

**EFFECT OF MERGERS AND ACQUISITIONS ON THE  
FINANCIAL PERFORMANCE OF THE COMPANIES LISTED AT  
THE NAIROBI STOCK EXCHANGE**

**GRACE WANGUI KERU**

**RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT  
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE  
OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF  
BUSINESS, UNIVERSITY OF NAIROBI**

**NOVEMBER, 2017**

## **DECLARATION**

I declare that this research project is my own work and it has not been submitted for any degree or examination in any other university.

Signature: ..... Date:.....

**Grace WanguiKeru**

**D61/82595/2015**

This research project has been submitted for examination with my approval as the University Supervisor.

Signature: ..... Date:.....

**James Nganga**

**Lecturer,**

**School of Business,**

**University of Nairobi**

## **DEDICATION**

I dedicate this research project to my parents for the support, encouragement and mentorship during the entire Master of Business Administration Course. I will forever be grateful.

## **ACKNOWLEDGEMENTS**

My sincere gratitude goes out to Almighty God, my family and friends who have made this journey a success through guidance, support and encouragement during the entire course.

Special thanks to my supervisor Mr. James Ng'ang'a for the time he spared giving valuable input and guidance during the course of this study. God will reward you abundantly. For all those who made a positive impact during this study, you are sincerely appreciated.

## TABLE OF CONTENTS

<b>DECLARATION.....</b>	<b>ii</b>
<b>DEDICATION.....</b>	<b>iii</b>
<b>ACKNOWLEDGEMENTS .....</b>	<b>iv</b>
<b>LIST OF TABLES .....</b>	<b>viii</b>
<b>LIST OF FIGURES .....</b>	<b>ix</b>
<b>ABSTRACT.....</b>	<b>x</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>xi</b>
<b>CHAPTER ONE:INTRODUCTION .....</b>	<b>1</b>
1.1 Background of the Study .....	1
1.1.1 Mergers and Acquisitions .....	2
1.1.2 Financial Performance .....	3
1.1.3 Mergers and Acquisitions and Financial Performance .....	4
1.1.4 Companies Listed at the Nairobi Securities Exchange .....	4
1.2 Research Problem .....	4
1.3 Research Objective .....	6
1.4 Value of the Study .....	6
<b>CHAPTER TWO:LITERATURE REVIEW.....</b>	<b>8</b>
2.1 Introduction.....	8
2.2 Theoretical Review .....	8
2.2.1 Monopoly Theory .....	8
2.2.2 Information Theories .....	9
2.2.3 Financial Efficiency Theory .....	9

2.2.4 Agency Problems Theory .....	10
2.2.5 Hubris Hypothesis.....	10
2.3 Determinants of Financial Performance .....	11
2.3.1 Liquidity.....	11
2.3.2 Macroeconomic Factors .....	11
2.3.3 Leverage.....	12
2.3.4 Company Size .....	12
2.4 Empirical Review.....	13
2.5 Conceptual Framework.....	18
2.6 Summary of Literature Review .....	19
<b>CHAPTER THREE:RESEARCH METHODOLOGY .....</b>	<b>20</b>
3.1 Introduction.....	20
3.2 Research Design.....	20
3.3 Population of the Study.....	20
3.4 Data Collection .....	20
3.5 Data Analysis .....	21
<b>CHAPTER FOUR:DATA ANALYSIS, FINDINGS AND INTREPRETATION ....</b>	<b>22</b>
4.1 Introduction.....	22
4.2 Pre and Post Mergers and Acquisitions Descriptive Data Analysis .....	22
4.3 Inferential Data Statistics .....	25
4.3.1 Correlation Analysis .....	26
4.3.2 Regression Analysis.....	27
4.4 Interpretation of Findings .....	29

<b>CHAPTER FIVE:SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.</b>	<b>30</b>
5.1 Introduction .....	30
5.2 Summary .....	30
5.3 Conclusion .....	31
5.4 Recommendations .....	31
5.5 Limitations of the Study.....	32
5.6 Areas of Further Research .....	32
<b>REFERENCES.....</b>	<b>33</b>
<b>APPENDIX.....</b>	<b>36</b>
APPENDIX I: DATA TEMPLATES .....	36

## LIST OF TABLES

Table 4.1: Correlation Matrix .....	26
Table 4.2: Model Summary .....	27
Table 4.3: Summary of One Way ANOVA.....	27
Table 4.4: Regression Coefficient.....	28
Table 4.5: The Analysis of the Variables.....	28



## LIST OF FIGURES

Figure 2.1: Conceptual Framework .....	18
Figure 4.1: Debt Ratio.....	22
Figure 4.2: Acid Test Ratio.....	23
Figure 4.3: Current Ratio .....	24
Figure 4.4: Log of Total Assets .....	24
Figure 4.5: Return on Assets.....	25

## **ABSTRACT**

A merger can be looked at as the process in which two or more business operations are combined into one business entity with the same management and ownership. From a legal stance, mergers can be looked at as the consolidation of two or more entities into one entity. An acquisition on the other hand, involves purchase of a controlling interest by a company in the share capital of a second existing company. Various motivations for mergers include synergy, diversification, acquiring market share, reduction of cost as well as gaining access to resources. Mergers and acquisitions are a strategic tool in the modern corporate world and the trend has been witnessed in the Nairobi Securities Exchange. The study set out to determine the effect of mergers and acquisitions on the financial performance of the companies listed at the Nairobi Securities Exchange. The population of the study was the mergers and acquisitions that took place between the years 2007 and 2013 and a census approach was adopted. Three year pre-mergers and acquisitions and post-mergers and acquisitions data was collected from secondary sources and compared to determine whether there was a significant change in the financial performance after mergers and acquisitions by the use of a paired t test at 5% significance level. From the findings of the study, mergers and acquisitions had a significant effect on the financial performance.

## **LIST OF ABBREVIATIONS**

<b>DPS</b>	Dividend per Share
<b>EPS</b>	Earnings per share
<b>M&amp;As</b>	Mergers and Acquisitions
<b>NSE</b>	Nairobi Securities Exchange
<b>ROA</b>	Return on Assets
<b>ROE</b>	Return on Equity

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

A merger is the consolidating of equal strong companies aimed at forming completely new company. The new entity formed lose their original identity after the combination and dominates the latter (Ruback, 2005). Combination of two or more firms is seen as a strategic move firms take to increase their value by consolidating their resources. An acquisition occurs when one business entity called the predator takes control over another business entity called the target. The idea behind mergers and acquisitions is risk diversification which is normally achieved through conglomerate merger especially where the returns of the two firms are negatively perfectly correlated.

In the recent times, mergers and acquisitions have gained corporate concern due to its significance. Mergers and acquisitions have necessitated the maximization of the returns of the shareholders (Scholes, 2009). Business entities have achieved short term growth this is made possible where the target is experiencing growth and profitability problems such a target can be acquired by the predator which will improve its financial performance hence increased profitability. Sharpe (2008) argues that mergers and acquisitions aims at limiting the competition through empire building where mergers and acquisitions are motivated by the resultant gains. After the merger, the business entities involved will gain the market power.

