THE EFFECT OF MERGERS AND ACQUISITIONS ON THE FINANCIAL PERFORMANCE OF FINANCIAL INSTITUTIONS IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

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This research project has been submitted for examination with my approval as university supervisor

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Dedication

I dedicate this paper to my family. Your faith in me has shaped my character and has made me to have faith in myself. Thanks to our almighty GOD for his blessings in our family.

Acknowledgement

Thank you wishes go to Almighty God, for giving me guidance and wisdom during the period of the project until completion.

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Abstract

Financial institutions strength depends on activities that enable the institutions to maximize profits, increase customer base, and minimize costs and also a strong capital strength. In order for financial institutions to be the top provider of financial services mergers and acquisitions between institutions enables them to be innovative, customer focused towards delivery of products and services of superior quality and also delivering value to our shareholders through positive financial performance.

This study examined the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. Mergers and acquisitions theories predict that the activities influence a firm's financial performance. The financial performance measures like ratios are considered essential indicators that capture the trend of the success or failures of the financial institutions. The performance can be either in the long term or short term. The research focused on the financial institutions in Kenya that have merged or being acquired from the period 2000 to 2010. The data that was used comprised of annual reports from the Central Bank of Kenya from the year 2000 to 2011 in order to meet the desired objective.

The analysis of the financial institutions performance for pre and post merger periods was conducted to establish whether there was significant improvement of financial performance on areas of profitability, investment and liquidity. Secondary data was collected for 2 years pre and post merger and analyzed with the aid of statistical tools. The data analyzed are for different years since M&A take place at different years. The results of the data analyzed showed that Return on Asset and Return on Investment indicate a insignificant difference while Return on Equity and Debt Equity Ratio indicate significant difference between measures of performance before and after merger.

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ABBREVIATIONS

M & A	Mergers and Acquisitions
RTPA	Restrictive Trade Practices Monopolies and Price Control Act
NBIFs	Non Bank Financial Institutions
VL	Volatile Liabilities
A. ASTS	Average Assets
LNS	Loans
AST	Average Assets
C.I.R	Cost Income Ratio
ROA	Return on Asset
ROE	Return on Equity
RBS	Royal Bank of Scotland
FTC	Federal Trade Commission
EBIT	Earnings Before Interest and Tax
ROI	Return on Investment
DER	Debt Equity Ratio

CHAPTER ONE

INTRODUCTION

1.1 Background to the study

Mergers and Acquisitions (M&A) are strategic decisions through which firms combine or acquire assets. The basic idea in mergers and acquisitions is to create value and maximize the existing shareholders wealth. Mergers and Acquisitions mean the combination of two or more business units under a single controlling ownership (Lasher 2008). Mergers occur when two or more companies combine into one company. One or more companies may merge with an existing company or they may merge to form a new company. In merger there is complete amalgamation of the assets and liabilities as well as shareholders interests and businesses of the merging companies (Pandey 2005).

Brealey et al (2007) proposed that an acquisition is a takeover, which refers to the transfer of control of a firm from one group of shareholders to another. The takeover involves all assets and liabilities absorbed by the buyer.

Mergers and Acquisitions are common incidents since the turn of the 20th century. M&A are used as tools for business expansion and restructuring. Through mergers and acquisitions financial institutions gets an expanded client base and acquired company gets additional lifeline in the form of capital invested by the purchasing company. The following motives are considered to improve financial performance of the organization: Financial motives: A merger allows the acquiring firm to enjoy a potentially desirable portfolio effect by achieving risk reduction while perhaps maintaining the firm's rate of return. A second financial motive: Is the improved financing posture that a merger can create as result of expansion. Larger firms may enjoy greater access to financial markets and thus be in a better position to raise debt and equity capital. Greater financing capability may also be inherent in the merger itself. This likely to be the case if the acquired firm has a strong cash position or a borrowing by the acquiring company. A final financial motive is the tax loss carry forward that might be available in a merger if one of the firms has previously sustained a tax loss. Non-financial motive for M&A include the desire to expand management and marketing capabilities as well as the

acquisition of new products. Synergy: Occur when the whole is greater than the sum of the parts. This effect may be the result of eliminating overlapping functions in production and marketing as well as meshing together various capabilities (Stanely et al 2009).

Empirical evidence relating mergers and acquisitions and financial performance in general supports the relation. Obaid et al (2010), used three financial measures; profitability, and earning, capital adequacy and solvency on a sample of banks in Pakistan. They found that there was improved financial performance due to improved attention to business, improved management, better credit assessment, and easy access to the new and expansive technology. Kumar and Bansal (2008) used financial data, tables and different ratios on a sample of banks. They used correlation to make analysis and concluded that the banks that acquire other through mergers and acquisitions got benefits like increase in cash flow, larger business and reduction in costs.

In general mergers and acquisitions are performed inorder to achieve a number of advantages which includes; enchancing profitability, maintaining or accelerating a company's growth, limiting the severity of competition, reducing tax liability and also diversifying the risk of the company (Pandey 2005).

1.1.1 Mergers and acquisitions in Kenya

In Kenya, there are changes that have occurred on the laws of mergers and acquisitions. The recently promulgated Competition Act come into effect on 1 August 2011 and replaces the Restrictive Trade Practices Monopolies and Price Control Act (RTPA). The new Act seeks to regulate mergers going forward, approval of mergers and takeovers. The Act defines merger when is deemed to have occurred when one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertakings. Mergers may be achieved by a purchase or lease of shares, acquisition of an interest or purchase of assets of an entity, exchange of shares between or among undertakings which results in a substantial change in ownership structure through what ever strategy or means adopted by the concerned undertakings or even through amalgamations and vertical integration.

The Act is now clear on multi-jurisdictional transactions that involve entities that are not within Kenya. To this effect, any acquisition of an undertaking under receivership by another undertaking either situated inside or outside Kenya or an acquisition by whatever means of the controlling interest in a foreign undertaking that has a controlling interest in a subsidiary in Kenya, will constitute a merger. Where conglomerate undertakings are concerned, acquiring the controlling interest of another undertaking or a section of the undertaking that is capable of being operated independently also falls under the definition of a merger.

Also the Authority must check the effect of a merger on a particular industrial sector or region, employment, the ability of small undertakings to gain access to or to be competitive in any market and the ability of national industries to compete in international markets

1.1.2 Financial performance review of Financial institutions in Kenya

According to the Central Bank of Kenya there has been a great growth in the financial performance of financial institutions in Kenya. The growth has been seen in the following areas; The profit after tax increased by 13 percent in 2009, Banks earnings reached Shs 48.9 billion, Asset base increased by 14 percent from Shs 1.18 Trillion in 2008 to Shs 1.35 Trillion in 2009 and also the expansion of the banks in other Eastern African Region by opening branches in other countries like KCB, Equity Bank, NIC Bank and also Consolidated bank.

The overall financial performance was driven by positive improvement in income, costs, efficiency and better impairment charge levels. The growth in income was influenced mainly by excellent management of interest rate margins as competition for high deposit rates and low borrowing rates soared throughout the markets. On the cost front, there has been tremendous improvement spurred by our commitment to improve the banks cost income ratio through automation of key business processes and increased productivity.

1.1.3 Mergers and acquisitions in the financial institutions

In Kenya when financial institutions were established they were characterized by interest rate restrictions, domestic financial markets, underdeveloped money and capital markets,

and exchange rate and international capital controls. In order to change the financial system, the government of Kenya undertook financial sector reforms from the late 1980s. The financial reforms were aimed at liberalizing interest rates, reducing controls on credit, enhancing competition and efficiency and productivity gains in the financial system. Furthermore, the reforms were directed towards strengthening the Central Bank's supervisory framework and improving the effectiveness of monetary policy through greater reliance on market forces. Financial reforms proposals were first incorporated in the 1986 to 1990 structural adjustment program. Due to the financial reforms there has been structural shifts in banks and other financial institutions in Kenya in the face of globalization. Kenya has increasingly moved into universal banking. This reflected in elimination of NBIFs, which converted to commercial banks merged with parent banks or closed (Oloo 2007).

In recent years a substantial number of mergers and acquisitions have taken place in the banking sector in Kenya, partly occasioned by the need to meet the increasing minimum core capital requirements and to enhance the institutions market share in the local banking industry. Between 1994 and 2005 there was 20 successful mergers, with the number increasing 28 by 2010. A full list of successful mergers and acquisitions are appended to the project see Appendix IV (Central Bank of Kenya 2010). In Kenya it has been noted however inspite the efforts made by the Central Bank of Kenya to encourage mergers, the rate of mergers has not been as high as expected. The low rates of mergers and acquisitions in Kenya is due the inability of individual institutions to get to the negotiating table and also being unable to integrate their diverse business areas. The central bank also notes that the convergence has been made difficult by the ownership of banks in Kenya where shareholding is foreign or family based.

1.2 Statement of the problem

There have been numerous studies done in developed countries like Europe and U.S.A on evaluation of effects of mergers and acquisition on financial performance. Cornett and Hassan (1992), examined changes in performance resulting from bank merger by measuring post merger accounting data and concluded that newly merged bank stock

outperforms the industry average in terms of improvement in the ability to attract loans and deposits, productivity and growth of profitable assets. Burner (2002) reviewed the findings of studies that have investigated directly or indirectly the question, "Does mergers and acquisitions pay?" The evidence from 14 informal studies and 100 scientific studies from 1971 to 2001. The review suggested that target shareholders earb sizeable positive market returns that bidders with interesting exception earn zero adjusted returns and that bidders and targets combined earn positive adjusted returns. On balance, he concluded that mergers and acquisitions do pay. Forcarelli (2002), examined the question of why do banks merge to improve performance using Italian data and concluded that merging firms did not show evidence of income improvement due to higher staff costs.

Local studies have been done on mergers and acquisitions: Korir (2006) did a research on effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange and found that mergers improves performance of companies listed at the Nairobi Stock Exchange; Katuu (2003) did a survey on factors considered important in mergers and acquisition decision by selected Kenyan based firms and established that the cardinal factors considered by firms when they make merger decisions from top priority to least were: synergy, growth and revenues, to be more competitive and cost reduction; Mukele (2006) did a research project on Doctors perception of mergers and acquisitions in the pharmaceutical industry Kenyan based firms in 2007 and found that respondents strongly agreed that merged pharmaceutical companies in Kenya were profit and market oriented.

Financial performance has come out to be the drive for mergers and acquisitions. None of these researches have been clear on the effect of mergers and acquisitions on financial performance of financial institutions in Kenya. This is the gap the research seeks to fill by answering the research question: Does mergers and acquisitions have an effect on the financial performance of financial institutions in Kenya?

1.3 Objective of the study

To determine effects of mergers and acquisitions on the financial performance of financial institutions in Kenya.

1.4 Importance of the study

The study will be useful to the following: -

Government - The government has mandate to create a conducive environment for merger and acquisition by encouraging the development of legislation in which sound merger and acquisition can thrive. The information from this research will among others provide information to support the government in fulfilling this duty.

Shareholders - Information from the study will be useful in making investment decisions. The information provided could help in comparison of different financial data that can help in making investment decisions that guarantee positive return.

Investment advisors - These include investment advisory departments of banks, other financial advisors and financial analysts. Investment advisors would be able to know in advance the current trend in the local and international market.

Regulatory Authorities - These researches will provide additional information that will further facilitate regulation and development of capital markets in Kenya. The regulatory authority will be able to know which areas to improve on regulation as per global requirements.

Academicians - The research findings will provide a basis for further research. It also provides a wealth of knowledge for those pursing studies in related areas as investment bank. The academicians can perform research on areas not researched on.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

There has been numerous studies on mergers and acquisitions abroad , in the last four deacdes and several theories have been proposed and tested for empirical validation. Researchers have studied effect of M&A on industry consolidation, returns to shareholders following M&A and the post-merger performance of companies. Whether or not a merged company achieves the expected performance is the critical question that has been examined by most researchers. Several measures have included both short term and long term impacts of merger announcements effects.

2.2 Theoretical basis of mergers and acquisitions

2.2.1 Efficiency Theory or Synergy Theory

The theory of efficiency generally involves improving the performance of incumbent management or achieving some form of synergy. Synergy expects that there is really something out there, which enables the merged entity to create shareholders value. This concept held that acquisitions were executed to achieve synergies. Rumelt (1986), identified three types of synergies; Financial, Operational and Managerial. Financial synergy comes from several sources. The first source is the lower costs of internal financing in comparison with external financing. This occurs when firms with large internal cash flows and small investment opportunities have excess cash flows whereas those with those with low funds have large growth opportunities. A combination of the two will result in advantages from the lower costs of internal funds ability. A second source of financial synergy is the ability to underpay because of the ability to bargain. This comes from the strength of managers at a given firm with stronger managers will have better bargaining power than that looking to augment managerial capabilities.

