to banks as well.

For a long period Nedcor has pursued the acquisition trail without much success. Their bid for Stanbic was stopped by the Minister of Finance because there should be no consolidation between the four major banks in the country. To a certain extent Mark Gilbert alluded to this when he said that Nedcor is under pressure to provide the required return to shareholders. Why are other banks providing this without necessarily following the acquisition route? Is Nedcor a supremist white bank that is failing to understand the dynamics of the new South Africa? Their multi-brand strategy could be compared to the apartheid government strategy of divide and rule through Bantustans. People's Bank is not a sincere effort to bring the black population as a client base. Other banks like ABSA were consolidated into one brand and have managed to appeal to the world spectrum of the South African population. This is similar to putting the cart before the horse. The strategic plan should indicate whether the strategy can be implemented through mergers and acquisitions or other alternatives. However, by clearly and unabatingly sticking to mergers and acquisitions as the only approach, the other alternatives are sacrificed. By nature mergers and acquisitions are not easy to implement. Nedcor might have done a good job in implementing the acquisition in terms of staff and customers, but the increased costs seem to suggest that the due diligence process was not as exhaustive as it should have been. BoE as a company had different technologies for the different brands forming its multi-brand strategy. Therefore with thorough due diligence, this should have been included as part of the costs to integrating the different technologies. Whilst Mark Gilbert suggests that Nedcor had been eyeing BoE for a while, no thorough

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and substantial work seems to have been done on BoE and its operations. It is also reported by David Woollam, the former Financial Director at BoE, that Stanbic was the first major bank to be approached by BoE as its liquidity crisis worsened.

5.6 Summary of chapter: Application of theory of constraints

The five focusing steps of theory of constraint are utilised as the means of applying theory of constraints in mergers and acquisitions. The first step in the five focusing steps is to identify the constraint. Three problems that were generally identified as facing Nedcor as a company. These problems relate to the multi-brand strategy, image and leadership. The multi-brand strategy and image are symptomatic problems within the company. Collins (2001) implicitly alludes to the fact that leadership is the key for business to continuously produce results. Leadership is found to be the constraint of the company as the bank invested in non-core investments that yielded unprecedented losses at Nedcor. However, leadership is viewed more in a collective approach as opposed to looking specifically at the individual leading the company.

The constraint could not be exploited as the second step of the five steps suggests. This view supports the assertion of Motwani *et al*. The nature of leadership is such that the exploitation of the constraint and the elevation of the constraint cannot be separated. It is important to note that the general statement that this step in the five focusing steps is not applicable in service organisations is not entirely accurate. It is possible for service organisations to have physical constraints and such constraints can be exploited.

The step involving the subordination of everything else to leadership would have ensured that Nedcor gives priority to leadership and there is urgency in elevating the constraint.

The elevation of the constraint is more complicated in terms of leadership at Nedcor as the constraint was identified as a collective rather than just the individual leading the organisation. However, there is no evidence that the CEO did not support the share incentive scheme and there is evidence that the strategy followed by the company was the brain-child of the CEO. A new leader would have to be sought for the company. There could be problems relating to whether the leader should come from inside (within the existing executive team) or outside the company. There are advantages and disadvantages for both approaches. The board of directors should play an important role in determining the terms of reference for appointing the new leader. It might be that the

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new leader would have to deal with the board to address the broader leadership problem at the company.

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6. CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

The acquisition of BoE was intended to address deficiencies other than the constraint identified in this research report. However, it is clear that Nedcor ran a high risk of not realising the intended results of the acquisition if the main constraint was not elevated. There is no match between Nedcor's constraint and the capabilities or strengths of BoE, hence the conclusion that the acquisition of BoE was not going to address the constraint. However, it is important to note that the theory of constraint is based on a systems thinking philosophy. Whilst the multi-brand strategy and leadership were not identified as constraints with the continuous improvement approach of theory of constraint, it would only be a matter of time before they become constraints.

TOC can play an important role in mergers and acquisitions, especially during the due diligence process.