Synergy is achieved through mergers and acquisitions. These are additional benefits associated with economies of scale after mergers and acquisitions. It is the creation of a whole which is greater than the sum of two combined business entities (Roll, 1988). He argued that mergers and acquisitions are undertaken because they generate synergy this is according to the financial efficiency theory. Synergy implies a situation in which the value of the consolidated business entities is greater than the value of independent entities. This also arises from management capabilities, creativity and innovativeness (Ross, 2005).

### **1.1.1 Mergers and Acquisitions**

A merger is an act of consolidating business entities to form one business entity (Ross, 2008). Basically a merger aims at the creation of synergy, which are the benefits achieved as a result of mergers and acquisitions by different business entities where the financial performance of the individual business entities is less than the combined business entities. Many mergers involve the agreement by the parties involved, but some time the predator can forcefully initiate the process by influencing the management of the target company. It is done majorly by 2 ways, by seeking the support of the stakeholders of the target firm or using the tender offer by striking the deal directly to management of the target. Mergers are majorly classified into 3 and they include horizontal mergers which is the combination of 2 or more business firms in same business, Conglomerate mergers which is the merger between firms in unrelated lines of business and vertical mergers which involves the combining of 2 or more companies in different levels of production of various components.

An acquisition is a scenario in which one firm called the predator acquires another firm called the target firm. Usually, a larger company takes over the smaller company. Normally, the negotiations to takeover can be good or bad. If the business deal is good, the management of both business entities agree to work together towards achieving their goal but if it is bad is likely to lead to poor financial performance since this is a forced deal. That means it was unfriendly and in such case the target company can resist the process by the use of the green mail where the target gets a counter offer to acquire the predator and the predator the target. This is possible where 2 firms are equally strong and can easily take over each other (Haley, 2001).

### **1.1.2 Financial Performance**

Financial performance deals with how prudent a company has used assets to realize income (Ross, 1995). It is normally over a specified period of time. It can be monthly, quarterly, semi-annually or annually. Measurement of financial performance is key to organizational success since all long term strategies are based on it. Financial performance is normally determined by the gearing ratios, profitability ratios and liquidity ratios. Liquidity ratios aims at establishing whether a company will be able to meet its short-term obligations, gearing ratios sheds more light on the degree to which debt financing has been employed by a business entity because debt financing also attracts the finance charge in form of interest rate. Profitability ratios aims at establishing how well the business entities have efficiently managed the resources to achieve their goals. The major goal of any business entity is to minimize losses and maximize the profits.

### **1.1.3 Mergers and Acquisitions and Financial Performance**

Mergers and acquisitions are strategic alliances aimed at improving the financial performance of the business entities involved in the deal. Due to the increased competition in the business environment, mergers and acquisitions have emerged as the only survival tactic to gain competitive advantage (Graham, 2010). According to the monopoly theory, (Lambert, 1980) mergers and acquisitions are undertaken to realize monopoly. Monopoly will increase the market share hence the market power. Dominance of a company will maximize on the profitability of that company as a result of high returns by limiting stiff competition.

### **1.1.4 Companies Listed at the Nairobi Securities Exchange**

Nairobi Securities Exchange is a market for securities and is among the most active market for securities in the world. The Nairobi Securities Exchange has classified the listed companies into segment basis. The following are some of the listed companies, equity group holding limited, Kenya Commercial Bank Limited, Stanbic Holding Limited, Cooperative Bank of Kenya, KenolKobil Limited, Total Kenya Limited, CIC Insurance Group Holding and Jubilee Holding Limited.

## **1.2 Research Problem**

Business entities are faced with stiff competition due to the rise of technological changes, this has forced the business entities to look for alternative ways to remain competitive. Many business entities have settled on mergers and acquisitions which is believed to be the only option. According to (Kim, 2009), the world has experienced

persistent rate of growth in M&As. According to the latest survey a merger and acquisition year 2015, number of M&As stand over 100million globally. In Kenya, we have experienced many mergers and acquisitions activities especially for the listed companies. The overall objective is aimed at the improvement of the financial performance. Many researchers have conducted research on M&As, Kioko (2009) did a research on the relationship between mergers and financial performance of banks in Kenya from 2001 to 2007. He conducted a comparative study 2 years before mergers and 2 years after mergers using a sample of 12 commercial banks. From his findings, financial performance of commercial banks greatly improved after mergers.

Momanyi (2010) did a study on the effect of mergers and acquisitions on the financial performance of selected firms listed at the Nairobi Securities Exchange in Kenya between 2006 to 2009. The study sample was 10 companies that had undergone mergers and acquisitions. He analysed the financial performance measurement indicators which included dividend per share, return on equity and return on assets. He concluded that selected firms performed poorly after mergers and acquisitions.

Nyambura (2015) did a study to assess the impact of mergers and acquisitions on the financial performance of the milk processing companies in Kenya between 2008 and 2013. The sample for analysis was 7 milk processing firms that had undergone acquisitions. She analyzed the performance using the financial performance measures from the financial statements of the milk processing companies. From the study findings the financial performance of the milk processing firms greatly improved.



Odongo(2012) conducted a survey to investigate the effect of mergers on the financial performance of commercial banks in Kenya from 2002 to 2008. He used the secondary data from the published financial statements from the sample of 10 commercial banks, he analysed financial performance measurement indicators. He concluded that after mergers, commercial banks in Kenya underperformed.

According to(Kioko,2009)and(Nyambura,2015) the financial performance of the companies greatly improved after mergers and acquisitions. However, (Momanyi, 2010) and (Odongo, 2012) concluded that financial performance of business entities did not have significant change after mergers and acquisitions. This research will therefore seek to answer this research questions;What is the effect of mergers and acquisitions on the financial performance of the companies listed at the Nairobi Securities Exchange?

### **1.3 Research Objective**

The objective of this study was to investigate the effect of mergers and acquisitions on the financial performance of companies listed at the Nairobi Securities Exchange.

### **1.4 Value of the Study**

Research will be of great use in conducting academic research. It will act as empirical reference source, literature and it will also form a basis for the conduct of further research in the area of mergers and acquisitions.

The study findings will contribute greatly to investment decisions. Investors will make investment decisions on mergers and acquisitions. Investors can make decisions whether to invest in companies that have been formed through mergers and acquisitions by analyzing their financial performances and their profitabilities.

The research findings will positively contribute into the finance field in general. Business entities will be able to establish profitability levels. This will in turn help finance managers to get insights and apply the outcome in the elimination of risk.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This section covers the theories and empirical review related to mergers and acquisitions, determinants of financial performance and summary of literature review.

#### **2.2 Theoretical Review**

The following theories are related to mergers and acquisitions; Information Theories (Fleming, 1980) which states that mergers are implemented by managers with enough information about the target's market value computed to the stock market. Monopoly Power Theory (Lambert, 2001) which implies that mergers and acquisitions are undertaken to realize monopoly power.

Agency Problems Theory (Ross, 1970) which asserts that mergers and acquisitions are executed by managers who are interested in the maximization of their own interest. Financial Efficiency Theory (Roll, 1980) which asserts that mergers and acquisitions create synergy and hubris hypothesis (Brigham, 1980) which concluded that errors of over optimism is normally committed by managers during evaluation of the potential targets.