The theory based on Operational synergy assumes that economies of scale and scope do exist in the industry and that prior to the merger the firms were operating at unfavorable levels of activity that cannot meet the potential for the economies of scale. Operational synergy targeted achieving operational excellence from a combined firm's operations.

Finally, managerial synergy was used to enhance a target's competitive position by transferring management expertise from the bidder to the target firm.

2.2.2 Monopoly Theory

This theory viewed that acquisitions were execute to achieve market power. The implications of this type of acquisition are that conglomerates use cross-subsidized products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market. These three advantages of the monopoly theory supported the idea of a collusive synergy (Trautwein 1990). He concluded that the monopoly theory's overall performance is even worse than that of the efficiency theory.

2.2.3 Valuation Theory

This philosophy viewed acquisitions as being executed by managers who have superior information than the stock market about their exact target's unrealized potential value. The assumption here is that the acquirer possesses valuable and unique information to enhance the value of a combined firm through purchasing an undervalued target or deriving benefits from combining the target's business with its own. The leveraged buyout can be categorized into this theory. Trautwein (1990), outlined that one of the most common criticism about this valuation theory is that it is impossible to acquire accurate and tangible information about the acquisition results, and further stated that the concept of private information as a basis for mergers warrants further consideration, since it shows why the problematic assumption of capital market efficiency can be avoided.

2.2.4 Empire Building Theory

This theory holds that managers maximize their personal goals, rather than their shareholders' value maximization through acquisitions. Trautwein (1990) concluded that the empire building theory has to be given the most credit of the theories investigated up to this point.

2.2.5 Process Theory

This approach indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory. Rumelt (1986) found that the manager's behavior was overoptimistic in the acquisition decision process. Jemison & Sitkin (1986) proposed a systematic acquisition process perspective. Gaddis (1987) found that political and structural matters affect the acquisition process and outcome.

2.3 Types of mergers and acquisitions

According to Imende and Odhiambo (2006), there are three types of mergers; Horizontal, Vertical and Conglomerate. Horizontal mergers take place where two merging companies produce a similar product in the industry. It is a strategy used by a business or corporation that seeks to sell a type of product in numerous markets. To get this market coverage, several small subsidiary companies are created. In vertical mergers, two firms each working at different stages in the production of the same good, combine. They are united through a hierarchy and share a common owner. Each member of the hierarchy produces a different product or service and the products combine to satisfy a common need. Finally conglomerate merger takes place when two firms operate in different industries.

A take-over is obtaining of control over the management of a company by another in most cases under hostile environment. An acquisition or take-over does not necessarily entail full legal control but may be on the basis of share interest e.g. even 25 % of the shareholding may have control over the company's affairs (Pandey, 2005). Acquisition can involve a cash and debt combination of cash and stock of the purchasing entity, or stock only. In addition, the acquisition can take the form of a purchase of the stock or other equity interests of the target entity. A company may require high yield debt to raise funds (often referred to as a leveraged buyout). The reason the debt carries a high yield is the risk involved. The owner does not want to risk his own money in the deal, but third party companies are willing to finance the deal for a high cost of capital (high interest yield). The combined company will be the borrowed of the high yield debt and be on it's balance sheet. This may result in the combined company having a low shareholders

equity to loan capital ratio (equity ratio). A good example is the Coca Cola Sabco limited on it's acquisition of various bottling companies and CFAO S.A. on it's acquisition of D.T Dobie (Kenya) limited (Imende and Odhiambo, 2006)

2.4 Post merger characteristics of the combined firms

Sufian (2002), compared the pre and post merger bank performance in Singapore by employing Financial Ratio Analysis and Data Envelopment Analysis (DEA) approach, The findings from financial ratio analysis suggests that the merger has not resulted in a higher profitability of Singaporean banking groups post mergers, which could be attributed to the higher cost incurred. However Badrelin and Kalhoefer (2009), analyzed the pre and post merger performance of Egyptian banks which have faced merger during the era of 2002 to 2007. They calculated companies Return on Equity (ROE) in order to know the level of progress and success of banking reforms in strengthening and consolidation this sector. Their analysis suggested an increase in the performance when when companies are compared with the pre-merger performance. They concluded in the study that M&A in the Egyptian banking sector's profitability showed a significant improvement and a small positive impact on the credit risk position.

Lipton (2006) investigated external factors affecting mergers and merger waves by analyzing global M&As from the year 1985 to 2006. Observed that during 1990s merger-waves, as stock prices and earnings ratios increased, mergers volumes increased dramatically from $339 billion in 1991 to $3.3 trillion in 2000 globally, hence positive relationship between stock price increase and M&A activity. Concluded that receptive equity and debt market were critical factors in M&A activity. These findings supported Nelson (1959) who investigated merger movement in American Industry by exploring impact of stock market performance on M&A activity. Found that stock prices increase was followed by merger activity increase. Concluded that M&As were highly concentrated in time clustering during periods of high stock market valuations. Mergers are distinguished by the relationship between two or more firms that are merging.

Guerard (1985), used regression model on a sample of mergers between 1947 to 1977. He tested for significant relationship among annual mergers, stock prices and production and further examined whether multiple time series model could forecast annual mergers more accurately than univariate merger model. He found that weakly positive relationship between economic conditions and mergers and acquisitions activity with changes in industrial production lagging behind changes in mergers and acquisitions activity. Luypaert (2008) used a sample of mergers between 1997-2005. A logit and probit regression analysis was used to estimate the determinants of growth through mergers and acquisitions. He concluded that intangible capital, profitability and firm size significantly positively affected merger and acquisition decision whereas ownership concentration and debt had a negative impact.

Intention to discover the relationship between mergers and acquisitions and financial performance (Healy et al 1992) used accounting data primarily but tested their results by using market valuation measures as well. Their findings were that; industry employment decreased which implies that the merging firms did more restructuring and reorganization than other firms in the industry. But the cash flow margin on sales did not significantly change. However, asset turnover significantly improved. The return on market value of assets also improved significantly.

Gosh (2001), extended the earlier Healey et al (1992) study post acquisitions performance. He used a sample of 315 of the largest acquisitions during the period 1981 to 1995. He initially replicated the Healey et al (1992) results that cash flow margins are higher than industry median benchmarks after acquisitions. But he found that the merging firms also have superior pre-acquisition performance; when he adjusted for this in his regression model, the cash flow margins are no longer higher. Alternatively, when control firms are matched by performance and size from pre-event years, the merging firms no longer show superior performance. For cash acquisitions, cash flows improve 3 percent per year, with the improvements coming from higher sales growth rather than cost reductions. In stock acquisitions, he finds that both operating cash flow margins and sales growth decline, but not significantly. The Gosh study confirmed the Healy et al.

results, which also reinforced their finding that the initial event was consistent with long terra accounting performance.

2.5 Analyzing financial performance of financial institutions

According to Srinivasan (2010) it's very essential to find out the financial health of any institution and more particularly banking institution. In Kenyan context the following indicators can measure the financial performance: -

2.5.1 Liquidity

Liquidity must be measured in the beat possible way because it is lack of liquidity, which may bring about the closing of the bank if financial problems become known. Two ratio's are shown under the liquidity heading. The ratio of TI - VL/A.ASTS measures liquid assets, minus volatile liabilities divided by average assets, which gives the net liquidity position relative to the bank's size. The ratio will vary considerably by the size of bank, with smaller banks having higher ratios on average than large banks. The ratio of LNS/AST stands for total loans to average assets. Generally, the more banks are loaned up, the less likely they are able to meet unforeseen deposit withdrawals.

2.5.2 Asset quality

Banks generally fail because of bad loans. For this reason, the ratio of non-performing assets to capital should be reviewed especially in relation to the bank's current and future earnings position. Banks having a non-performing asset ratio to capital approaching 100 percent or greater and negative earnings are likely to be struggling for survival. When evaluating asset quality, one should compare the ratio of charge off/Assets to the ratio of loss RSRV/ASTS (loan loss reserve ratio). If the level of non-performing assets or the level of charge - off is above normal, the loan - loss reserve ratio should be higher to cover future losses.

2.5.3 Capital adequacy

In Kenya, the government, through the Central Bank of Kenya has put requirements that all commercial banks should gradually increase their capital base to one billion Kenya shillings from the current 250 million Kenya shillings (Central Bank of Kenya, 2008). This represents a 300 % increase. This means that the level of capital has some implication on the performance and bankruptcy of a bank. These capital adequacy

requirements are continuously monitored and reviewed from time to time by the Central Bank of Kenya (CBK). A financial institution that fails to meet the minimum requirements is urged to merge with other banks, loses its licence or is put under liquidation.

According to Christian et al (2008), explains that capital adequacy measures provide significant information regarding a firm's returns, while a few of the individual variables representing asset quality and earnings are informative. Size and growth and loan exposure measures do not appear to have any significant explanatory power when examining returns. The study establishes that the change that the change in total assets is also significant.

2.5.4 Measuring earnings

According to Srinivasan (2010), the most important earnings ratios are those that represent the bottom line of the income statement, mainly the ratios of income to assets or pre tax income on a tax equivalent basis to assets. A return on capital ratio may be misleading because banks can increase the ratio through higher leveraging. Analysis of bank earnings should begin with the net interest income ratio, which has been adjusted for tax equivalency. Higher this ratio the better, especially in relationship to other peer banks. The interest income, and pretax income ratios should all be evaluated on a tax equivalent basis, which adds back to the income stream tax benefits. The no interest income ratio has become more important to banks in recent years because the deregulation of interest rates has narrowed net interest margins and has caused banks to rely more on free income.

The overhead ratios should be looked at with caution because a bank's cost will vary by its type of operation. Retail consumer oriented banks with a large branch network should have higher overhead costs and higher margins than banks specializing in wholesale banking. The ratio of provisions to the loan - loss reserve should also be evaluated in relation to the bank's margins. Higher provisions generally mean there are loan problems. However, further evaluation should be made by looking at the ratio of non - performing loans to assets and at the bank's net interest margins.

2.5.5 Measuring cost income ratio

The cost income ratio (CIR), with its limitations (Welch 2006) is another emerging measure of bank's efficiency and benchmarking metric (Tripe, 1998; Hess and Francis 2004). Being a standard benchmark of bank's efficiency, the CIR measures a bank's operating costs as a proportion of its total (i.e. net interest and non interest) income (Welch 2006).

2.5.6 Measuring profitability of a bank

In measuring the profitability of a bank, bank regulators and analysts have used Return on Assets (ROA) and Return on Equity (ROE) to assess industry performance and forecast trends in market structure as inputs in statistical models to predict bank failures and mergers and for a variety of other purposes where a measure of profitability is desired (Gilbert and Wheelock, 2007; Mostafa 2007; Christian et al., 2008).

Navapan and Tripe (2003) explained that comparing bank's Return on Equity (ROE) is one way of measuring their performance relative to each other. The return on equity looks at the return on the shareholder's investment and thus from the shareholder's perspective, allows a comparison of investment in a bank's shares with other investment opportunities, while it can also provide a measure of bank's riskiness (Gilbert and Wheelock, 2007).

2.6 Empirical evidence

2.6.1 Merger and acquisition changes in performance

Neena et al (2010) studied the impact of mergers and acquisitions on the financial efficiency of the selected financial institutions. The analysis consists of two stages. Firstly, by using the ratio analysis approach, and secondly they examined changes in efficiency of the companies during the pre and post merger by using non - parametric Wilcoxon signed rank te+st. The period was between 2000 to 2008 for 17 companies. They found that there is significant change in the earnings of the shareholders, there is no significant change in liquidity position of the firms. There is a significant correlation between financial perfromance and the merger and acquisition deal, in the long run, and the acquiring firms were able to generate value.

Kithinji and Waweru (2007) investigated the effects of merger restructuring on the financial performance of commercial banks in Kenya. The research compared the pre and post merger financial performance of 20 Kenyan banks that had merged between 1993 and 2000. The results indicate that the legal implications like capital adequacy and solvency ratios improved after the merger. However profitability ratios indicate that the majority of the merged banks reported a decline in financial performance.

According to Ravichandran et al (2010) carried out a study on the efficiency and performance before and after merger for the selected public and private banks. The results suggest that the mergers did not seem to enhance the productive efficiency of the banks as they did not indicate any significant difference. The financial performance suggests that the banks are becoming more focused on their retail activities. How ever it is found that the total advances to deposits and the profitability are the main parameters affected by mergers. Also the profitability of the firm is significantly affected giving a negative impact on the returns.

2.6.2 **M&A and reaction of stock prices**

Anita and Nagar (2010) studied the impact of mergers on the operating performance of the acquiring firm by examining pre and post merger financial ratios. They also examined the behavior of share prices 20 days before and after merger of Tata Steel with Corpus steel. The findings from the period studied is that acquiring firm generally earns positive returns prior to the announcement day, but less than market portfolio in the post merger period. The result of this study fails to support our hypothesis that merger gains are captured at the beginning of a merger program. It is found that stockholders suffer loss for different window periods around the announcement period.