However, TOC alone will not assist a company to determine which company to buy. By nature acquisitions suggest that there is an advantage that is being purchased and TOC seems to be well placed to identify constraints instead of strengths.

Other tools, like core competency, could be utilised together with TOC as the core competency of the company being acquired could be the constraint of the acquirer. Therefore the process is one of matching the core competency of the acquiree with the constraint of the acquirer. The elevation step in the five focusing steps of constraint management could be the actual acquisition of a company. However, issues of time should be taken into account. Acquisitions tend to take long to process and implement. Therefore the TOC process, as indicated by its original author, should be a continuous process based on systems thinking. Hostile takeovers are likely to lengthen the period even further before the deal is finalised.

There is an inclination to suggest that acquisitions could be best placed to deal with constraints that are in the market, but clearly not all market-based constraints can be dealt with through acquisitions. Convincing customers to buy your new product could easily be a marketing function rather than engaging in an expensive acquisition. But in a saturated and mature industry like the banking industry, acquisitions could be the only way. But perhaps in Nedcor's situation a change of strategy and change of image could

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also assist. Nedcor is South Africa's biggest bank, is the CEO happy now? No, it does not seem so. Therefore being big has its drawbacks.

It seems logical that the actual acquisition or merger should primarily form part of step 4 of elevating the constraint. This has after all, been done without incurring too much cost. However, when the exploitation is not enough, the elevation is necessary. It must, however, be borne in mind that acquisitions could be the most expensive form of elevating the constraint. Businesses should first check other less expensive alternatives of elevating the constraint.

Did Nedcor make a strategically wrong decision but good implementation? David Woollam seems to suggest that in the long run the acquisition will benefit Nedcor, but there should be a strategically sound plan for the company. Only after this is in place can Nedcor realise the full fruits of the acquisition.

Nedcor retained 93% of it's customers through the merger. As indicated by John Bestbier, the main focus of the merger activity was to ensure customer retention, otherwise the rationale of volumes was going to fall by the wayside. It can be argued that Nedcor will be able to offer better services to their clients through the high retention of skills from BoE. Most of BoE's theme as a company was innovation. Most of the middle management positions at Nedcor are held by former BoE staff.

It seems impossible to separate mergers and acquisitions from the strategy of an enterprise. It is possible that some companies like Nedcor have always failed to measure up to their competitors. For long period Nedcor's strategic plans have failed to yield results in such a way that they would begin to challenge the three other major banks in South Africa. In fact, between the four major banks, they have 92% of the total market. Nedcor's multi-brand strategy does not seem to work. The company incurred huge costs when it needed to consolidate technologies and systems between the different brands it holds. Due to this lack of improved return to investors, Nedcor seems to have fallen to the acquisition trail in order to achieve the required return to shareholders. However, it is interesting that other banks like ABSA are consolidating their brands. The application of TOC in the strategic planning process is likely to indicate that the strategy is perhaps the problem. With the leadership in love with the strategy, it is unlikely to help Nedcor improve its earnings and return.

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The theory of constraints seems to be focused on potential. In other words, how can we improve our position from where we are? Clearly this is relevant in mergers and acquisitions if the aim of the measure is for the business to increase its profits. Companies should rather look at what is preventing them from achieving more results before engaging in an acquisition trail. Therefore TOC seems to be appropriate for self-introspection rather than it for determining whether a candidate is suitable for the acquisition. Therefore it seems that TOC alone cannot to assist with a complete assessment of and decision making on the correct candidate to acquire or merge with.

A tool similar to core competency, as articulated by Prahalad and Hamel (1990), could be utilised to assess the candidate's strengths to see if they fit with the constraint of the acquirer.

Thompson and Strickland (2003) alluded to the fact that there is a need to concentrate on the revenue rather than the costs in a business especially for mergers and acquisitions. This is further entrenched by a view in the *McKinsey Quartely* that in fact it is better to concentrate on how to increase the revenues rather than just reduce the costs. The McKinsey article further states that mergers actually do not realise their intended purpose due to the obsession with reducing costs without understanding how the business makes money. The other danger that Prof Strickland alluded to was that with cost reduction it is never easy to determine when you are actually eating into the quality of the product or service you are offering. More often than not, business easily chews into the quality of their products without realising it and therefore starts affecting revenue as customers easily move to competitors. In fact, these views seem to support the fundamental underpinnings of the theory of constraints- what to change, what to change to and how to change it.