##### **2.2.1 Monopoly Theory**

Lambert(2001) defines monopoly as taking total control of a situation. Monopoly theory asserts that mergers and acquisitions are basically after taking control of a certain market.

Monopoly will result into creased market power. When 2 or more firms merge, the resultant business entity normally is larger than the previously separate entities. When a firm controls a market it means it is likely to earn more profits because monopoly power can dictate the setting of the selling prices which have a direct effect on profitability hence monopoly leads to improved financial performance.

### **2.2.2 InformationTheories**

According to the information theories, M&As are executed by managers with enough information about the target market value computed to the stock market (Fleming, 1980). In normal circumstances, the forces of demand and supply can determine the stock prices but when it comes to M&As, the managers of the predator company for example should have enough facts about the value of the target before making any bidding.

### **2.2.3 Financial Efficiency Theory**

The idea behind M&As is that they occur because they generate synergy (Roll, 1986). Synergy is the economies form the consideration of business entities where the financial performance of the combined business entities is greater than the individual separate business entities. Normally before any M&As agreement is reached, the managers of the business entities should evaluate the outcome to determine if it will be beneficial or not. According to the financial efficiency theory, the optimal return is that with positive value creation.

### **2.2.4 Agency Problems Theory**

According to the agency problems theory, management plan mergers and acquisitions which are aimed at maximizing their own interest and not the interest of the shareholders (Ross, 1970). In most cases, managers tend to own a small fraction of the company's share capital. This means that managers may not work towards maximizing the returns for the shareholders but instead their interests. The shareholders may not have enough resources to oversee the activities of the managers. Some managers may acquire business entities that require their personal skills hence it can be costly to be replaced by the shareholders. Some managers are always after their personal needs like awarding themselves huge salaries and this greatly contributes to agency problems between the managers and the shareholders.

### **2.2.5 Hubris Hypothesis**

According to the hubris hypothesis, management commits mistakes of overoptimism in the evaluation of the target party. This can make them bid more and transfer more than they should (Brigham, 1980). Management can easily overestimate the value for their money. Managers can also underestimate the cost of their post-merger integration or the controlling a larger business entity. The outcome is that the shareholders of acquiring firm will not benefit from the deal.

## **2.3 Determinants of Financial Performance**

When business firms undergo corporate reconstruction, it is expected that their financial performance will change. According Campbell(2001) financial performance measures how firms have employed asset to generate incomes. It is normally over specified period of time. It can be monthly, quarterly, semi-annually or annually. The determinants include Macroeconomic factors, leverage, company size and liquidity.

### **2.3.1 Liquidity**

This is the extent of buying or selling securities and not affecting the price of the asset (Desai, 1980).It is measured using acid test ratio and current ratio. Current ratio tells us about those assets that can be liquid within 1 year and the liabilities that will be due for payment. Acid test ratio on the other hand is about the availability of sufficient resources which are more liquid to cater for the current liabilities. Business entities with more liquid assets normally outperform the companies with less liquid assets because cash is readily available to cater for their needs at any point in time.

### **2.3.2 Macroeconomic Factors**

Macroeconomic factors include inflation, political instability, fluctuations in exchange rates and changes in interest rates. Political instability like wars will have a negative effect on the financial performance because investments will be slow due to wars. Investors will reduce investment activities for fear of destruction. During wars, client level will reduce this will in turn affect the financial performance on the other hand

political stability will encourage investment hence business entities will be willing to invest more. This will increase the returns and financial performance will definitely improve. Inflation will affect the financial performance of the business entities due to the persistent rise in the prices of the products (Cornell, 2001).

### **2.3.3 Leverage**

Leverage is the amount of debt financing (Wood, 1950), many companies have resorted to debt financing due to its advantages. However there are risks associated with debt financing for example the finance charge which is the interest rate. The capital structure of many business entities consist of debt and equity. High amount of debt causes financial distress. Financial distress is a situation where companies face cash flow problems. However, there are benefits associated with leverage. Business entities will always have enough stock to run their businesses because some business entities require the amount of stock which cannot be solely provided by the owner hence need for borrowing. Good debt management skills can have a positive influence on the financial performance.

### **2.3.4 Company Size**

The size of the firm play a crucial role in the financial performance and the profitability. It is believed that the larger the company the better the financial performance because of the economies of scale. Large companies can easily carryout diversification too which is aimed at reduction of risk. Large companies are able to buy in bulk, by buying in bulk they can be able to enjoy trade discounts hence save on costs.

Companies that minimize their costs tend to have higher returns in the long run. Smaller companies on the other hand are constrained due to cashflow problems hence financial performance is positively related to the size of the firm

## **2.4 Empirical Review**

Empirical literature reviewed presents conflicting outcomes with respect to business entities involved. Some existing empirical literature have proven companies that have resorted to mergers and acquisitions have enjoyed the financial gains. However, other empirical works have revealed no financial gains from mergers and acquisitions of the business entities involved. Litondo(2013) studied how mergers and acquisitions will affect the financial performance of companies in Kenya. The study period was 2001 to 2010. Population was the 40 selected firms but a sample of 21 firms was selected for the study. He collected secondary data from the firm's websites. The analysis of financial performance measurement indicators were determined before the mergers and acquisitions and after the mergers and acquisition. From his findings, mergers and acquisitions had a significant positive influence on the financial performance.

Maina (2016) researched on the influence of mergers and acquisitions on the financial performance of the firms in Kenya. The period under study was from 2008 to 2013. The population of interest was 27 oil firms in Kenya. However, a sample of 13 oil firms was selected for the study. Data for analysis was the secondary data and was obtained from the financial statements.



The study employed a linear regression model in the analysis. Return on equity and dividend per share were determined 3 years before mergers and acquisitions and 3 years after mergers and acquisitions from the findings of the study he concluded that oil firms performed better after mergers and acquisitions.

Thomson(2010) did a study on share price reaction to acquisition announcement in New York stock Exchange in America. The objective of the survey was to study the effect of acquisitions announcement on share price reaction of the firms listed at the New York stock Exchange. A sample of 102 firms was selected from the 200 firms listed at the New York stock exchange. The study used the secondary data from their findings, stock prices experienced an upward trend a few days prior to acquisitions announcement.

Mohamed et al. (2011) researched on the impact of mergers and acquisitions on the financial performance of companies in India from 2001 to 2008. 182 selected firms listed at the Bombay securities exchange was selected for the study. However, due to time and resources constraints 91 firms were selected as a sample for the study. The study also employed the linear regression model in the survey. The research used secondary data for companies for analysis, dividend per share and earnings per share was determined 4 years after mergers and acquisitions and 4 years before mergers and acquisitions. From the findings, the financial performance of the companies listed at the Bombay securities exchange improved after mergers and acquisitions.

Jamal and Malik(2013) researched on howM&Aaffected the financial performance of banks in Pakistan between 2005 and 2011. All the 157 listed commercial banks were selected for the study. However 70 banks which hadundergone M&Aswere selected as a sample for study. Secondary data was obtained from the published and audited financial statements for the commercial banks. The study employed a linear regression model in the analysis. DPS and ROA were determined and three (3) years before M&Asand 3 years after M&As. From their findings, M&Ashad insignificant effect on the financial performance of the commercial banks in Pakistan.

