

Chapter 1: Nature and Scope of the study

1.1 Introduction

1.1.1 Shareholder Value

A *shareholder* is a co-owner of a company and owns his share of the company by means of shares (Megginson *et al.*, 2001:16). According to Megginson *et al.* (2001:126), the value of an asset equals the present value of all future benefits accruing to the asset's owner. A shareholder is therefore prepared to buy a share at a given price based on his/her expectation of future earnings through dividends or capital gains by means of growth of the share price.

The shareholders of a company will therefore appoint a management team that they believe will manage their assets in such a manner that they will receive optimal value from it. The management team will in turn be compensated based on their ability to optimise the shareholders' value.

Sustainable growth in shareholder value is largely dependent on the net operating profit of a company. This mini-dissertation aims to explain this statement in detail and focuses on the strategies that a management team can utilize in order to maintain a stable and profitable stream of earnings. These strategies cover different facets of management, which includes:

Financial management: Investment, financing, working capital, cash flow and debt management.

Public relations and Marketing: Product volumes, communications and public relations strategies.

Production strategies: Production efficiencies, cost effectiveness and technological improvement strategies.

Risk management Human Resource strategies, safety performance, corporate governance and environmental compliance

1.1.2 Recession

A recession is widely described as a period during which the gross domestic product (GDP) of a country has decreased in two consecutive quarters. According to Economics Help (Anonb, 2009) a recessionary period is distinguished by:

- Increase in saving due to nervous perceptions of the market.
- Decrease in investment due to the lack of confidence by banks and other financial institutions.
- Decrease in consumption due to the fact the people are worse off (lay offs, reduced working hours, no pay increases).
- Government spending increases in order to simulate economic activity.

This will in turn lead to higher debt and ultimately to higher tax rates.

For platinum mining companies whose major markets consist of the jewellery and automotive sectors, a recessionary period will definitely decrease demand for their product and positive cash flow will be much harder to achieve.

1.1.3 Platinum mining in South Africa

Platinum is a precious metal, which is comparable to other metals such as gold and uranium. According to Creamer (2006), platinum exists in its natural environment together with five similar metals namely palladium, rhodium, iridium, ruthenium and osmium. This group of metals is usually referred to as the platinum group metals or PGM's. PGM's main uses are for auto catalysts in the motor industry and as a precious metal in the jewellery industry.

South Africa (SA) produces in the region of 75% of the world's total output of platinum (Rufini, 2008:50), which makes it one of SA's major sources for export. Rufini (2008:50) points out that due to the current expansion programs, the South African platinum industry will further improve their stronghold in the PGM sector. With major companies already owning mining rights to over 100 years of viable platinum mining resources, this industry will be a cornerstone of the South African mining industry in the coming century just as gold mining was in the previous 100 years. The major players include Anglo Platinum, Impala Platinum and Lonmin. Due to the importance of the platinum industry now and in the future, it is

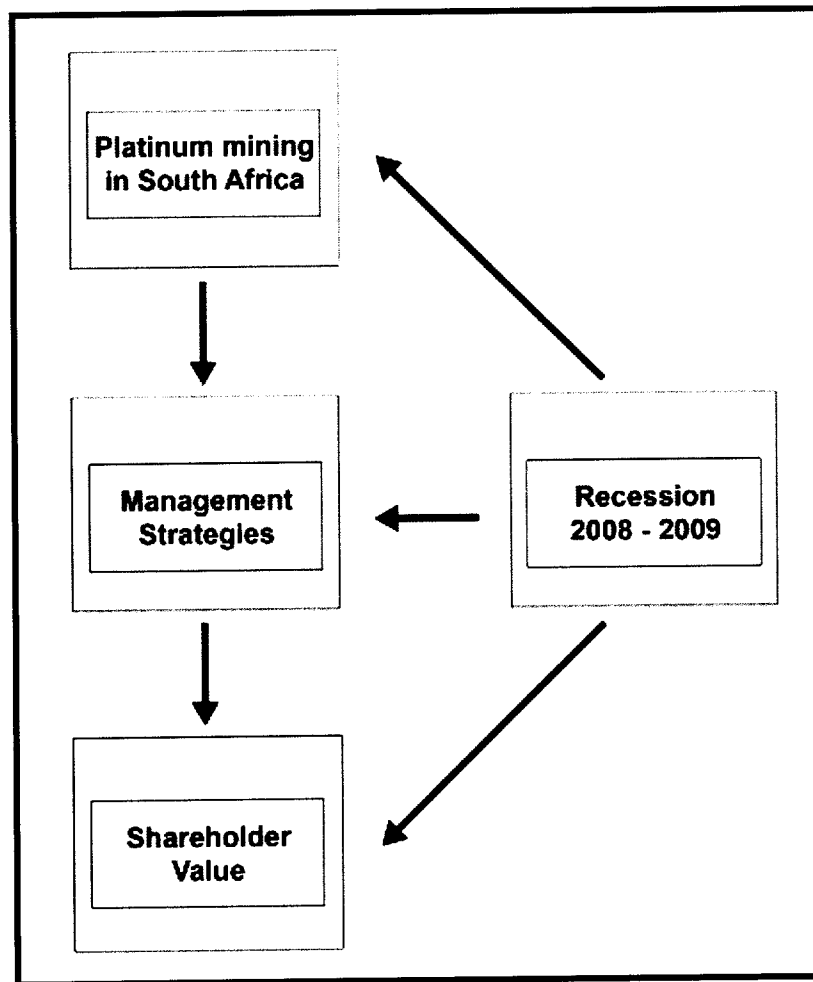
necessary to have an understanding of how economic turmoil and especially recessionary periods affect this sector. Reviewing recent performances and developing relevant best practices in this industry will place management teams in a better position to handle future recessions and other market threats leading to a decline in demand.