A point can be made about whether what is identified through TOC cannot be identified through other mechanisms. A swot analysis could easily come up with the same weaknesses as the information that could be obtained in constraint management. Where is the value of this approach?

Theory of constraints provides value in mergers and acquisitions. It allows for strategic fit between the core competency of one organisation and the constraint of the other organisation. This is clearly demonstrated in the situation where the acquiring company identifies a constraint within the company that could be exploited by purchasing a capability from another company. There is also the reverse approach in terms of the

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acquiring company identifying a constraint in another company through a due diligence process. The constraint of the company to be acquired could be matched with the core competency of the acquiring company. However, both these scenarios assume that mergers and acquisitions are the best options to deal with the constraint in the first example and the growth strategy in the second example. The second example is more appropriate for companies that employ an aggressive growth strategy. This is not to suggest that companies that purchase capability or market share do not embark on aggressive growth strategies. It is possible that both these examples could occur simultaneously in an acquisition or merger.

Theory of constraints is a useful tool for crafting strategy. The identification and the nature of a constraint should determine how that constraint should be exploited. A constraint cannot always be exploited through mergers and acquisitions. In service industries constraints are sometimes issues like leadership, which clearly cannot be exploited through mergers and acquisitions. Therefore the theory of constraint is an important strategic management tool that can be utilised to craft a strategy and to adjust that strategy as internal and external forces dictate. In situations whereby the constraint cannot be exploited through mergers and acquisitions yet a business utilises acquisitions as a means of growth, it is difficult to identify what the constraint is. In some instances the acquisitions seem to come in handy in hiding strategic flaws that the company does not necessarily want to face. This could be attributed to individuals in specific influential positions within a company.

Objectivity of the process is important. TOC, if applied correctly, brings the objectivity that is necessary, not only during the strategic evolution of the process, but also during the due diligence process that the organisation should conduct before deciding whether to merge or acquire.

By implication the theory of constraint approach to mergers and acquisition forces the process to have the interests of the organisation at heart as opposed to the acquisition being a personal ambition of the leader who might be interested in settling old scores. As Collins (2001) indicated in his book, in those organisations that were able to move from good to great, the company was first priority before the personal ambitions of the leader. As the case study of Nedcor indicated, the company would have been able to identify the leadership constraint the company was facing. Importantly, the TOC will not exclude the

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leader in the process of identifying the constraint that is impeding the company from making money now and in the future.

6.2 Recommendations

The theory of constraint is not a panacea to mergers and acquisitions. Achieving the strategic fit between the acquirer and acquiree, or between two merging companies, does not guarantee the success of the merger. However, strategically flawed mergers and acquisitions will almost certainly not succeed. Whilst companies operating in monopoly or near monopoly industries might afford such strategically flawed acquisitions, businesses operating in industries with strong competition can ill-afford such failures. Similarly, companies that are carrying the flag regarding black economic empowerment in South Africa can equally ill-afford such failures as the future of black economic empowerment and changing of stereotypes rely heavily on the success of these companies.

Therefore the foundation of any successful merger or acquisition is laid with a strategically fitting marriage or takeover. Theory of constraints value as a revenue-focused approach to mergers and acquisition cannot be doubted. Part of the reasons for the failure of mergers and acquisitions is the lack of focus on revenues, as companies concerned themselves with reducing costs rather than increasing sales.

However, theory of constraint will not help ensure that the acquirer is not paying more than it should. This relates to the share price at that particular time of the transaction. Financial experts should be engaged to determine the price that should be paid. However, this should be viewed in relation to the benefits of the acquisition.

With due diligence, organisations need to be able to exactly identify the capability that they are acquiring, just as the acquiring company needs to accurately identify its constraint. In situations where such capability or core competence lies with specific individuals, those individuals should be identified and be made part of the process of the acquisition.

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