Vasicek and Stoll (1998) did a study to determine the effect of M&Ason the financial performance of the United Kingdom's top 600 firms from 1990 to 1996. 30 mergers and 82 acquisitions were selected for the study. The study relied on the secondary data to analyse the return on equity and DPSafter and before mergers. From their findings, they concluded that financial performance of the United Kingdom firms improved after M&As.

Busse (2008) did a research to establish the effect of M&Ason the financial performance of commercial banks in Canada from 2001 to 2006. 102 commercial banks which had undergone M&As were selected for the study. The study sample was 30 commercial banks. Linear regression model was also employed in the study. He used secondary data to determine the commercial banks' performance measurement indicators which included ROA, ROE, and DPS were determined 2 years before mergers and 2years after M&As. From their findings the commercial banks underperformed after M&As.

Osoro (2010) did a study on the impact of mergers and acquisitions on the financial performance of insurance firms in Kenya between 2001 to 2007. A sample of 6 mergers and 8 acquisitions was selected for the study from the 21 mergers and acquisitions. The study relied on secondary data which was readily available from the financial statements of the insurance companies in Kenya. Earnings per share and dividend per share were determined and computed 2 years before mergers and acquisitions and from the findings of the study, insurance firms underperformed after mergers and acquisitions.

Rono (2012) did a study on how mergers and acquisitions of construction and manufacturing companies influenced their financial performance in Kenya between 2003 to 2010. The population of interest was 13 construction and manufacturing companies which had undergone mergers and acquisitions. A sample of 7 construction and manufacturing companies was selected for analysis. The linear regression model was employed in the analysis. Financial performance indicators which included return on assets and return on equity were computed and compared. She concluded that financial performance of construction and manufacturing companies improved after mergers and acquisitions.

Odongo (2014) did a study on the effect of mergers and acquisitions on the financial performance of commercial banks listed at the Nairobi Securities Exchange between 2008 and 2012 in Kenya. A sample of 10 commercial banks which had undergone mergers and acquisitions were selected for the study. The study relied on the secondary data which was readily available from the published financial statements of the

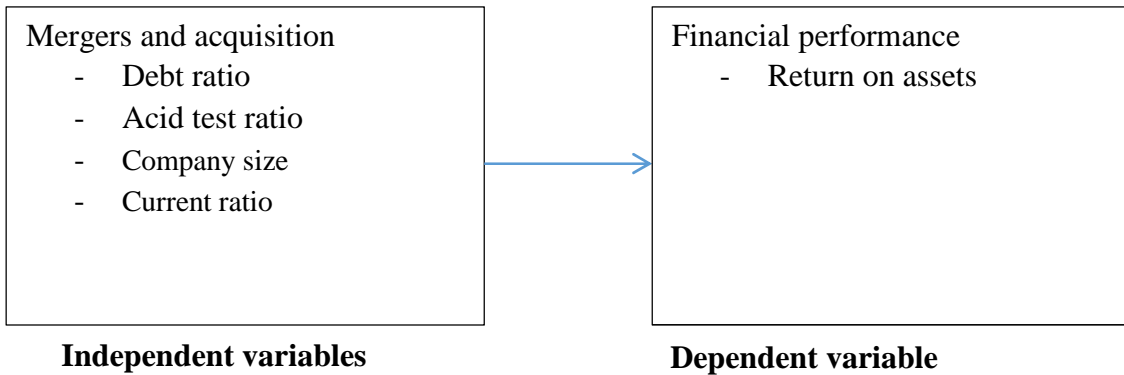
commercial banks in Kenya. Data was analysed two years after mergers and acquisitions and two years after mergers and acquisitions. Financial performance measurement indicators which included return on assets and return on equity were determined and compared. The study also employed the regression model to study the relationship among the study variables, from her findings mergers and acquisitions had insignificant effect.

Kauki (2011) did a study on the effect of mergers on the financial performance of commercial banks listed at the NSE from 2006 to 2010 in Kenya. A sample of 8 commercial banks which had undergone mergers was selected for the study. The study relied on the secondary data which was readily available from the published financial statements of the commercial banks in Kenya. Data was analysed three years after mergers and three years before mergers. Financial performance measurement ratios which included DPS and earnings per share were computed and compared. The study also employed the linear regression model in the analysis. From his findings, the financial performance of commercial banks greatly improved after mergers.

Kimeu (2015) did a study on the effect of mergers on the financial performance of the oil marketing firms in Kenya between 2008 to 2013. A sample of 10 oil marketing firms was selected for the study. The study used secondary data which was readily available for the financial statements of the firms. Financial performance was measured by return on assets, ROE and DPS for the oil marketing firms. The study also employed the linear regression model. From the findings, the oil marketing firms underperformed after mergers.

From the study findings, the researchers have different opinions on the effect of mergers and acquisitions on the financial performance of the business entities. While other findings can confirm a positive impact of the M &As, others concluded that mergers and acquisitions had insignificant effect on the financial performance. It is against this background that the present study will be undertaken so as to confirm the existing literature.

## 2.5 Conceptual Framework



**Figure 2.1: Conceptual Framework**

The figure above shows the relationship between the independent variable which is the mergers and acquisition and is measured by debt ratio, acid test ratio and company size while return on assets measured the financial performance.

## **2.6 Summary of Literature Review**

The literature review entails the theories that were discussed and included; monopoly theory, information theory, financial efficiency theory, agency problems theory and hubris hypothesis; the determinants of financial performance which included; liquidity, macroeconomic factors, leverage and company size and the empirical review which included (Litondo, 2013), (Omollo, 2015), Maina( 2016), (Kauki, 2010) (Mohamed et al., 2011), (Jamal and Malik,2013), Vasicek and Stoll (1998) (Busse, 2008),(Osoro, 2010),(Rono, 2012) (Odongo, 2014) and Kimeu, 2015) which has presented varied outcomes results on the effect of mergers and acquisition .Majorly, studies have been conducted on segment basis The current study will therefore be conducted in all the segments of the listed companies.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This section discusses the methods which were used to conduct this study, the kind of research design that was employed, the population of the study, the methods that were used to collect data and the techniques that were used to analyze the data.

#### **3.2 Research Design**

The methodology employed in the research process is research design (Mugenda, 2005). Descriptive research design was employed in this study.

#### **3.3 Population of the Study**

The set Population is a well-defined set of elements that are being investigated (Mugenda, 2005). This study used 12 companies which had undergone mergers and acquisitions.

#### **3.4 Data Collection**

This study relied on the secondary data for analysis and was obtained from the published financial statements for the period 2007 to 2013. Data that was collected include, net income, current liabilities, total assets, current assets and total liabilities.

### 3.5 Data Analysis

This research used the debt ratio, current ratio, logarithm of assets, acid test ratio and return on assets in the analysis. Data was analyzed 3 years before mergers and acquisitions and 3 years after mergers and acquisitions to assess whether M&A had any significant effect on the financial performance. To establish the relationship among the different variables in the study, a paired t-test at 5% significance level was conducted on the mean of current ratio, acid test ratio, logarithm of total assets and return. The mean of each variable before and after the mergers and acquisitions was computed and comparisons made and the t-value for each variable was computed to determine if the effect was significant or not.