Mitchell and Lehn (1990) studied stock price reactions to acquisitions during the period 1982 to 1986. One sample was composed of firms that became targets of takeovers after they had made acquisitions. The stock prices of acquirers that became targets declined significantly when they announced acquisitions. The stock prices of acquiring firms that did not become subsequent targets increased significantly when they announced acquisitions. They found that for the entire sample of acquisitions, those that were subsequently divested had significantly positive returns.

According to Agrawal et al, (1992) they studied post merger performance. They developed a larger sample of 937 mergers and 227 tender offers. Their sample included firms smaller, which focused on 50 largest mergers. They used data analysis method of historical data. They adjusted for size effect and for beta-weighted market returns. They found that shareholders of acquiring firms experienced a wealth loss of about 10 percent over the five years following the merger completion. Hannan and Wolken (1989) conducted a study of the value weighted abnormal returns experienced in 43 deals announced between 1982 and 1987. The researchers found that, on average, total shareholder value was not significantly affected by the announcement of the deal. They also found that, target capitalization and cross-sectional factors influenced expected synergistic gains. The target capital was negatively related to the change in total value.

Houston and Ryngaert (1994) examined abnormal returns from four days before the target was initially declared a takeover candidate (by any bank) to the announcement day. In their sample of 153 mergers announced between 1985 and 1991, they found that

acquirers suffered a loss in value and targets enjoyed a gain. However, there was no significant aggregate effect on the overall value of the two organizations. The amount of value that was created was highest when acquirers were strong pre-merger performers and when substantial overlap existed.

2.6.3 Mergers and acquisitions failures

Kemal (2011) carried out a study on Post-Merger Profitability. The sample used in the study was Royal Bank of Scotland. Researcher used accounting ratios to analyze the financial performance of Royal Bank of Scotland (RBS) after merger. Study analyzed financial statements for four years (2006-2009) by using 20 vital ratios. It was concluded that the financial performance of RBS in the areas of profitability, liquidity, assets management, leverage, and cash flows have been quite satisfactory before the merger deal. It means that merger fails to improve the financial performance of the bank.

McCauley (1997) carried out a study on reasons why many deals still failed to provide value. The sample used was the outcomes of 71 business deals undertaken between 1989 and 1993. It was concluded that: in some cases acquirers were not clear about the rationale behind the deal, the mergers that seemed to fail most often were those done to expand revenue. These deals often had no other substantive strategic goal; Next in line for failure were those mergers undertaken to pioneer new territory, an inherently risky undertaking. Inexperience also seemed to hinder deal value enhancement, as the returns relative to peers were higher for those deals done by experienced acquirers.

2.6.4 Mergers announcement and the reaction

Eckbo (1981) finds that on the announcement of the mergers, there are positive residuals both for the participants and their major rivals. This appears to be consistent with the monopoly theory. It is unambiguous though, because one could also argue that the announcement of the proposed merger conveys information to rivals and opportunities for increased efficiency by expanding scale. He also finds that at the announcement of the filling of the suit by the antitrust authorities, there is not much effect on the residuals of either the participants or their rivals; in fact, in cases brought buy the Federal Trade

Commission (FTC) the effect on rivals is slightly positive. He concluded that the positive performance of rivals of challenged mergers at the time of the original merger announcement reflects information conveyed by the proposed merger that efficiencies could be achieved by expanding scale either internally or externally.

Cornett & Sankar (1991), they Investigated stock market reaction to announcements of interstate bank mergers, the resources of takeovers gains, and the process of distributing these gains between acquiring and acquired banks. They proposed two hypotheses in relation to overall benefits of bank mergers: One hypothesis, known as the capital quality hypothesis, states that a merger announcement is a favorable signal to the market, since it speaks positively about the capital position of the acquiring bank. It means that the acquiring bank has successfully undergone financial examination by regulatory authorities and the market with regard to its capital position; The other hypothesis is expansion of geographic scope of operations and improving management of the acquired bank's existing assets. They concluded that the two hypotheses showed positive returns during announcement period for bidding banks and their target.

2.7 Conclusion

The effect of mergers and acquisitions can be seen on all aspects of the organization from the financial performance and also the changes on the operations of the organization. The effect can be positive or negative or no effect on the organization. The strategy put in place can lead to a successful merger or acquisition, which in the long run can lead to increase in shareholders value.

Consistent financial performance has built confidence in the leadership and management among the financial institutions shareholders, as well as the industry. Financial institutions once they posts solid year in terms of profitability it signals a positive performance to the investors, government, public and shareholders that the merger was successful. The institutions proven strategy and well-diversified business, which is supported by well-trained and experienced employees will help achieve desired objectives. The changes in the board of directors of the financial institutions after the

merger should bring in continuity and be instrumental in shaping the bank's customer and financial focus agenda.

In order for financial institutions to meet their desired objectives once they have entered into merger or acquisition they must ensure that; they should continuously monitor the information system put in place in order to have efficiency, review the bank's financial reporting systems and processes, assessing the performance of the internal and external auditors to ensure that they remain effective in carrying out their responsibilities, the financial institutions should carry out stress test on the loan book to assess the impact of the volatile macroeconomic indicators such as inflation and foreign currency fluctuation on the ability of the bank's borrowers to repay their loans.

Mergers and Acquisitions bring a number of changes within the organization. The size of the organization change, its stocks, shares and assets also change, even the ownership may also change due to mergers and acquisitions. The mergers and acquisitions play a major role on the activities of the organizations. However, the effect of mergers and acquisitions varies from entity to entity.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the methodology, which was used in carrying out the study. Aspects covered include; research design, population, sample, data collection and data analysis. It describes in detail all steps involved in conducting the study to arrive at proper conclusions regarding the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya.

3.2 Research design

The study helps in the documentation, analysis and comparison of the data obtained. To meet the objective of this study an exploratory research was used to investigate the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. The exploratory study is appropriate because it enables the researcher to identify effect in their processes and practices and also it enables testing of hypothesis in line with research objective. The research design has been used by (Ebimobowei and Sophia 2011).

3.3 Population

The population of the study consists of all 36 financial institutions that were merged and acquired during the period of 1989 to 2010. The list of institutions are either quoted or not quoted at the Nairobi Securities Exchange. The financial data was obtained from the period between 2000 and 2011, this will be considered adequate enough to be able to obtain information in order to meet the objective.

3.4 Sample

The sample consists of 12 financial institutions both quoted and unquoted at the Nairobi Securities Exchange. The selected institutions have faced merger and acquisition during the period from 2000 to 2010.

3.5 Data Collection

The study relied on secondary data. This include accounting data on; Return on Equity, Return on Assets, Debt Equity ratio and Return on Investment of financial institutions quoted and unquoted at the Nairobi Securities Exchange. The data for calculating the ratios was secondary data derived from Central Bank of Kenya, Capital Markets Authority and financial statements of the companies obtained from annual reports. The secondary data obtained helps to meet desired objective.

3.6 Data analysis

The data was collected was analyzed and summarized. The analysis was made using spss version. Correlation analysis and descriptive analysis especially the mean and standard deviation were used. Descriptive analysis was used to determine the effect of mergers and acquisitions on the financial performance of the financial institutions in Kenya. Correlation analysis is used to measure the strength or degree of relationship and also express the strength of the relationship as a quantity between +1 and -1. Correlation analysis measures the strength of the relationship between the independent and dependent variable. The ratios for measuring performance that changes due to the effect of mergers and acquisitions for the period 2000 to 2010. The financial institutions selected were involved in pre and post merger activity. The period selected was 2 years pre and post merger.

Ratios to be used:

Return on Asset = EBIT (1 - Tax Rate)/Assets

Return on Equity = Profit after taxes/Net Worth

Return on investment = EBIT (1 - Tax Rate)/Capital Employed

Debt to Equity Ratio = Total Debt/Net worth

A mean and standard deviation for each ratio was computed for the period between 2000 to 2011 for the financial institutions that have merged. The ratios for both pre and post merger data was compared to establish any difference in the means observed was tested for significance using paired T-test. The difference in the average rate of change in ROA, ROE, Debt to Equity ratio, Return on Investment, was tested for significance using T-test and also Analysis of Variance (ANOVA) was used to establish any difference in the means observed in order to test the significance.

The null hypothesis (Ho) was that the two variables are independent that is financial performance is independent of mergers and acquisitions. The alternative hypothesis (Hi) tested was that financial performance is dependent on mergers and acquisitions.

The formula for the one-way ANOVA F - Test statistics is: -

F = Explained Variance/Unexplained Variance

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter contains the summaries, findings together with the interpretations of the data based on the objective identified earlier in this study. The findings of the study are also presented in tables. The significant results are further discussed and analyzed in detail in this section. The information processed from the data found by the study on effect of merger and acquisition on the financial performance of financial institutions in Kenya. The data was collected on 12 financial institutions that had merged or acquired during the period 2000 to 2010. The ratios used was Return on Assets, Return on Equity, Return on Investment and Debt Equity Ratio.

4.2 Data Presentation

Basic analysis begun with the determination of mean and standard deviation before and after the merger. Standard deviation was used as measure of dispersion (variation). Calculations were carried out for paired T - test compares the means for the two variables it was useful to know what mean values are: -

Table 4.2.1 Descriptive Statistics for Measures of Performance

	N	Mean	Standard Deviation	Std. Error Mean
Return on Assets Pre - Merger	12	-0.1194	3.36319	0.97087
Return on Assets Post-Merger	12	0.2992	1.46026	0.42154
Return on Equity Pre-Merger	12	7.9850	11.17200	3.22508
Return on Equity Post - Merger	12	7.0075	9.32522	2.69196
Return on Investment Pre-	12	-0.1867	4.80296	1.38650

["Merger				
Return on Investment Post - Merger	12	0.4500	2.01958	0.58300
Debt Equity Ratio Pre Merger	12	6.3958	4.02378	1.16157
Debt Equity Ratio Post - Merger	12	7.6975	4.58861	1.32462

Source: Research Data

The paired t- test is generally used to compare means on related subject over time or in differing circumstances. The table above displays the mean and standard deviation values of the measures of performance before and after merger.

The mean values of the measures of performance before and after were: - The mean Return on Asset before the merger was -0.1194, Return on Equity was 7.9850, Return on Investment was -0.1867 and Debt Equity Ratio was 6.3958. The standard deviation before merger for Return on Asset was 3.36319, Return on Equity was 11.17200, Return on Investment was 4.80296 and Debt Equity Ratio was 4.02378.

The same analysis was carried out for the four measures of performance after merger. The mean Return on Assets was 0.2992, Return on Equity was 7.0075, Return on Investment was 0.4500 and Debt Equity Ratio was 7.6975. The standard deviation after merger was as follows: - Return on Assets was 1.46026, Return on Equity was 9.32522, Return on Investment was 2.01958 and Debt Equity Ratio was 4.58861.

Table 4.2.2 Inter-Item Correlation Matrix

	ROA Post-merger	ROE post-merger	ROI post-merger	DER post-merger	ROA pre-merger	ROE pre-merger	ROI Pre merger	DER pre merger
ROA Post-merger	1.000							
ROE post-merger	.829 .000	1.000						
ROI post-merger	1.000	.838	1.000					
DER post-merger	.630	.605	.630	1.000				
ROA pre-merger	.450	.546	.457	.272	1.000			
ROE pre-merger	.688	.810	.697	.641	.643	1.000		
ROI Pre merger	.378	.520	.389	.267	.980	.624	1.000	
DER pre - merger	.612	.551	.611	.754	.625	.636	.608	1.000

Source: Research Data

Correlation indicates the direction of the relationship (positive or negative). The absolute value of the correlation indicates the strength with larger absolute values indicating stronger relationships. For these study both the variables show a positive relationship, with stronger relationship being between Return on Investment pre merger and Return on Asset pre merger were indicated by 0.980 and lowest was between Return on Investment pre merger and Debt Equity Ratio post merger indicated by 0.267. There was high

correlation between Return on Investment post merger and Return on Equity post merger indicated by 0.838.

Table 4.2.3: Paired T- test for merged financial institutions

					95 % Confidence Interval of the	Difference
	Test Value = 0					
Test	t	df	Sig.(2-tailed)	Mean Difference	Lower	Upper
Return on assets Pre - merger	-.123	11	.904	-.11942	-2.2563	2.0175
Return on assets post - merger	.710	11	.493	.29917	-.6286	1.2270
Return on equity pre- merger	2.476	11	.031	7.98500	.8866	15.0834
Return on equity post - merger	2.603	11	.025	7.00750	1.0825	12.9325
Return on Investment pre-merger	-.135	11	.895	-.18667	-3.2383	2.8650
Return on investment post-merger	.772	11	.456	.45000	-.8332	1.7332
Debt equity ratio pre- merger	5.506	11	.000	6.39583	3.8392	8.9524
Debt equity ratio post- merger	5.5811	11	.000	7.69750	4.7820	10.6130

Source: Research data

The mean values for the measures of performance before and after merger are displayed in the paired sample statistics table above. The paired samples T test procedure compares the mean of two variables for a single group. It computes the difference between values of the two variables for each case and tests whether the average differs from 0.