1.2 Problem Statement

The economic recession of 2008-2010 provided numerous challenges for the South African platinum mining companies and the management of these entities had to come up with creative and sometimes drastic measures in order to preserve company as well as shareholder value/wealth. Careful consideration had to be given to all the strategic issues in order to minimize the impact of the recession in the short term as well as to ensure future competitiveness for the SA platinum industry. A clear understanding of the impact of these strategies is needed in order to ensure future success in similar economic times.

Figure 1.1 provides a flow diagram indicating the focus of the study. The arrows show the impacting forces on key focus areas and how they ultimately combine to influence shareholder value.

Fig 1.1: Focus of study



Source: Researcher's own compilation

1.3 Objective

1.3.1 Primary Objective

The primary objective of this mini-dissertation is to provide an overview of how the management teams of the platinum mining industry optimised shareholder value during the recessionary period of 2008 – 2010. This assessment will be based on specific strategies implemented by these companies, measured against best practices derived from a literature study.

1.3.2 Secondary Objectives

The following secondary objectives will support the primary objective:

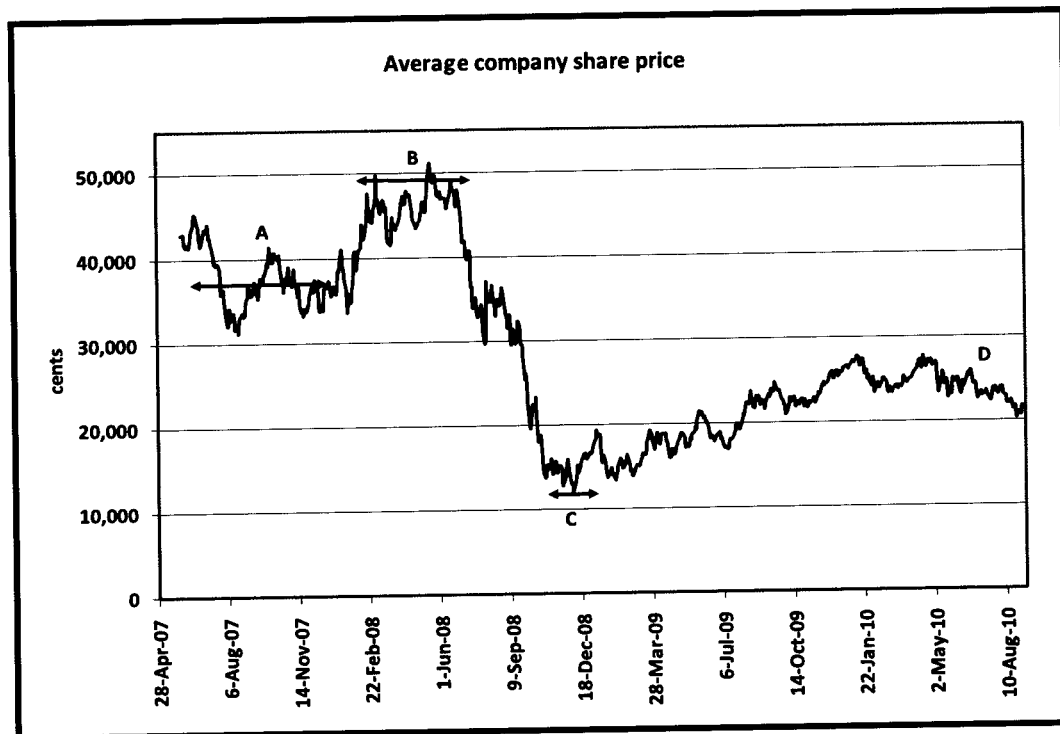
- To provide specific best practices that could be utilized by South African platinum companies in future recessionary times based on empirical and analytical research.
- To provide a summary of the opportunities that exist in the SA platinum industry in the next 3 - 5 years.