The multiple linear regression model will be used is

$$Y = S_0 + S_1x_1 + S_2x_2 + S_3x_3 + S_4x_4 + e$$

Where Y is the financial performance as measured by the return on assets.

$x_1$  is the acid test ratio as measured by current asset minus closing stock divided by current liabilities

$x_2$  is debt ratio as measured by debts to assets.

$x_3$  is the current ratio as measured by current assets divided by current liabilities.

$x_4$  is the size of the company as determined by the log of assets.



## CHAPTER FOUR

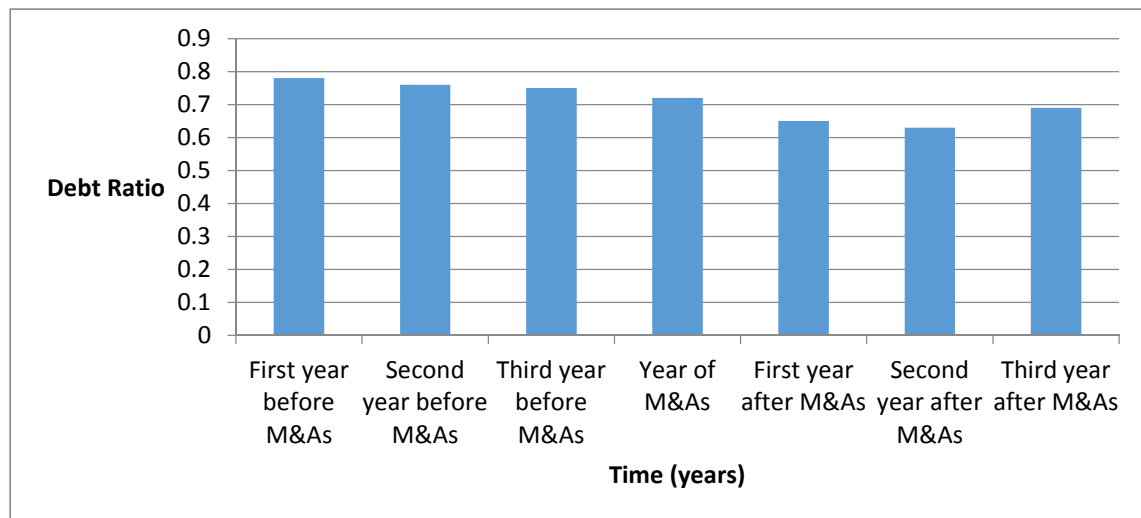
### DATA ANALYSIS, FINDINGS AND INTREPRETATION

#### 4.1 Introduction

This chapter deals with the analysis of data. The study relied on the secondary data which was mainly obtained from the capital markets authority for the listed companies for the analysis. Section 4.2 presented descriptive data analysis, section 4.3 presented inferential data statistics and ends with section 4.4. which highlighted major discussions and findings thereon.

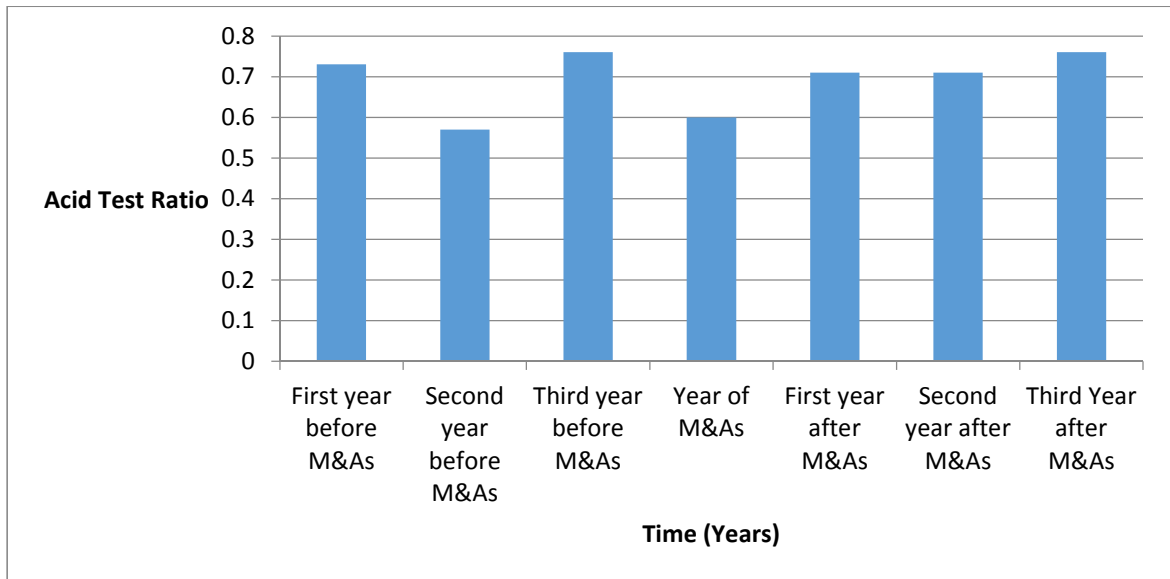
#### 4.2 Pre and Post Mergers and Acquisitions Descriptive Data Analysis

The secondary data from the Capital Markets Authority obtained for the listed companies was analyzed for a period of three years before the mergers and acquisitions and after the M&As with an aim of determining their significance on the financial performance. The data for the debt ratio, current ratio, acid test ratio, logarithm of assets and return on assets were determined and recorded in the following graphs.



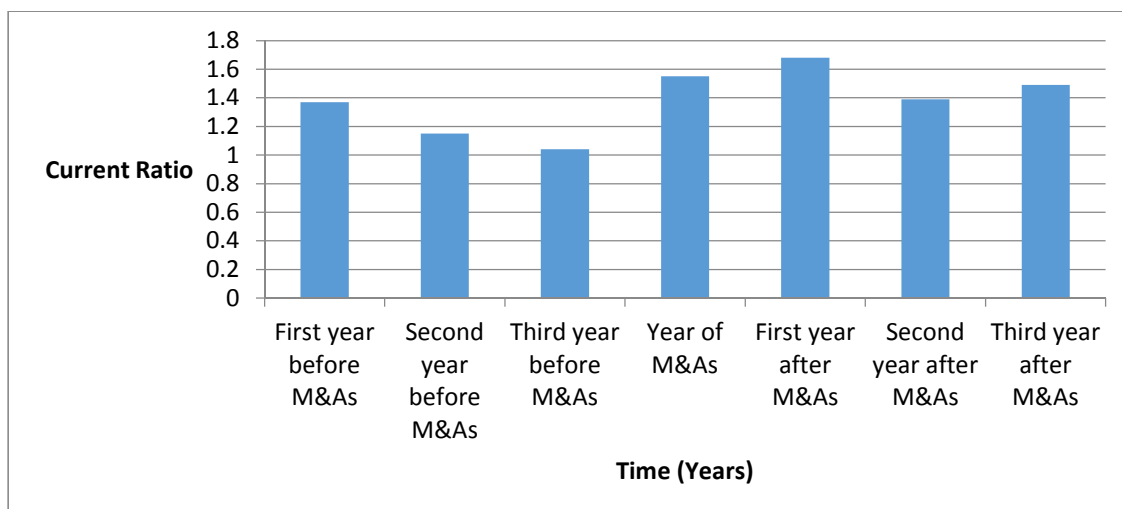
**Figure 4.1: Debt Ratio**

From the graph above, the debt ratios were 0.78, 0.76 and 0.75 for the first year before mergers and acquisitions, second year before mergers and acquisitions and third year before mergers and acquisitions respectively. There was a decline in the value of debt ratios after mergers and acquisition and the values were 0.65, 0.63 and 0.69.