Table 4.2.4 ANOVA

		Sum of Squares	df	Mean Square	F	Sig
Between Ratios		1106.598	11	100.600		
Within Ratios	Between Items	1067.187	7	152.455	9.775	.000
	Residual	1200.888	77	15.596		
	Total	2268.075	84	27.001		
Total		3374.674	95	35.523		

Source: Research Data

Anova was used to establish any difference in means observed in order to test the significance and also to test whether there is effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. The table shows that the means are statistically significant (p = 0.000< 0.05). The results state that there is a statistically significance when mergers and acquisitions occur.

4.3 Summary and Interpretation of the Findings

The data was analyzed using paired T-test revealed changes in Return on Asset. As shown in the table the findings of pre and post merger from the t- test indicate there was slight increase in t -value from - 0.123 to 0.710 and indication that there was an increase in the Return on Asset after the merger. There was also noteable decrease in the mean difference from 0.904 to 0.493, which is a clear indication of no much difference in Return on Asset. There is high significance for the t - test (typically more than 0.05) indicates that there is no much significant difference between the increase of performance before and after merger.

The results of pre and post merger from the paired t- test table above indicate that there is a slight increase from 2.476 to 2.603 an indication that there was an increase in the Return on Equity after the merger there was notable decrease in mean difference from 7.98500 to 7.00750 which is a clear indication that the increase was not much. A low

significance value for the t- test (typically less than 0.05) indicates there is significant difference between the measures of performance before and after merger.

The analysis of data by use of paired T-test for the data on Return on Investment before and after merger. From the results it was found that there was an increase from -0.135 to 0.772, which is an indication on the increase in Return on Investment. This was evident on the increase in the mean difference from -0.18667 to 0.45000. A high significance value for the t -test (typically more than 0.05) indicate there is no much significant difference between the measures of performance before and after merger.

The findings from the paired T-test table indicate that there was an increase in t - value from 5.506 to 5.811 that is an indication on the increase in Debt Equity Ratio. This was also evident on the notable increase in the mean difference from 6.39583 to 7.69750, which is a clear indication of increase in Debt Equity Ratio, which was found to be statistically significance value was found to be 0.00, which was less than 0.05.

The conclusions and findings on effect of mergers and acquisitions on the financial performance of financial Institutions in Kenya in comparison to the results drawn from similar studies done in different parts of the world gave mixed comparisons. For example this study constrated with that of (Kouser and Saba 2011) they found in their study that there was a decline in Debt Equity Ratio and therefore a negative relationship or impact of mergers and acquisitions on banks performance after mergers and acquisitions. However this study confirmed, the research findings from the study indicate there is an increase in Debt Equity Ratio and therefore a positive impact of mergers and acquisitions on financial institutions after the merger and acquisition.

Obaid et al (2010), have indicated that Return on Asset and Return on Equity are Insignificant but shareholders equity and total assets showed significant improvement. They conclude that as an option for improving the bank's performance as mergers and acquisition may have positive effects on performance due to renewed attention to business. It is also consistent with the results of some other past studies Neely and

Rochester (1987) found a decline of the profitability ratio's especially the Return on Asset in the post merger period. Sharma and Ho (2002) also found a decline for the Return on Asset and the Return on Equity ratios.

Korir (2006) used four measures of performance like turnover, volume, market capitalization and profit. The study established the financial performance of the merged companies in the pre and post merger. The results concluded using correlation that both the variables showed a strong positive relationship between profit and market capitalization. Another finding concluded that profit and volume showed a weak correlation.

The research conducted on the international M&As activities of the Greek listed sample firms in the selected countries (Bulgaria, Romania, and Albania) of this research have not lead them to enhanced post-merger accounting performance, but, in general, to a performance deterioration that also have a negative impact on three profitability examined ratios. Thus, these results for the Greek market, since there is no significant profitability improvement, do not support the hypotheses of market power (Lubatkin, 1983)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The aim of the study was to determine the effect between mergers and acquisitions and financial performance of financial institutions in Kenya using mean, standard deviation and T- test analysis. It is therefore necessary to assess how mergers and acquisitions have an effect on the financial performance. The focus was on 12 Financial Institutions in Kenya. This was because earlier studies recommended investigation of financial performance data of institutions up to the year 2011 as an area warranting further research. Employing T- test analysis uncovered changes in financial performance due to the effect of mergers and acquisitions. And also correlation portrays the strength or weakness there is a strong positive relationship on Return on asset post merger and Return on Investment post merger these shows a strong relationship. There is a slightly weak relationship between Return on Investment pre merger and Debt Equity ratio post merger.

The study looked at financial performance measures ratios like Return on Assets, Return on Equity, Return on Investment and Debt equity Ratio. The ratios portray the real financial position of an institution. The use of mean, standard deviation and T- test analysis to know the significance of the study. The findings of the study indicates that the T- test elaborates that Return on Assets, Return on Equity and Debt Equity ratio showed an improvement after the merger while Return on Investment showed no much improvement on performance.

The results from the research indicate that there is strong evidence that significant factors that determine the financial performance of financial institution in Kenya once mergers and acquisitions occur. Mergers and acquisition have an effect either positive or negative. Return on Assets, Return on Investment indicates an insignificant difference between measures of performance before and after merger. The implications of these findings is that the Central Bank of Kenya needs to revise legal requirements that give benchmarks

THE EFFECT OF MERGERS AND ACQUISITIONS ON THE FINANCIAL PERFORMANCE OF FINANCIAL INSTITUTIONS IN KENYA

BY

CAROLINE NYAGICHUHI NJOROGE

A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE AWARD OF THE DEGREE OF MASTERS OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

NOVEMBER 2012

DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

Signed... . . . . .D a t ; X

CAROLINE NYAGICHUHINJOROGE

D61/60039/2010

This research project has been submitted for examination with my approval as university supervisor

DR. JOSIAH AQfmA *fj*

Signed. . . . . .^ ^ . f T T ^ S

Chairman Department Of Finance and Accounting

Dedication

I dedicate this paper to my family. Your faith in me has shaped my character and has made me to have faith in myself. Thanks to our almighty GOD for his blessings in our family.

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Thank you wishes go to Almighty God, for giving me guidance and wisdom during the period of the project until completion.

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Abstract

Financial institutions strength depends on activities that enable the institutions to maximize profits, increase customer base, and minimize costs and also a strong capital strength. In order for financial institutions to be the top provider of financial services mergers and acquisitions between institutions enables them to be innovative, customer focused towards delivery of products and services of superior quality and also delivering value to our shareholders through positive financial performance.

This study examined the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. Mergers and acquisitions theories predict that the activities influence a firm's financial performance. The financial performance measures like ratios are considered essential indicators that capture the trend of the success or failures of the financial institutions. The performance can be either in the long term or short term. The research focused on the financial institutions in Kenya that have merged or being acquired from the period 2000 to 2010. The data that was used comprised of annual reports from the Central Bank of Kenya from the year 2000 to 2011 in order to meet the desired objective.

The analysis of the financial institutions performance for pre and post merger periods was conducted to establish whether there was significant improvement of financial performance on areas of profitability, investment and liquidity. Secondary data was collected for 2 years pre and post merger and analyzed with the aid of statistical tools. The data analyzed are for different years since M&A take place at different years. The results of the data analyzed showed that Return on Asset and Return on Investment indicate a insignificant difference while Return on Equity and Debt Equity Ratio indicate significant difference between measures of performance before and after merger.

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ABBREVIATIONS

M & A	Mergers and Acquisitions
RTPA	Restrictive Trade Practices Monopolies and Price Control Act
NBIFs	Non Bank Financial Institutions
VL	Volatile Liabilities
A. ASTS	Average Assets
LNS	Loans
AST	Average Assets
C.I.R	Cost Income Ratio
ROA	Return on Asset
ROE	Return on Equity
RBS	Royal Bank of Scotland
FTC	Federal Trade Commission
EBIT	Earnings Before Interest and Tax
ROI	Return on Investment
DER	Debt Equity Ratio

CHAPTER ONE

INTRODUCTION

1.1 Background to the study

Mergers and Acquisitions (M&A) are strategic decisions through which firms combine or acquire assets. The basic idea in mergers and acquisitions is to create value and maximize the existing shareholders wealth. Mergers and Acquisitions mean the combination of two or more business units under a single controlling ownership (Lasher 2008). Mergers occur when two or more companies combine into one company. One or more companies may merge with an existing company or they may merge to form a new company. In merger there is complete amalgamation of the assets and liabilities as well as shareholders interests and businesses of the merging companies (Pandey 2005).

Brealey et al (2007) proposed that an acquisition is a takeover, which refers to the transfer of control of a firm from one group of shareholders to another. The takeover involves all assets and liabilities absorbed by the buyer.

Mergers and Acquisitions are common incidents since the turn of the 20th century. M&A are used as tools for business expansion and restructuring. Through mergers and acquisitions financial institutions gets an expanded client base and acquired company gets additional lifeline in the form of capital invested by the purchasing company. The following motives are considered to improve financial performance of the organization: Financial motives: A merger allows the acquiring firm to enjoy a potentially desirable portfolio effect by achieving risk reduction while perhaps maintaining the firm's rate of return. A second financial motive: Is the improved financing posture that a merger can create as result of expansion. Larger firms may enjoy greater access to financial markets and thus be in a better position to raise debt and equity capital. Greater financing capability may also be inherent in the merger itself. This likely to be the case if the acquired firm has a strong cash position or a borrowing by the acquiring company. A final financial motive is the tax loss carry forward that might be available in a merger if one of the firms has previously sustained a tax loss. Non-financial motive for M&A include the desire to expand management and marketing capabilities as well as the

acquisition of new products. Synergy: Occur when the whole is greater than the sum of the parts. This effect may be the result of eliminating overlapping functions in production and marketing as well as meshing together various capabilities (Stanely et al 2009).

Empirical evidence relating mergers and acquisitions and financial performance in general supports the relation. Obaid et al (2010), used three financial measures; profitability, and earning, capital adequacy and solvency on a sample of banks in Pakistan. They found that there was improved financial performance due to improved attention to business, improved management, better credit assessment, and easy access to the new and expansive technology. Kumar and Bansal (2008) used financial data, tables and different ratios on a sample of banks. They used correlation to make analysis and concluded that the banks that acquire other through mergers and acquisitions got benefits like increase in cash flow, larger business and reduction in costs.

In general mergers and acquisitions are performed inorder to achieve a number of advantages which includes; enchancing profitability, maintaining or accelerating a company's growth, limiting the severity of competition, reducing tax liability and also diversifying the risk of the company (Pandey 2005).

1.1.1 Mergers and acquisitions in Kenya

In Kenya, there are changes that have occurred on the laws of mergers and acquisitions. The recently promulgated Competition Act come into effect on 1 August 2011 and replaces the Restrictive Trade Practices Monopolies and Price Control Act (RTPA). The new Act seeks to regulate mergers going forward, approval of mergers and takeovers. The Act defines merger when is deemed to have occurred when one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertakings. Mergers may be achieved by a purchase or lease of shares, acquisition of an interest or purchase of assets of an entity, exchange of shares between or among undertakings which results in a substantial change in ownership structure through what ever strategy or means adopted by the concerned undertakings or even through amalgamations and vertical integration.

The Act is now clear on multi-jurisdictional transactions that involve entities that are not within Kenya. To this effect, any acquisition of an undertaking under receivership by another undertaking either situated inside or outside Kenya or an acquisition by whatever means of the controlling interest in a foreign undertaking that has a controlling interest in a subsidiary in Kenya, will constitute a merger. Where conglomerate undertakings are concerned, acquiring the controlling interest of another undertaking or a section of the undertaking that is capable of being operated independently also falls under the definition of a merger.

Also the Authority must check the effect of a merger on a particular industrial sector or region, employment, the ability of small undertakings to gain access to or to be competitive in any market and the ability of national industries to compete in international markets

1.1.2 Financial performance review of financial institutions in Kenya

According to the Central Bank of Kenya there has been a great growth in the financial performance of financial institutions in Kenya. The growth has been seen in the following areas; The profit after tax increased by 13 percent in 2009, Banks earnings reached Shs 48.9 billion, Asset base increased by 14 percent from Shs 1.18 Trillion in 2008 to Shs 1.35 Trillion in 2009 and also the expansion of the banks in other Eastern African Region by opening branches in other countries like KCB, Equity Bank, NIC Bank and also Consolidated bank.

The overall financial performance was driven by positive improvement in income, costs, efficiency and better impairment charge levels. The growth in income was influenced mainly by excellent management of interest rate margins as competition for high deposit rates and low borrowing rates soared throughout the markets. On the cost front, there has been tremendous improvement spurred by our commitment to improve the banks cost income ratio through automation of key business processes and increased productivity.