1.4 Scope of Study

The following boundaries apply to this study:

- The study is primarily confined to the platinum industry in South Africa, whilst the identified companies' operations in Zimbabwe are also explored.
- Although the study will mainly focus on platinum, other PGM's and associated minerals and metals of the PGM mining industry will also be explored.
- The literature study on best practices will be discussed in reference to a global scale.
- The study will focus on different areas of business management, including financial management, operational management and improvement, marketing strategies and human resources management.
- To provide some comparability and also due to the availability of information, only the following companies will be investigated: Anglo Platinum, Impala Platinum, Lonmin, Northam Platinum and Aquarius Platinum.
- The period July 2007 to August 2010 is the total period under review, with specific periods used to compare company performance (Fig. 1.2).

Fig. 1.2: Specific periods for the share price evolution during the period under review



Source: Researcher's own compilation (Data: McGregor BFA)

- A – The baseline period before the pricing bubble. July – Dec 2007
- B – The bubble period Jan – Jun 2008
- C – The base trough period Nov/Dec 2008
- C – D – Recovery period Dec '08 – Jun 10
- D – 30 June 2010. Final date used as comparison between companies (Month average to eliminate the impact of volatility)

1.5 Research Methodology

The research methodologies used in this study are as follows:

Theoretical: The literature study offers basic background information to the study focusing on the three main research topics, and covers some theoretical aspects of shareholder value and recessionary periods

Empirical: The study employs information gathered from statements, interviews, questionnaires and other media. The aim will be to provide an objective view

utilising the information gathered, but also to gain insight into the view from the inside of targeted companies utilising questionnaires and interviews.

Analytical: This will take the form of annual financial results analysis. The aim will be to critically and analytically analyze the annual financial results of the companies under review. Widely used financial as well as statistical methods will be utilised.

1.6 Limitations of the study

The following limitations apply to the study:

- Some financial information that might have an impact on this study's conclusions published after Sept 2010 will not be reviewed due to time constraints.
- Conclusions and recommendations will be specifically aimed at the platinum mining industry, and care should be exercised in applying the findings to other economic sectors.
- Assumptions and conclusions by the researcher are based on the knowledge gained during the MBA course at the North West University as well as personal experience gained in the heavy industrial industry as a process engineer and production manager at the Blast Furnaces of ArcelorMittal South Africa. Experience gained in these areas allows insight into the complex nature of mining and metals refining and the specific difficulties of operating such plants in the South African environment, and more specifically during the recessionary period.

1.7 Layout of the study

Chapter 1

Chapter 1 provides the itinerary for the mini-dissertation and gives the reader a quick overview of the problem, focus, methodologies and results that can be expected.

Chapter 2

In chapter 2, a literature study supplies the necessary background information covering the three main research areas, namely shareholder value, the

recessionary period in SA and the platinum mining industry in South Africa. The literature study aims to provide a theoretical overview of the specific strategies a management team can or should utilize to maximize shareholder value in a recessionary period. There is also a focus on the uniqueness of the South African Platinum industry. Specific overviews of selected platinum companies and an overview of future demand will be provided.

Chapter 2 runs parallel to chapter 3 where an empirical study attempts to compare actual strategies to best practices.

Chapter 3

How did the SA platinum companies' management teams perform in the current financial turmoil? Chapter 3 aims to answer this question by analyzing the following information sources:

- Financial statements
- Share price data
- Media releases and management statements
- Interviews/questionnaires

The data is portrayed in three different segments:

- A specific timeline for the period under review is compiled for each company to give a quick overview of the evolvement in share price
- A summary of information gathered from questionnaires
- Statistical financial analysis

Chapter 4

Chapter 4 addresses the requirements set out in the objectives. This includes conclusions as well as recommendations on future opportunities for the management teams of the companies discussed.