**Figure 4.2: Acid Test Ratio**

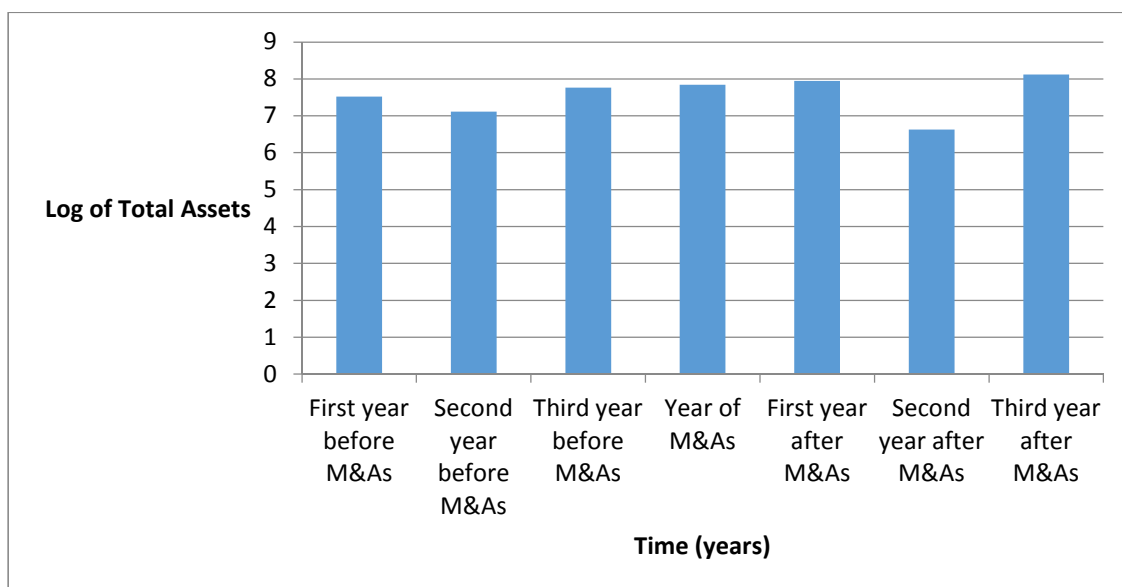
On average, the acid test ratios of the companies before mergers and acquisitions were 0.73, 0.57 and 0.76 then after mergers and acquisitions, the values were 0.74, 0.71 and 0.76.



**Figure 4.3: Current Ratio**

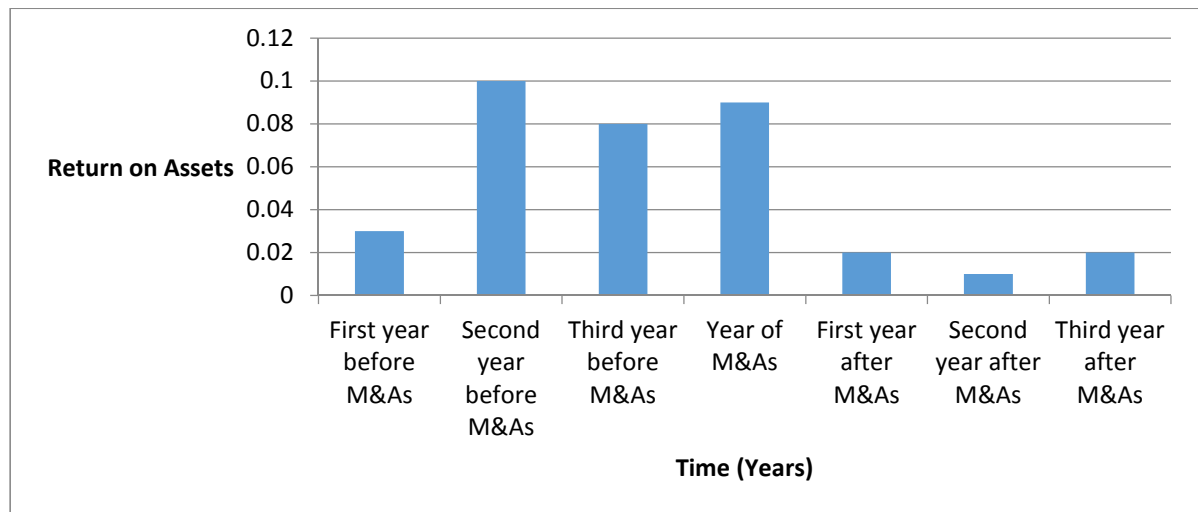
The average values of the current ratios were 1.37, 1.15 and 1.04 before mergers and acquisitions and after the mergers and acquisitions the values were 1.55, 1.68 and 1.39.

The companies reported an improvement after the mergers and acquisitions.



**Figure 4.4: Log of Total Assets**

The average values of the size of the company as measured by the logarithm of assets were 7.52, 7.11 and 7 before mergers and acquisitions and after mergers and acquisitions the values were 7.95, 6.63 and 8.19. This was an improvement as a result of the mergers and acquisitions.



**Figure 4.5: Return on Assets**

The average values of the return on assets were 0.03, 0.1 and 0.08 after the mergers and acquisition the companies recorded the values of 0.02, 0.01 and 0.02. It shows that return on assets declined after mergers and acquisitions.

### 4.3 Inferential Data Statistics

The inferential data statistics was conducted on the average values of the current ratio, acid test ratio, debt ratio, log of assets and ROA. Regression analysis was employed to bring out the relationships of the variables and the paired t-test statistics at 5% significance level was conducted on the mean values of current ratio, acid test ratio, debt ratio, log of assets and return on assets.

### 4.3.1 Correlation Analysis

**Table 4.1: Correlation Matrix**

		Debt Ratio	Acid Test Ratio	Current Ratio	Log Assets	ROA
Debt Ratio	Pearson Correlation	1	0.179	0.07	0.525	0.454
	Sig. (2 tailed)		0.821	0.930	0.475	0.546
	N	4	4	4	4	4
Acid Test Ratio	Pearson Correlation	0.179	1	-0.628	-0.538	-0.571
	Sig. (2 tailed)	0.821		0.372	0.462	0.429
	N	4	4	4	4	4
Current Ratio	Pearson Correlation	0.070	-0.628	1	0.877	0.913
	Sig. (2 tailed)	0.930	0.372		0.123	0.087
	N	4	4	4	4	4
Log Assets	Pearson Correlation	0.525	-0.538	0.877	1	0.997
	Sig. (2 tailed)	0.475	0.462	0.123		0.003
	N	4	4	4	4	4
ROA	Pearson Correlation	0.454	-0.57	0.913	0.997	1
	Sig. (2 tailed)	0.546	0.429	0.087	0.03	
	N	4	4	4	4	4

From the analysis of the correlation above, it is evident that a relationship between return on assets and debt ratio exist but the relationship is not significant. The value of correlation coefficient is 0.454 which is a moderate relationship. A negative relationship exists between acid test ratio which is not significant, there exists a strong relationship between the current ratio and return on asset of 0.913 which is not significant and finally logarithm of assets is positively and strongly related with the return on asset and that relationship is significant.