1.1.3 Mergers and acquisitions in the financial institutions

In Kenya when financial institutions were established they were characterized by interest rate restrictions, domestic financial markets, underdeveloped money and capital markets,

and exchange rate and international capital controls. In order to change the financial system, the government of Kenya undertook financial sector reforms from the late 1980s. The financial reforms were aimed at liberalizing interest rates, reducing controls on credit, enhancing competition and efficiency and productivity gains in the financial system. Furthermore, the reforms were directed towards strengthening the Central Bank's supervisory framework and improving the effectiveness of monetary policy through greater reliance on market forces. Financial reforms proposals were first incorporated in the 1986 to 1990 structural adjustment program. Due to the financial reforms there has been structural shifts in banks and other financial institutions in Kenya in the face of globalization. Kenya has increasingly moved into universal banking. This reflected in elimination of NBIFs, which converted to commercial banks merged with parent banks or closed (Oloo 2007).

In recent years a substantial number of mergers and acquisitions have taken place in the banking sector in Kenya, partly occasioned by the need to meet the increasing minimum core capital requirements and to enhance the institutions market share in the local banking industry. Between 1994 and 2005 there was 20 successful mergers, with the number increasing 28 by 2010. A full list of successful mergers and acquisitions are appended to the project see Appendix IV (Central Bank of Kenya 2010). In Kenya it has been noted however inspite the efforts made by the Central Bank of Kenya to encourage mergers, the rate of mergers has not been as high as expected. The low rates of mergers and acquisitions in Kenya is due the inability of individual institutions to get to the negotiating table and also being unable to integrate their diverse business areas. The central bank also notes that the convergence has been made difficult by the ownership of banks in Kenya where shareholding is foreign or family based.

1.2 Statement of the problem

There have been numerous studies done in developed countries like Europe and U.S.A on evaluation of effects of mergers and acquisition on financial performance. Cornett and Hassan (1992), examined changes in performance resulting from bank merger by measuring post merger accounting data and concluded that newly merged bank stock

outperforms the industry average in terms of improvement in the ability to attract loans and deposits, productivity and growth of profitable assets. Burner (2002) reviewed the findings of studies that have investigated directly or indirectly the question, "Does mergers and acquisitions pay?" The evidence from 14 informal studies and 100 scientific studies from 1971 to 2001. The review suggested that target shareholders earb sizeable positive market returns that bidders with interesting exception earn zero adjusted returns and that bidders and targets combined earn positive adjusted returns. On balance, he concluded that mergers and acquisitions do pay. Forcarelli (2002), examined the question of why do banks merge to improve performance using Italian data and concluded that merging firms did not show evidence of income improvement due to higher staff costs.

Local studies have been done on mergers and acquisitions: Korir (2006) did a research on effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange and found that mergers improves performance of companies listed at the Nairobi Stock Exchange; Katuu (2003) did a survey on factors considered important in mergers and acquisition decision by selected Kenyan based firms and established that the cardinal factors considered by firms when they make merger decisions from top priority to least were: synergy, growth and revenues, to be more competitive and cost reduction; Mukele (2006) did a research project on Doctors perception of mergers and acquisitions in the pharmaceutical industry Kenyan based firms in 2007 and found that respondents strongly agreed that merged pharmaceutical companies in Kenya were profit and market oriented.

Financial performance has come out to be the drive for mergers and acquisitions. None of these researches have been clear on the effect of mergers and acquisitions on financial performance of financial institutions in Kenya. This is the gap the research seeks to fill by answering the research question: Does mergers and acquisitions have an effect on the financial performance of financial institutions in Kenya?

1.3 Objective of the study

To determine effects of mergers and acquisitions on the financial performance of financial institutions in Kenya.

1.4 Importance of the study

The study will be useful to the following: -

Government - The government has mandate to create a conducive environment for merger and acquisition by encouraging the development of legislation in which sound merger and acquisition can thrive. The information from this research will among others provide information to support the government in fulfilling this duty.

Shareholders - Information from the study will be useful in making investment decisions. The information provided could help in comparison of different financial data that can help in making investment decisions that guarantee positive return.

Investment advisors - These include investment advisory departments of banks, other financial advisors and financial analysts. Investment advisors would be able to know in advance the current trend in the local and international market.

Regulatory Authorities - These researches will provide additional information that will further facilitate regulation and development of capital markets in Kenya. The regulatory authority will be able to know which areas to improve on regulation as per global requirements.

Academicians - The research findings will provide a basis for further research. It also provides a wealth of knowledge for those pursing studies in related areas as investment bank. The academicians can perform research on areas not researched on.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

There has been numerous studies on mergers and acquisitions abroad , in the last four deacdes and several theories have been proposed and tested for empirical validation. Researchers have studied effect of M&A on industry consolidation, returns to shareholders following M&A and the post-merger performance of companies. Whether or not a merged company achieves the expected performance is the critical question that has been examined by most researchers. Several measures have included both short term and long term impacts of merger announcements effects.

2.2 Theoretical basis of mergers and acquisitions

2.2.1 Efficiency Theory or Synergy Theory

The theory of efficiency generally involves improving the performance of incumbent management or achieving some form of synergy. Synergy expects that there is really something out there, which enables the merged entity to create shareholders value. This concept held that acquisitions were executed to achieve synergies. Rumelt (1986), identified three types of synergies; Financial, Operational and Managerial. Financial synergy comes from several sources. The first source is the lower costs of internal financing in comparison with external financing. This occurs when firms with large internal cash flows and small investment opportunities have excess cash flows whereas those with those with low funds have large growth opportunities. A combination of the two will result in advantages from the lower costs of internal funds ability. A second source of financial synergy is the ability to underpay because of the ability to bargain. This comes from the strength of managers at a given firm with stronger managers will have better bargaining power than that looking to augment managerial capabilities.

The theory based on Operational synergy assumes that economies of scale and scope do exist in the industry and that prior to the merger the firms were operating at unfavorable levels of activity that cannot meet the potential for the economies of scale. Operational synergy targeted achieving operational excellence from a combined firm's operations.

Finally, managerial synergy was used to enhance a target's competitive position by transferring management expertise from the bidder to the target firm.

2.2.2 Monopoly Theory

This theory viewed that acquisitions were execute to achieve market power. The implications of this type of acquisition are that conglomerates use cross-subsidized products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market. These three advantages of the monopoly theory supported the idea of a collusive synergy (Trautwein 1990). He concluded that the monopoly theory's overall performance is even worse than that of the efficiency theory.

2.2.3 Valuation Theory

This philosophy viewed acquisitions as being executed by managers who have superior information than the stock market about their exact target's unrealized potential value. The assumption here is that the acquirer possesses valuable and unique information to enhance the value of a combined firm through purchasing an undervalued target or deriving benefits from combining the target's business with its own. The leveraged buyout can be categorized into this theory. Trautwein (1990), outlined that one of the most common criticism about this valuation theory is that it is impossible to acquire accurate and tangible information about the acquisition results, and further stated that the concept of private information as a basis for mergers warrants further consideration, since it shows why the problematic assumption of capital market efficiency can be avoided.

2.2.4 Empire Building Theory

This theory holds that managers maximize their personal goals, rather than their shareholders' value maximization through acquisitions. Trautwein (1990) concluded that the empire building theory has to be given the most credit of the theories investigated up to this point.

2.2.5 Process Theory'

This approach indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory. Rumelt (1986) found that the manager's behavior was overoptimistic in the acquisition decision process. Jemison & Sitkin (1986) proposed a systematic acquisition process perspective. Gaddis (1987) found that political and structural matters affect the acquisition process and outcome.

2.3 Types of mergers and acquisitions

According to Imende and Odhiambo (2006), there are three types of mergers; Horizontal, Vertical and Conglomerate. Horizontal mergers take place where two merging companies produce a similar product in the industry. It is a strategy used by a business or corporation that seeks to sell a type of product in numerous markets. To get this market coverage, several small subsidiary companies are created. In vertical mergers, two firms each working at different stages in the production of the same good, combine. They are united through a hierarchy and share a common owner. Each member of the hierarchy produces a different product or service and the products combine to satisfy a common need. Finally conglomerate merger takes place when two firms operate in different industries.

A take-over is obtaining of control over the management of a company by another in most cases under hostile environment. An acquisition or take-over does not necessarily entail full legal control but may be on the basis of share interest e.g. even 25 % of the shareholding may have control over the company's affairs (Pandey, 2005). Acquisition can involve a cash and debt combination of cash and stock of the purchasing entity, or stock only. In addition, the acquisition can take the form of a purchase of the stock or other equity interests of the target entity. A company may require high yield debt to raise funds (often referred to as a leveraged buyout). The reason the debt carries a high yield is the risk involved. The owner does not want to risk his own money in the deal, but third party companies are willing to finance the deal for a high cost of capital (high interest yield). The combined company will be the borrowed of the high yield debt and be on it's balance sheet. This may result in the combined company having a low shareholders

equity to loan capital ratio (equity ratio). A good example is the Coca Cola Sabco limited on it's acquisition of various bottling companies and CFAO S.A. on it's acquisition of D.T Dobie (Kenya) limited (Imende and Odhiambo, 2006)

2.4 Post merger characteristics of the combined firms

Sufian (2002), compared the pre and post merger bank performance in Singapore by employing Financial Ratio Analysis and Data Envelopment Analysis (DEA) approach, The findings from financial ratio analysis suggests that the merger has not resulted in a higher profitability of Singaporean banking groups post mergers, which could be attributed to the higher cost incurred. However Badrelin and Kalhoefer (2009), analyzed the pre and post merger performance of Egyptian banks which have faced merger during the era of 2002 to 2007. They calculated companies Return on Equity (ROE) in order to know the level of progress and success of banking reforms in strengthening and consolidation this sector. Their analysis suggested an increase in the performance when when companies are compared with the pre-merger performance. They concluded in the study that M&A in the Egyptian banking sector's profitability showed a significant improvement and a small positive impact on the credit risk position.

Lipton (2006) investigated external factors affecting mergers and merger waves by analyzing global M&As from the year 1985 to 2006. Observed that during 1990s merger-waves, as stock prices and earnings ratios increased, mergers volumes increased dramatically from $339 billion in 1991 to $3.3 trillion in 2000 globally, hence positive relationship between stock price increase and M&A activity. Concluded that receptive equity and debt market were critical factors in M&A activity. These findings supported Nelson (1959) who investigated merger movement in American Industry by exploring impact of stock market performance on M&A activity. Found that stock prices increase was followed by merger activity increase. Concluded that M&As were highly concentrated in time clustering during periods of high stock market valuations. Mergers are distinguished by the relationship between two or more firms that are merging.

Guerard (1985), used regression model on a sample of mergers between 1947 to 1977. He tested for significant relationship among annual mergers, stock prices and production and further examined whether multiple time series model could forecast annual mergers more accurately than univariate merger model. He found that weakly positive relationship between economic conditions and mergers and acquisitions activity with changes in industrial production lagging behind changes in mergers and acquisitions activity. Luypaert (2008) used a sample of mergers between 1997-2005. A logit and probit regression analysis was used to estimate the determinants of growth through mergers and acquisitions. He concluded that intangible capital, profitability and firm size significantly positively affected merger and acquisition decision whereas ownership concentration and debt had a negative impact.

Intention to discover the relationship between mergers and acquisitions and financial performance (Healy et al 1992) used accounting data primarily but tested their results by using market valuation measures as well. Their findings were that; industry employment decreased which implies that the merging firms did more restructuring and reorganization than other firms in the industry. But the cash flow margin on sales did not significantly change. However, asset turnover significantly improved. The return on market value of assets also improved significantly.

Gosh (2001), extended the earlier Healey et al (1992) study post acquisitions performance. He used a sample of 315 of the largest acquisitions during the period 1981 to 1995. He initially replicated the Healey et al (1992) results that cash flow margins are higher than industry median benchmarks after acquisitions. But he found that the merging firms also have superior pre-acquisition performance; when he adjusted for this in his regression model, the cash flow margins are no longer higher. Alternatively, when control firms are matched by performance and size from pre-event years, the merging firms no longer show superior performance. For cash acquisitions, cash flows improve 3 percent per year, with the improvements coming from higher sales growth rather than cost reductions. In stock acquisitions, he finds that both operating cash flow margins and sales growth decline, but not significantly. The Gosh study confirmed the Healy et al.

results, which also reinforced their finding that the initial event was consistent with long terra accounting performance.

2.5 Analyzing financial performance of financial institutions

According to Srinivasan (2010) it's very essential to find out the financial health of any institution and more particularly banking institution. In Kenyan context the following indicators can measure the financial performance: -

2.5.1 Liquidity

Liquidity must be measured in the beat possible way because it is lack of liquidity, which may bring about the closing of the bank if financial problems become known. Two ratio's are shown under the liquidity heading. The ratio of TI - VL/A.ASTS measures liquid assets, minus volatile liabilities divided by average assets, which gives the net liquidity position relative to the bank's size. The ratio will vary considerably by the size of bank, with smaller banks having higher ratios on average than large banks. The ratio of LNS/AST stands for total loans to average assets. Generally, the more banks are loaned up, the less likely they are able to meet unforeseen deposit withdrawals.

2.5.2 Asset quality

Banks generally fail because of bad loans. For this reason, the ratio of non-performing assets to capital should be reviewed especially in relation to the bank's current and future earnings position. Banks having a non-performing asset ratio to capital approaching 100 percent or greater and negative earnings are likely to be struggling for survival. When evaluating asset quality, one should compare the ratio of charge off/Assets to the ratio of loss RSRV/ASTS (loan loss reserve ratio). If the level of non-performing assets or the level of charge - off is above normal, the loan - loss reserve ratio should be higher to cover future losses.

2.5.3 Capital adequacy

In Kenya, the government, through the Central Bank of Kenya has put requirements that all commercial banks should gradually increase their capital base to one billion Kenya shillings from the current 250 million Kenya shillings (Central Bank of Kenya, 2008). This represents a 300 % increase. This means that the level of capital has some implication on the performance and bankruptcy of a bank. These capital adequacy

requirements are continuously monitored and reviewed from time to time by the Central Bank of Kenya (CBK). A financial institution that fails to meet the minimum requirements is urged to merge with other banks, loses its licence or is put under liquidation.

According to Christian et al (2008), explains that capital adequacy measures provide significant information regarding a firm's returns, while a few of the individual variables representing asset quality and earnings are informative. Size and growth and loan exposure measures do not appear to have any significant explanatory power when examining returns. The study establishes that the change that the change in total assets is also significant.

2.5.4 Measuring earnings

According to Srinivasan (2010), the most important earnings ratios are those that represent the bottom line of the income statement, mainly the ratios of income to assets or pre tax income on a tax equivalent basis to assets. A return on capital ratio may be misleading because banks can increase the ratio through higher leveraging. Analysis of bank earnings should begin with the net interest income ratio, which has been adjusted for tax equivalency. Higher this ratio the better, especially in relationship to other peer banks. The interest income, and pretax income ratios should all be evaluated on a tax equivalent basis, which adds back to the income stream tax benefits. The no interest income ratio has become more important to banks in recent years because the deregulation of interest rates has narrowed net interest margins and has caused banks to rely more on free income.

The overhead ratios should be looked at with caution because a bank's cost will vary by its type of operation. Retail consumer oriented banks with a large branch network should have higher overhead costs and higher margins than banks specializing in wholesale banking. The ratio of provisions to the loan - loss reserve should also be evaluated in relation to the bank's margins. Higher provisions generally mean there are loan problems. However, further evaluation should be made by looking at the ratio of non - performing loans to assets and at the bank's net interest margins.

2.5.5 Measuring cost income ratio

The cost income ratio (CIR), with its limitations (Welch 2006) is another emerging measure of bank's efficiency and benchmarking metric (Tripe, 1998; Hess and Francis 2004). Being a standard benchmark of bank's efficiency, the CIR measures a bank's operating costs as a proportion of its total (i.e. net interest and non interest) income (Welch 2006).

2.5.6 Measuring profitability of a bank

In measuring the profitability of a bank, bank regulators and analysts have used Return on Assets (ROA) and Return on Equity (ROE) to assess industry performance and forecast trends in market structure as inputs in statistical models to predict bank failures and mergers and for a variety of other purposes where a measure of profitability is desired (Gilbert and Wheelock, 2007; Mostafa 2007; Christian et al., 2008).

Navapan and Tripe (2003) explained that comparing bank's Return on Equity (ROE) is one way of measuring their performance relative to each other. The return on equity looks at the return on the shareholder's investment and thus from the shareholder's perspective, allows a comparison of investment in a bank's shares with other investment opportunities, while it can also provide a measure of bank's riskiness (Gilbert and Wheelock, 2007).

2.6 Empirical evidence

2.6.1 Merger and acquisition changes in performance

Neena et al (2010) studied the impact of mergers and acquisitions on the financial efficiency of the selected financial institutions. The analysis consists of two stages. Firstly, by using the ratio analysis approach, and secondly they examined changes in efficiency of the companies during the pre and post merger by using non - parametric Wilcoxon signed rank te+st. The period was between 2000 to 2008 for 17 companies. They found that there is significant change in the earnings of the shareholders, there is no significant change in liquidity position of the firms. There is a significant correlation between financial perfromance and the merger and acquisition deal, in the long run, and the acquiring firms were able to generate value.

Kithinji and Waweru (2007) investigated the effects of merger restructuring on the financial performance of commercial banks in Kenya. The research compared the pre and post merger financial performance of 20 Kenyan banks that had merged between 1993 and 2000. The results indicate that the legal implications like capital adequacy and solvency ratios improved after the merger. However profitability ratios indicate that the majority of the merged banks reported a decline in financial performance.

According to Ravichandran et al (2010) carried out a study on the efficiency and performance before and after merger for the selected public and private banks. The results suggest that the mergers did not seem to enhance the productive efficiency of the banks as they did not indicate any significant difference. The financial performance suggests that the banks are becoming more focused on their retail activities. How ever it is found that the total advances to deposits and the profitability are the main parameters affected by mergers. Also the profitability of the firm is significantly affected giving a negative impact on the returns.

2.6.2 M&A and reaction of stock prices

Anita and Nagar (2010) studied the impact of mergers on the operating performance of the acquiring firm by examining pre and post merger financial ratios. They also examined the behavior of share prices 20 days before and after merger of Tata Steel with Corpus steel. The findings from the period studied is that acquiring firm generally earns positive returns prior to the announcement day, but less than market portfolio in the post merger period. The result of this study fails to support our hypothesis that merger gains are captured at the beginning of a merger program. It is found that stockholders suffer loss for different window periods around the announcement period.

Mitchell and Lehn (1990) studied stock price reactions to acquisitions during the period 1982 to 1986. One sample was composed of firms that became targets of takeovers after they had made acquisitions. The stock prices of acquirers that became targets declined significantly when they announced acquisitions. The stock prices of acquiring firms that did not become subsequent targets increased significantly when they announced acquisitions. They found that for the entire sample of acquisitions, those that were subsequently divested had significantly positive returns.

According to Agrawal et al, (1992) they studied post merger performance. They developed a larger sample of 937 mergers and 227 tender offers. Their sample included firms smaller, which focused on 50 largest mergers. They used data analysis method of historical data. They adjusted for size effect and for beta-weighted market returns. They found that shareholders of acquiring firms experienced a wealth loss of about 10 percent over the five years following the merger completion. Hannan and Wolken (1989) conducted a study of the value weighted abnormal returns experienced in 43 deals announced between 1982 and 1987. The researchers found that, on average, total shareholder value was not significantly affected by the announcement of the deal. They also found that, target capitalization and cross-sectional factors influenced expected synergistic gains. The target capital was negatively related to the change in total value.

Houston and Ryngaert (1994) examined abnormal returns from four days before the target was initially declared a takeover candidate (by any bank) to the announcement day. In their sample of 153 mergers announced between 1985 and 1991, they found that

acquirers suffered a loss in value and targets enjoyed a gain. However, there was no significant aggregate effect on the overall value of the two organizations. The amount of value that was created was highest when acquirers were strong pre-merger performers and when substantial overlap existed.

2.6.3 Mergers and acquisitions failures

Kemal (2011) carried out a study on Post-Merger Profitability. The sample used in the study was Royal Bank of Scotland. Researcher used accounting ratios to analyze the financial performance of Royal Bank of Scotland (RBS) after merger. Study analyzed financial statements for four years (2006-2009) by using 20 vital ratios. It was concluded that the financial performance of RBS in the areas of profitability, liquidity, assets management, leverage, and cash flows have been quite satisfactory before the merger deal. It means that merger fails to improve the financial performance of the bank.

McCauley (1997) carried out a study on reasons why many deals still failed to provide value. The sample used was the outcomes of 71 business deals undertaken between 1989 and 1993. It was concluded that: in some cases acquirers were not clear about the rationale behind the deal, the mergers that seemed to fail most often were those done to expand revenue. These deals often had no other substantive strategic goal; Next in line for failure were those mergers undertaken to pioneer new territory, an inherently risky undertaking. Inexperience also seemed to hinder deal value enhancement, as the returns relative to peers were higher for those deals done by experienced acquirers.

2.6.4 Mergers announcement and the reaction

Eckbo (1981) finds that on the announcement of the mergers, there are positive residuals both for the participants and their major rivals. This appears to be consistent with the monopoly theory. It is unambiguous though, because one could also argue that the announcement of the proposed merger conveys information to rivals and opportunities for increased efficiency by expanding scale. He also finds that at the announcement of the filling of the suit by the antitrust authorities, there is not much effect on the residuals of either the participants or their rivals; in fact, in cases brought buy the Federal Trade

Commission (FTC) the effect on rivals is slightly positive. He concluded that the positive performance of rivals of challenged mergers at the time of the original merger announcement reflects information conveyed by the proposed merger that efficiencies could be achieved by expanding scale either internally or externally.

Cornett & Sankar (1991), they Investigated stock market reaction to announcements of interstate bank mergers, the resources of takeovers gains, and the process of distributing these gains between acquiring and acquired banks. They proposed two hypotheses in relation to overall benefits of bank mergers: One hypothesis, known as the capital quality hypothesis, states that a merger announcement is a favorable signal to the market, since it speaks positively about the capital position of the acquiring bank. It means that the acquiring bank has successfully undergone financial examination by regulatory authorities and the market with regard to its capital position; The other hypothesis is expansion of geographic scope of operations and improving management of the acquired bank's existing assets. They concluded that the two hypotheses showed positive returns during announcement period for bidding banks and their target.

2.7 Conclusion

The effect of mergers and acquisitions can be seen on all aspects of the organization from the financial performance and also the changes on the operations of the organization. The effect can be positive or negative or no effect on the organization. The strategy put in place can lead to a successful merger or acquisition, which in the long run can lead to increase in shareholders value.

Consistent financial performance has built confidence in the leadership and management among the financial institutions shareholders, as well as the industry. Financial institutions once they posts solid year in terms of profitability it signals a positive performance to the investors, government, public and shareholders that the merger was successful. The institutions proven strategy and well-diversified business, which is supported by well-trained and experienced employees will help achieve desired objectives. The changes in the board of directors of the financial institutions after the

merger should bring in continuity and be instrumental in shaping the bank's customer and financial focus agenda.

In order for financial institutions to meet their desired objectives once they have entered into merger or acquisition they must ensure that; they should continuously monitor the information system put in place in order to have efficiency, review the bank's financial reporting systems and processes, assessing the performance of the internal and external auditors to ensure that they remain effective in carrying out their responsibilities, the financial institutions should carry out stress test on the loan book to assess the impact of the volatile macroeconomic indicators such as inflation and foreign currency fluctuation on the ability of the bank's borrowers to repay their loans.

Mergers and Acquisitions bring a number of changes within the organization. The size of the organization change, its stocks, shares and assets also change, even the ownership may also change due to mergers and acquisitions. The mergers and acquisitions play a major role on the activities of the organizations. However, the effect of mergers and acquisitions varies from entity to entity.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the methodology, which was used in carrying out the study. Aspects covered include; research design, population, sample, data collection and data analysis. It describes in detail all steps involved in conducting the study to arrive at proper conclusions regarding the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya.

3.2 Research design

The study helps in the documentation, analysis and comparison of the data obtained. To meet the objective of this study an exploratory research was used to investigate the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. The exploratory study is appropriate because it enables the researcher to identify effect in their processes and practices and also it enables testing of hypothesis in line with research objective. The research design has been used by (Ebimobowei and Sophia 2011).

3.3 Population

The population of the study consists of all 36 financial institutions that were merged and acquired during the period of 1989 to 2010. The list of institutions are either quoted or not quoted at the Nairobi Securities Exchange. The financial data was obtained from the period between 2000 and 2011, this will be considered adequate enough to be able to obtain information in order to meet the objective.

3.4 Sample

The sample consists of 12 financial institutions both quoted and unquoted at the Nairobi Securities Exchange. The selected institutions have faced merger and acquisition during the period from 2000 to 2010.

3.5 **Data Collection**

The study relied on secondary data. This include accounting data on; Return on Equity, Return on Assets, Debt Equity ratio and Return on Investment of financial institutions quoted and unquoted at the Nairobi Securities Exchange. The data for calculating the ratios was secondary data derived from Central Bank of Kenya, Capital Markets Authority and financial statements of the companies obtained from annual reports. The secondary data obtained helps to meet desired objective.