### 4.3.2 Regression Analysis

**Table 4.2: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the estimate
1	0.52	0.27	0.065	0.341

From the analysis of the table above, the adjusted R square was 0.065, the adjusted  $R^2$  indicates the percentage with which the independent variables are explained. It means that the debt ratio, acid test ratio, current ratio and size of the company will affect the financial performance up to an extent of 6.5%.

**Table 4.3: Summary of One Way ANOVA**

Model	Sum of squares	df	Mean Square	F	Sig.
1 Regression	0.624	3	0.156	1.54	0.0289
	0.895	18	0.117		
	2.519	21			

The analysis of the ANOVA tells us that the model is sufficiently fit to analyze the effect of M&As on the financial performance since the F value of 1.54 is greater than the critical value and the P value of 0.0289 is less than 0.05.

**Table 4.4: Regression Coefficient**

	Unstandardized Coefficient		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
1 (Constant)	-0.035	0.006		1.528	0.108
Debt ratio	0.012	0.067	-0.109	0.851	0.536
Acid Test Ratio	0.003	0.006	0.564	3.258	0.000
Log Assets	0.08	0.054	0.618	1.423	0.15

The findings of the regression analysis shows that relationship which is positive exist between debt ratio and ROA and was insignificant . Acid test ratio was found to be positively related to ROA and the relationship is significant since the p value is 0.000 which is less than 0.05 and a positive relationship exist between the size of the company and the financial performance.

**Table 4.5: The Analysis of the Variables**

	Mean		
	Pre M&As	Post M&As	T-statistics
Debt ratio	0.014	0.025	0.026
Acid Test Ratio	0.851	0.369	0.012
Current ratio	0.738	0.808	0.035
Log Assets	7.020	8.103	0.228
ROA	0.035	0.044	0.007

#### **4.4 Interpretation of Findings**

The companies which had undergone mergers and acquisitions posted improved financial results this is shown from the return on assets which on average is greater than the average value of return on assets before mergers and acquisitions which is a variable for the measurement of financial performance. The pre mergers and acquisitions mean of return on assets is 0.035 and post mergers and acquisitions mean of return on asset is 0.0344 this shows that M &As improves the financial performance.

From the regression analysis the results indicate the model of analysis used was ideal. This is due to the fact that the p value of 0.0289 which is less than 0.05. The coefficient of correlation was 0.52 which showed that a relationship exists between debt ratio, acid test ratio, the size of the company and the return on assets. The value of adjusted R Square was 0.065 which explains the viability of the independent variable and the value was 6.5% which means that the independent variables (Debt ratio, acid test ratio) explains the effect up to 6.5% of the effect on the financial performance.

The regression coefficient table implies that positive relationship exists between the debt ratio and return on assets however the relationship is not significant, acid test ratio, is positively related with the financial performance and the relationship is significant. The size of the company is positively related with the size of the company however the relationship is not significant. The findings of this study concurs with the study by Mwangi (2012) who concluded that mergers and acquisitions have a positive effect on the financial performance.



## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter highlights the findings of the study, conclusion, recommendations, limitations of the study and areas for further research.

#### **5.2 Summary**

The idea behind the investigation of the results of mergers and acquisitions on the financial performance of the listed companies was based on the argument that in Kenya currently major business restructuring activities by mergers and acquisitions are on the rise. This study aimed at establishing the actual relationship between mergers and acquisitions and the financial performance of the companies listed at the Nairobi securities Exchange. The study obtained the secondary data from the capital markets authority for the analysis by the help of event study methodology. The study involved the analysis of debt ratio, acid test ratio, current ratio, log of assets and return on assets.

The analysis of the data was done in a six year period. It involved the analysis of the 3 years before mergers and 3 years after mergers . The 3 year mean of debt ratio, acid test ratio, log of assets and return on assets was compared with the average post mergers and acquisitions and the corresponding t –values were used to determine whether the variables were significant or not at 5% level of significance. Based on the analysis of the findings of the study, mergers and acquisitions have a significant effect on the financial performance.

### **5.3 Conclusion**

This research was aimed at determining how mergers and acquisitions will affect the financial performance of the companies listed at the Nairobi Securities Exchange. From the findings of study, a positive relationship exist between debt ratio and the financial performance of the companies listed at the Nairobi Securities Exchange, acid test ratio is positively related with the financial performance and the size of the company is positively related with the financial performance. The conclusion of this research is that mergers and acquisitions improves the financial performance. This study is in agreement with the previous studies by Momanyi (2010), Omondi (2015) and Mwangi (2013) who both concluded that indeed mergers and acquisitions improve the financial performance.

### **5.4 Recommendations**

The outcome of this research have proved that M&As improve the financial performance. This study highly recommends that any company which is financially challenged should consider mergers and acquisitions as the better option due to the benefits associated with it. This can be done by proper identification of the target firms which can enhance synergies as well.

This research makes a recommendation that the management of the companies to come up with more elaborate strategic options on how the assets of the companies should be managed since they are an important component which affects the financial performance.

## **5.5 Limitations of the Study**

One major key challenge for this study was availability of enough time considering the quantity of data needed in order to do data analysis therefore if enough time was available, other qualitative aspects of financial performance could have been incorporated in this study and this will make it more conclusive by combining the quantitative and qualitative aspects.

The sample of the study was not sufficiently enough because not many companies at the Nairobi Securities Exchange have undergone mergers and acquisitions. A larger sample gives more conclusive outcomes. Despite the fact that the sample size was small it was representative of the entire population.

## **5.6 Areas of Further Research**

The study should be done using both the secondary data and the primary data. Primary data is a good source of qualitative aspects which contribute greatly to the financial performance while the secondary data focuses on the quantitative aspects.

Future studies should be conducted by incorporating both listed and unlisted companies to come up with more conclusive results. This can be a comparative study between listed companies and unlisted companies.

## REFERENCES

- Campbell, S. (2001). Comparison of Post-merger Performance of Acquiring Firms in India Involved in Domestic and Cross-Border Acquisitions, MPRA Paper, No. 19274, University Library of Munich, Munich.
- Cornell, M. (2009). *Deregulation, Consolidation and Efficiency: Evidence from Spanish Insurance Industry*: Wharton Financial Institution Center.
- Desai, B. (1980). Impact of Mergers on Corporate Performance of Acquirer and Target Companies in India, *Journal of Modern Accounting and Auditing*, 11, 55 – 64.
- Frank, W. (1990). *Financial Accounting I*. (3rd ed.)
- Graham, P. (2010). Corporate Acquisitions: A Review of Event Studies Applied to Acquisitions, *the Journal of Finance*, 11, 127-150.
- Hutchison, J. (2005). *Corporate Finance. Principles of Investment, Financing and Valuations*. StanleyThornes.
- Jamal, S. & Malik, J. (2013). Effect of Mergers and Acquisitions on the Financial Performance of Commercial Banks in Pakistan. The Empirical Evidence. *Journal of Finance*, 6, 47-85.
- Kauki, N. (2011). Effect of Mergers on the Financial Performance of Commercial Banks Listed at the Nairobi Securities Exchange. *Unpublished MBA Thesis of the University of Nairobi*.
- Kimeu, C. (2015). Effect of Mergers on the Financial Performance of oil Marketing Firms Listed at the Nairobi Securities Exchange in Kenya. *Unpublished MBA Thesis of the University of Nairobi*.

- Kioko, M. (2009). Effect of Mergers on the Financial Performance of Commercial Banks in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*
- Litondo, N. (2013). Effect of Mergers and Acquisitions on the Financial Performance of Selected Firms in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*
- Maina, N. (2016). Effect of Mergers and Acquisitions on the Financial Performance of Oil Firms in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*
- Mohamed, K., Thakor, F., & Wasley, N. (2011). Impact of Mergers and Acquisitions on the Financial Performance of Companies Listed at Bombay Securities Exchange in India. The empirical Evidence. *Journal of Finance*, 34, 172-210.
- Momanyi, S.K. (2010). Effect of Mergers and Acquisitions on the Financial Performance of Selected Firms Listed at the Nairobi Securities Exchange in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*
- Mugenda, O.M. (2005). Research Methods: *Quantitative and Qualitative Approaches.*
- Nyambura, K. (2015). Effect of Acquisitions on the Financial Performance of the Milk Processing Firms in Kenya. *Unpublished Master of Science of the University of Nairobi.*
- Odongo, B. (2014). Effect of Mergers and Acquisitions on the Financial Performance of Commercial Banks Listed at the Nairobi Securities Exchange. *Unpublished MBA Thesis of the University of Nairobi.*
- Odongo, O.M. (2012). Effect of Mergers on the Financial Performance of Commercial Banks in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*
- Osoro, C. (2010). Effect of Mergers and Acquisition on the Financial Performance of Insurance Firms in Kenya. *Unpublished MBA Thesis of the University of Nairobi.*

- Rono, K. (2012). Effect of Mergers and Acquisitions on the Financial Performance of Construction and Manufacturing Companies in Kenya. *Unpublished Master of Science Thesis of the University of Nairobi*.
- Ruback, P. G. (2005). Mergers & Acquisition; *Administrative Science Quarterly Review* 29, 426-543.
- Scholes, G. (2009). The Impact of Business Restructuring on Firm Performance.
- Sharpe, G. (2008). Exploring the Improvement of Corporate Performance after Merger. *Journal of Finance and Economics*, 19, 146-184.
- Thomson, M. (2010). Share Price Reaction to Acquisition Announcement on the Companies Listed at the New York Stock Exchange in America. The Empirical Evidence. *Journal of Finance*, 14, 110-139.

## APPENDIX

### APPENDIX I: DATA TEMPLATES

#### Debt ratio of merged and acquired companies

Company /year	First year before M&As	Second year before M&As	Third year before M&As	Year of M& As	First year after M&As	Second year after M&As	Third year after M&As
Britam Holdings Limited	0.74	0.76	0.65	0.65	0.82	0.77	0.79
Kenya Commercial Bank	0.89	0.89	0.88	0.84	0.87	0.09	0.84
Co-operative Bank of Kenya	0.85	0.87	0.88	0.85	0.82	0.85	0.86
Total Kenya Limited	0.71	0.65	0.71	0.68	0.07	0.57	0.61
CFC Stanbic Bank	0.86	0.81	0.83	0.76	0.71	0.73	0.81
KenolKobil Limited	0.64	0.59	0.54	0.55	0.63	0.75	0.80
Average Debt Ratio	0.78	0.76	0.75	0.72	0.65	0.63	0.69

### Acid Test ratio of merged and acquired companies

Company /year	First year before M&As	Second year before M&As	Third year before M&As	Year of M& As	First year after M&As	Second year after M&As	Third year after M&As
Britam Holdings Limited	0.65	0.65	0.72	0.69	0.72	0.69	0.65
Kenya Commercial Bank	0.73	0.70	0.71	0.81	0.85	0.84	0.83
Co-operative Bank of Kenya	0.48	0.79	0.83	0.90	0.94	1.23	0.97
Total Kenya Limited	0.65	0.66	0.62	0.07	0.22	0.41	0.50
CFC Stanbic bank	0.59	0.61	1.64	1.07	1.02	0.59	1.0
KenolKobil Limited	1.29	0.01	0.02	0.02	0.70	0.50	0.61
Average Acid Test Ratio	0.73	0.57	0.76	0.6	0.74	0.71	0.76



### Current Ratio of merged and acquired companies

Company /year	First year before M&As	Second year before M&As	Third year before M&As	Year of M& As	First year after M&As	Second year after M&As	Third year after M&As
Britam Holdings Limited	2.31	2.16	2.39	1.94	1.89	2.35	2.27
Kenya Commercial Bank	1.51	1.22	1.15	1.41	1.57	1.28	1.33
Co-operative Bank of Kenya	1.08	1.41	1.49	1.56	1.5	1.62	1.52
Total Kenya Limited	1.28	1.23	1.11	2.78	2.26	1.3	1.3
CFC Stanbic Bank	0.67	0.71	1.38	1.48	1.48	0.59	1.53
KenolKobil Limited	1.35	0.144	0.203	0.18	1.38	1.22	0.97
Average current Ratio	1.37	1.15	1.04	1.55	1.68	1.39	1.49

### Log of total assets of the merged and acquired companies

Company /year	First year before M&As	Second year before M&As	Third year before M&As	Year of M& As	First year after M&As	Second year after M&As	Third year after M&As
Britam Holdings Limited	7.381	7.460	7.554	7.671	7.658	7.890	7.922
Kenya Commercial Bank	8.050	8.242	8.236	8.400	8.519	8.592	9.519
Co-operative Bank of Kenya	8.044	5.188	8.224	8.302	8.364	8.455	8.534
Total Kenya Limited	7.055	7.162	7.498	7.482	7.518	7.601	7.546
CFC Stanbic Bank	7.606	7.636	8.045	8.106	8.146	8.176	8.155
KenolKobil Limited	7.003	6.994	6.984	7.046	7.477	7.635	7.482
Average Log of total assets	7.523	7.113	7.757	7.835	7.947	6.626	8.193

### Return on Assets of Merged and acquired companies

Company /year	First year before M&As	Second year before M&As	Third year before M&As	Year of M& As	First year after M&As	Second year after M&As	Third year after M&As
Britam Holdings Limited	-0.03	0.36	0.32	0.33	0.03	-0.04	0.01
Kenya Commercial Bank	0.02	0.02	0.03	0.04	0.02	0.01	0.03
Co-operative Bank of Kenya	0.03	0.03	0.01	0.03	0.04	0.02	0.03
Total Kenya Limited	0.05	0.05	0.02	0.03	-0.05	-0.02	0.06
CFC Stanbic Bank	0.02	0.03	0.01	0.01	0.03	0.01	0.02
KenolKobil Limited	0.06	0.09	0.07	0.08	0.06	0.07	-0.15
Average Return on Assets	0.03	0.1	0.08	0.09	0.02	0.01	0.02