3.6 **Data analysis**

The data was collected was analyzed and summarized. The analysis was made using spss version. Correlation analysis and descriptive analysis especially the mean and standard deviation were used. Descriptive analysis was used to determine the effect of mergers and acquisitions on the financial performance of the financial institutions in Kenya. Correlation analysis is used to measure the strength or degree of relationship and also express the strength of the relationship as a quantity between +1 and -1. Correlation analysis measures the strength of the relationship between the independent and dependent variable. The ratios for measuring performance that changes due to the effect of mergers and acquisitions for the period 2000 to 2010. The financial institutions selected were involved in pre and post merger activity. The period selected was 2 years pre and post merger.

Ratios to be used:

Return on Asset = EBIT (1 - Tax Rate)/Assets

Return on Equity = Profit after taxes/Net Worth

Return on investment = EBIT (1 - Tax Rate)/Capital Employed

Debt to Equity Ratio = Total Debt/Net worth

A mean and standard deviation for each ratio was computed for the period between 2000 to 2011 for the financial institutions that have merged. The ratios for both pre and post merger data was compared to establish any difference in the means observed was tested for significance using paired T-test. The difference in the average rate of change in ROA, ROE, Debt to Equity ratio, Return on Investment, was tested for significance using T-test and also Analysis of Variance (ANOVA) was used to establish any difference in the means observed in order to test the significance.

The null hypothesis (Ho) was that the two variables are independent that is financial performance is independent of mergers and acquisitions. The alternative hypothesis (Hi) tested was that financial performance is dependent on mergers and acquisitions.
The formula for the one-way ANOVA F - Test statistics is: -

F = Explained Variance/Unexplained Variance

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter contains the summaries, findings together with the interpretations of the data based on the objective identified earlier in this study. The findings of the study are also presented in tables. The significant results are further discussed and analyzed in detail in this section. The information processed from the data found by the study on effect of merger and acquisition on the financial performance of financial institutions in Kenya. The data was collected on 12 financial institutions that had merged or acquired during the period 2000 to 2010. The ratios used was Return on Assets, Return on Equity, Return on Investment and Debt Equity Ratio.

4.2 Data Presentation

Basic analysis begun with the determination of mean and standard deviation before and after the merger. Standard deviation was used as measure of dispersion (variation). Calculations were carried out for paired T - test compares the means for the two variables it was useful to know what mean values are: -

Table 4.2.1 Descriptive Statistics for Measures of Performance

	N	Mean	Standard Deviation	Std. Error Mean
Return on Assets Pre - Merger	12	-0.1194	3.36319	0.97087
Return on Assets Post-Merger	12	0.2992	1.46026	0.42154
Return on Equity Pre-Merger	12	7.9850	11.17200	3.22508
Return on Equity Post - Merger	12	7.0075	9.32522	2.69196
Return on Investment Pre-	12	-0.1867	4.80296	1.38650

["Merger				
Return on Investment Post - Merger	12	0.4500	2.01958	0.58300
Debt Equity Ratio Pre Merger	12	6.3958	4.02378	1.16157
Debt Equity Ratio Post - Merger	12	7.6975	4.58861	1.32462

Source: Research Data

The paired t- test is generally used to compare means on related subject over time or in differing circumstances. The table above displays the mean and standard deviation values of the measures of performance before and after merger.

The mean values of the measures of performance before and after were: - The mean Return on Asset before the merger was -0.1194, Return on Equity was 7.9850, Return on Investment was -0.1867 and Debt Equity Ratio was 6.3958. The standard deviation before merger for Return on Asset was 3.36319, Return on Equity was 11.17200, Return on Investment was 4.80296 and Debt Equity Ratio was 4.02378.

The same analysis was carried out for the four measures of performance after merger. The mean Return on Assets was 0.2992, Return on Equity was 7.0075, Return on Investment was 0.4500 and Debt Equity Ratio was 7.6975. The standard deviation after merger was as follows: - Return on Assets was 1.46026, Return on Equity was 9.32522, Return on Investment was 2.01958 and Debt Equity Ratio was 4.58861.

Table 4.2.2 Inter-Item Correlation Matrix

	ROA Post-merger	ROE post-merger	ROI post-merger	DER post-merger	ROA pre-merger	ROE pre-merger	ROI Pre merger	DER pre merger
ROA Post-merger	1.000							
ROE post-merger	.829 .000	1.000						
ROI post-merger	1.000	.838	1.000					
DER post-merger	.630	.605	.630	1.000				
ROA pre-merger	.450	.546	.457	.272	1.000			
ROE pre-merger	.688	.810	.697	.641	.643	1.000		
ROI Pre merger	.378	.520	.389	.267	.980	.624	1.000	
DER pre - merger	.612	.551	.611	.754	.625	.636	.608	1.000

Source: Research Data

Correlation indicates the direction of the relationship (positive or negative). The absolute value of the correlation indicates the strength with larger absolute values indicating stronger relationships. For these study both the variables show a positive relationship, with stronger relationship being between Return on Investment pre merger and Return on Asset pre merger were indicated by 0.980 and lowest was between Return on Investment pre merger and Debt Equity Ratio post merger indicated by 0.267. There was high

correlation between Return on Investment post merger and Return on Equity post merger indicated by 0.838.

Table 4.2.3: Paired T- test for merged financial institutions

					95 % Confidence Interval of the Difference	
	Test Value = 0					
Test	t	df	Sig.(2-tailed)	Mean Difference	Lower	Upper
Return on assets Pre - merger	-.123	11	.904	-.11942	-2.2563	2.0175
Return on assets post - merger	.710	11	.493	.29917	-.6286	1.2270
Return on equity pre-merger	2.476	11	.031	7.98500	.8866	15.0834
Return on equity post - merger	2.603	11	.025	7.00750	1.0825	12.9325
Return on Investment pre-merger	-.135	11	.895	-.18667	-3.2383	2.8650
Return on investment post-merger	.772	11	.456	.45000	-.8332	1.7332
Debt equity ratio pre-merger	5.506	11	.000	6.39583	3.8392	8.9524
Debt equity ratio post-merger	5.5811	11	.000	7.69750	4.7820	10.6130

Source: Research data

The mean values for the measures of performance before and after merger are displayed in the paired sample statistics table above. The paired samples T test procedure compares the mean of two variables for a single group. It computes the difference between values of the two variables for each case and tests whether the average differs from 0.

Table 4.2.4 ANOVA

		Sum of Squares	df	Mean Square	F	Sig
Between Ratios		1106.598	11	100.600		
Within Ratios	Between Items	1067.187	7	152.455	9.775	.000
	Residual	1200.888	77	15.596		
	Total	2268.075	84	27.001		
Total		3374.674	95	35.523		

Source: Research Data

Anova was used to establish any difference in means observed in order to test the significance and also to test whether there is effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. The table shows that the means are statistically significant ($p = 0.000 < 0.05$). The results state that there is a statistically significance when mergers and acquisitions occur.

4.3 Summary and Interpretation of the Findings

The data was analyzed using paired T-test revealed changes in Return on Asset. As shown in the table the findings of pre and post merger from the t- test indicate there was slight increase in t -value from - 0.123 to 0.710 and indication that there was an increase in the Return on Asset after the merger. There was also noteable decrease in the mean difference from 0.904 to 0.493, which is a clear indication of no much difference in Return on Asset. There is high significance for the t - test (typically more than 0.05) indicates that there is no much significant difference between the increase of performance before and after merger.

The results of pre and post merger from the paired t- test table above indicate that there is a slight increase from 2.476 to 2.603 an indication that there was an increase in the Return on Equity after the merger there was notable decrease in mean difference from 7.98500 to 7.00750 which is a clear indication that the increase was not much. A low

significance value for the t- test (typically less than 0.05) indicates there is significant difference between the measures of performance before and after merger.

The analysis of data by use of paired T-test for the data on Return on Investment before and after merger. From the results it was found that there was an increase from -0.135 to 0.772, which is an indication on the increase in Return on Investment. This was evident on the increase in the mean difference from -0.18667 to 0.45000. A high significance value for the t -test (typically more than 0.05) indicate there is no much significant difference between the measures of performance before and after merger.

The findings from the paired T-test table indicate that there was an increase in t - value from 5.506 to 5.811 that is an indication on the increase in Debt Equity Ratio. This was also evident on the notable increase in the mean difference from 6.39583 to 7.69750, which is a clear indication of increase in Debt Equity Ratio, which was found to be statistically significance value was found to be 0.00, which was less than 0.05.

The conclusions and findings on effect of mergers and acquisitions on the financial performance of financial Institutions in Kenya in comparison to the results drawn from similar studies done in different parts of the world gave mixed comparisons. For example this study constrated with that of (Kouser and Saba 2011) they found in their study that there was a decline in Debt Equity Ratio and therefore a negative relationship or impact of mergers and acquisitions on banks performance after mergers and acquisitions. However this study confirmed, the research findings from the study indicate there is an increase in Debt Equity Ratio and therefore a positive impact of mergers and acquisitions on financial institutions after the merger and acquisition.

Obaid et al (2010), have indicated that Return on Asset and Return on Equity are Insignificant but shareholders equity and total assets showed significant improvement. They conclude that as an option for improving the bank's performance as mergers and acquisition may have positive effects on performance due to renewed attention to business. It is also consistent with the results of some other past studies Neely and

Rochester (1987) found a decline of the profitability ratio's especially the Return on Asset in the post merger period. Sharma and Ho (2002) also found a decline for the Return on Asset and the Return on Equity ratios.

Korir (2006) used four measures of performance like turnover, volume, market capitalization and profit. The study established the financial performance of the merged companies in the pre and post merger. The results concluded using correlation that both the variables showed a strong positive relationship between profit and market capitalization. Another finding concluded that profit and volume showed a weak correlation.

The research conducted on the international M&As activities of the Greek listed sample firms in the selected countries (Bulgaria, Romania, and Albania) of this research have not lead them to enhanced post-merger accounting performance, but, in general, to a performance deterioration that also have a negative impact on three profitability examined ratios. Thus, these results for the Greek market, since there is no significant profitability improvement, do not support the hypotheses of market power (Lubatkin, 1983)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The aim of the study was to determine the effect between mergers and acquisitions and financial performance of financial institutions in Kenya using mean, standard deviation and T- test analysis. It is therefore necessary to assess how mergers and acquisitions have an effect on the financial performance. The focus was on 12 Financial Institutions in Kenya. This was because earlier studies recommended investigation of financial performance data of institutions up to the year 2011 as an area warranting further research. Employing T- test analysis uncovered changes in financial performance due to the effect of mergers and acquisitions. And also correlation portrays the strength or weakness there is a strong positive relationship on Return on asset post merger and Return on Investment post merger these shows a strong relationship. There is a slightly weak relationship between Return on Investment pre merger and Debt Equity ratio post merger.

The study looked at financial performance measures ratios like Return on Assets, Return on Equity, Return on Investment and Debt equity Ratio. The ratios portray the real financial position of an institution. The use of mean, standard deviation and T- test analysis to know the significance of the study. The findings of the study indicates that the T- test elaborates that Return on Assets, Return on Equity and Debt Equity ratio showed an improvement after the merger while Return on Investment showed no much improvement on performance.

The results from the research indicate that there is strong evidence that significant factors that determine the financial performance of financial institution in Kenya once mergers and acquisitions occur. Mergers and acquisition have an effect either positive or negative. Return on Assets, Return on Investment indicates an insignificant difference between measures of performance before and after merger. The implications of these findings is that the Central Bank of Kenya needs to revise legal requirements that give benchmarks

of the above ratios to ensure that the mergers and acquisitions are effective once entered into. This will enhance that the shareholders and investors get their desired return.

§.2 Conclusion

The findings of the study are mixed. This is because some findings are consistent with theoretical expectations and others are not. It is evident that mergers and acquisitions influences financial institutions in Kenya. As an evolving and critical business activity especially in the financial sector an understanding of the linkeage between merger and acquisition and financial performance is appropriate addition to the main contribution of this study. The main objective of this research was to find effect of mergers and acquisitions on the financial institutions in Kenya. In line with the objectives, data from financial Institutions that merged was compared pre and post merger. The results show that most mergers are improving financial performance after the merger. The Return on Asset, Return on Equity and Debt Equity ratio indicate an improvement of performance while Return on Investment shows no much financial improvement of performance. Again the T-test results points to the fact that mean difference shows a difference in mean variations.

Profitability is the most important to the firm's total shareholders. Profit serves as backbone against adverse conditions on losses on loans, or losses caused by unexpected changes in interest rates. Return on Assets and Return on Equity are the most commonly applied ratios used to assess financial performance. The study concludes that Return on Assets showed insignificant impact before and after the merger. The Return on Equity showed a significance difference between measures of performance before and after merger.

The Return on Investment is a measure of performance used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. The result of the study indicates there is insignificant difference between the measures of performance before and after the merger.

On Debt Equity Ratio measure company's financial leverage. It helps in providing investment decisions to the financial Institutions. The results of the study showed significant improvement.

Mergers and acquisitions activities could still be considered and recommended as an option for improving the financial institutions. As mergers and acquisitions may have positive effects on financial performance due to renewed attention, to business, improved management, better credit assessment and utilizing the new technology.

5.3 Policy Recommendations

From the findings of the study I recommend the development of appropriate policies to enable mergers and acquisitions to be embraced among financial institutions in Kenya. In this regard, the central bank of Kenya should encourage financial institutions to merge by ensuring that laid down laws don't act as hindrance towards the achieving desired objective of merging.

Also government, capital markets authority and Nairobi securities Exchange should develop or do away with strict trade practices that discourage foreign banks from investing in Kenya.

There is need for financial institutions to embrace mergers and acquisitions in order to increase the capital base, customer base and also cash reserves to facilitate profitability and stability of the financial institutions. Form the findings of the study we recommend the development of appropriate policies to enable foreign banks to easily have access in order to enter the Kenyan banking industry either through acquisitions or mergers. This is because from past information very few foreign banks have ventured into the country. In this regard the Nairobi Securities Exchange and Capital Markets Authority should have a look at how financial institutions from other countries can get listed at the Nairobi Securities Exchange without the trade barriers.

The operating environment that is in the country will enable the financial institutions to improve performance. It is therefore the mandate of the government to have government led initiatives like; fiscal and monetary policy reforms, legal reform and regional integration aimed to improve the business climate.

There are challenges that are faced by financial institutions like; the weakening of the Kenyan shilling against major currencies, high inflation and the rise in international commodity prices. Therefore the Nairobi Securities Exchange, Central Bank of Kenya and Capital Markets Authority should ensure that they have policies and laws that enables financial institutions be cushioned against such challenges.

5.4 Limitations of the study

First, the major limitation of the study was getting financial information from financial statements that is prone to manipulation by the management to distort the financial position of financial institutions in order to please the shareholders. Also it was difficult to access the data on banks given they are found in Central Bank of Kenya and because of security threat there was limited accessibility.

The second limitation is that the available data was for early 2000's onwards while most banks merged in early and mid 1990's this made the research to sample only a few banks. The data was not readily available for analysis.

Finally, the study was conducted within the constraints of time and limited resources and inherent problems associated with these limitations. The time period does not give the researcher enough time to develop a large database.

5.5 Suggestions for other studies

The research is not conclusive in areas of foreign banks that have merged or acquired local banks. A further research can be carried out in the areas of cross border merger in order to understand the overall effect of mergers and acquisitions in Kenya and across Africa.

A further study could be carried out to cover a longer period say 15 years and cover the first banks that merged in the 1980's. Longer time period would generate better insight on the issue of comparative performance of financial institutions. A study could also be carried out to find out why there is low number of mergers and acquisition in Kenya.

The research used a few variables to measure pre and post merger data, the researcher suggests a further research using an alternative measures of performance than the ones used. The use of production efficiency performance measures for pre and post merger may be in order to get a better conclusion on the financial institutions overall performance. Therefore financial ratios alone may not be useful for an evaluation of financial institutions performance. The use of production measures reveal the factors that are identified as the cause of inefficiency i.e. managerial inefficient or technological inefficient.

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APPENDIX111

THE INFORMATION FOR DIFFERENT FINANCIAL INSTITUTIONS OBTAINED FROM THE CENTRAL BANK OF KENYA DATA BASE

BANKS

Ratios (Indicators)	Equatorial Commercial bank Ltd (Pre - Merger)	Southern Credit Banking Corporation (Pre-Merger)	Equatorial Commercial Bank Ltd (Post- Merger)
Return on Assets	1.19	-10.29	0.39
	-0.13	0.077	-0.23
Return on Equity	7.38	0	4.14
	-0.83	0.87	-2.63
Return on Investment	1.69	-14.7	0.55
	-0.13	0.1	-0.32
Debt to Equity Ratio	5.2	0	9.74
	5.62	10.31	10.48

BANKS

Ratios (Indicators)	East African Building Society (Pre- Merger)	Akiba Bank Ltd (Pre- Merger)	EABSBANK LTD (Post- Merger)
Return on Assets	0.28	-0.87	0.31
	0.714	-0.126	0.05
Return on Equity	2.26	-7.19	2.09
	5.38	0.77	0.39
Return on Investment	0.42	-1.24	0.4
	1.019	-0.18	0.07
Debt Equity Ratio	6.88	7.29	5.75
	6.54	5.06	7.28

BANKS

Ratios (Indicators)	City Finance Bank Ltd (Pre- Merger)	Jamii Bora Ltd (Pre - Merger)	Jamii Bora Bank Ltd (Post - Merger)
Return on Assets	-0.66	-0.057	-1.25
	-2.13	0.055	-3.41
Return on Equity	-1.21	-0.274	-1.69
	-6.01	0.131	-5.76
Return on Investment	-3.1	-0.31	-1.79
	-0.5	0.15	-4.58
Debt Equity Ratio	0.82	3.73	0.36

	1.82	1.37	0.69

BANKS

Ratios (Indicators)	CFC Bank Ltd (Pre - Merger)	Stanbic Bank Ltd (Pre - Merger)	CFC Stanbic Bank Ltd (Post - Merger)
Return on Assets	2.19	2.38	0.95
	1.49	2.05	1.10
Return on Equity	19.31	24.89	11.46
	15.89	23.44	12.91
Return on Investment	3.1	3.4	1.35
	2.1	2.9	1.59
Debt Equity Ratio	7.83	9.45	11.08
	9.66	10.41	11

BANKS

Ratios (Indicators)	First American Bank (Pre - Merger)	Commercial Bank of Africa (Pre - Merger)	Commercial Bank of Africa (Post - Merger)
Return on Assets	1.56	1.36	2.04
	1.58	2.08	1.19
Return on Equity	11.31	16.07	25.27
	8.45	23.11	18.43
Return on Investment	2.23	1.94	2.90
	2.25	2.97	1.68
Debt Equity Ratio	6.27	10.81	11.39
	4.36	10.13	14.64

BANKS

Ratios (Indicators)	Biashara Bank Ltd (Pre - Merger)	Investment & Mortgages Ltd (Pre - Merger)	I & M Bank Ltd (Pre - Merger)
Return on Assets	1.80	0.79	1.64
	1.74	1.12	0.81
Return on Equity	13.18	6.56	12.50
	6.51	8.98	6.98
Return on Investment	2.57	1.14	2.35
	2.49	1.59	1.20
Debt to Equity	6.32	7.21	6.60
	2.74	7.05	7.61

APPENDIX111

LIST OF RESEARCHES ON MERGERS AND ACQUISITIONS DONE BY UNIVERSITY OF NAIROBI MBA STUDENTS			
YEAR	**NAME**	**TILE**	**DIFFERENCES IN THERE RESEARCHES**
2011	Tuni Majala Mwalukumbi	' Tie impact of mergers and acquisitions on profitability of commercial ?anks Kenya.	RESEARCH METHODOLOGY • Research design used was causal study • Population of study was 70 banks from 1995 to 2010 • The sample selected was 20 banks • Data collection method was secondary data on the 20 banks • Data analysis the banks were analyzed for 5 year pre and post merger and acquisition • The financial measures used were profitability indicators like earnings per share, return on asset and return on equity. The used excel to aid in data analysis. The paired test an on parametric test of difference was in this study of significance.
2011	Wanguru **N.** Purity	The effect of mergers on profitability of firms in Kenya.	RESEARCH METHODOLOGY • Research design used was event study • Population of study was firms involved in mergers and acquisitions between 2004 and 2008. There are total of 82 firms firms comprised of companies in:- manufacturing, oil and gas, telecommunication service industry. • Sampling was based on census survey on the 82 Kenyan firms for a period of 5 years. • Data collection was based on secondary data. The study collects data 3 years before and after the merger • The data collected will be on profitability. The ratios used

			are:- return on assets, return on equity, return on investment capital and return on investment. • Data analysis used is:- arithmetic mean, median, maximum, minimum, standard deviation, percentage and rankings. The use of Chi-Square to assess industry difference.
2011	Ndung'u Boniface Muita	Effects of mergers and acquisitions on the financial performance of commercial banks in Kenya.	RESEARCH METHODOLOGY • Research design used is descriptive research design • Population of study was 36 banks • Sample of study that was chosen was 16 banks for the period 1999 to 2005. The period of study used was 5 years pre and post merger and acquisition. Banks sampled are: Diamond Trust Bank (K) Ltd, National Bank of Kenya Ltd, Standard Chartered Bank (K) Ltd, Barclays Bank of Kenya Ltd, Habib Bank A.G. Zurich, Guardian Bank Ltd, EABS Bank ltd, Co-operative Bank of Kenya ltd, Citibank NA, Southern Credit Banking Corp. Ltd, Kenya Commercial Bank Limited, Commercial Bank of Africa ltd. Bank of Africa Bank Ltd, Paramount Universal Bank, Investment & Mortgage Bank Ltd, Dubai Bank Ltd. • Data collection was based on secondary data. • Data Analysis was based on means and the analysis of variance was used to test whether there are significant differences between two means derived from two groups at a specified probability level. • Performance measures used are: Return on Asset, Capital Adequacy ratio and Total
1 1 1 1	1		

			liabilities to Total Asset.
2007	Felistus Wangui Njoroge	A survey of mergers and acquisitions experiences by commercial banks in Kenya.	RESEARCH METHODOLOGY • Research design used descriptive survey in nature • Population of target was 26 banks and therefore no need for sampling. The period of study 1994 to 2005 • Data collection method used was questionnaire • Data analysis used was descriptive in nature. This was used to generate reports through graphs, tables and pie charts.

APPENDIX 111

MERGERS THAT HAVE BEEN SELECTED FOR ANALYSIS

Mergers

No.	Institution	Merged with	Current Name	Date approved
1	Biashara Bank Ltd.	Investment & Mortgage Bank Ltd.	Investment & Mortgage Bank Ltd.	01.12.2002
2	First American Bank ltd	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	01.07.2005
3	East African Building Society	Akiba Bank ltd	EABS Bank ltd	31.10.2005
4	CFC Bank Ltd.	Stanbic Bank Ltd.	CFC Stanbic Bank Ltd.	01.06.2008
5	City Finance Bank Ltd.	Jamii Bora Kenya Ltd.	Jamii Bora Bank Ltd.	11.02.2010
6	Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010

Source: Central Bank of Kenya

APPENDIX 111

LIST OF FINANCIAL INSTITUTIONS THAT HAVE MERGED OR ACQUIRED IN KENYA

Mergers

No.	Institution	Merged with	Current Name	Date approved
1	9 Financial Institutions	All 9 Financial Institutions Merged together	Consolidated Bank of Kenya Ltd	1989
2	Mercantile Finance Ltd.	Ambank Ltd.	Ambank Ltd.	15.01.1996
3	National Industrial Credit Bank Ltd.	African Mercantile Banking Corp.	NIC Bank Ltd.	14.06.1997
4	Giro Bank Ltd.	Commerce Bank Ltd.	Giro Commercial Bank Ltd.	24.11.1998
5	Guardian Bank Ltd.	First National Finance Bank Ltd.	Guardian Bank Ltd.	24.11.1998
6	Guilders Inter. Bank Ltd.	Guardian Bank Ltd.	Guardian Bank Ltd.	03.12.1999
7	Universal Bank Ltd.	Paramount Bank Ltd.	Paramount Universal Bank	11.01.2000
	Citibank NA	ABN Amro Bank Ltd.	Citibank NA	16.10.2001
	Bullion Bank Ltd.	Southern Credit Banking Corp. Ltd.	Southern Credit Banking Corp. Ltd.	07.12.2001
10	Biashara Bank Ltd.	Investment & Mortgage Bank Ltd.	Investment & Mortgage Bank Ltd.	01.12.2002
11	First American Bank ltd	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	01.07.2005
12	East African Building Society	Akiba Bank ltd	EABS Bank ltd	31.10.2005
13	CFC Bank Ltd.	Stanbic Bank Ltd.	CFC Stanbic Bank Ltd.	01.06.2008
14	City Finance Bank Ltd.	Jamii Bora Kenya Ltd.	Jamii Bora Bank Ltd.	11.02.2010
15	Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010

Acquisitions

No.	Institution	Acquired by	Current Name	Date approved
1	Mashreq Bank Ltd.	Dubai Kenya Ltd.	Dubai Bank Ltd.	01.04.2000
2	Credit Agricole Indosuez (K) Ltd.	Bank of Africa Kenya Ltd.	Bank of Africa Bank Ltd.	30.04.2004
3	EABS Bank Ltd.	Ecobank Kenya Ltd.	Ecobank Bank Ltd.	16.06.2008

Source : Central Bank of Kenya 2010

UNIVERSITY OF NAIROBI
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MBA PROGRAMME

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TO WHOM IT MAY CONCERN

The bearer of this letter eft Q p ^ , t^E... tfy.fftr.l^ttv.rt.y ...MX?

Registration No....b.&.l./.

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

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IMMACULA1
MBA ADMINISTRATOR
MBA OFFICE, AMBANK HOUSE