DO MERGERS AND ACQUISITIONS AFFECT FIRM VALUE?

CASE STUDY OF KENYA COMMERCIAL BANK AND NATIONAL BANK OF KENYA AQUISITION

BY

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DECLARATION

I, the undersigned declare that this is my original work and has never been presented to any institution college or university for examination purposes.

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Abstract

The current study sought to establish whether M&As enhance or destroy value in Kenyan firms. Through the theoretical lenses of the synergy theory, the differential efficiency theory, the free cash flow theory and the resource-based theory, the researcher critically examined the M&A phenomenon in terms of whether or not it can create value for the firms. Using event analysis methodology, the study tests key hypotheses and establishes that M&As do not significantly improve the returns and the value of the company outside the sum of the individual values of the companies. Since the analysis finds no statistical significance in the event analysis in the short, medium and long term, it can be concluded that M&As are neither value creating nor destroying based on the sample investigated. In other words, M&As do not have significant effects on the value of the merging companies apart from their combined capitalization.

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Among the many reasons why studying mergers and acquisitions and the value they create, is the fact that incredible amounts of money are spent in these deals/transactions (Chalençon et al., 2017). The M&A deals, in most cases, draw a lot of attention as well as dispute, and in some cases, stakeholders criticize the financial reality of the deals. The basic idea of M&As as Alexandridiset al (2017) point out, is the creation of value using an activity that is potentially synergistic. This is why the implementation of any M&A transaction requires a clear and deliberate plan, especially as far as proper financing, correct valuation, and actual deal completion is concerned. M&As, as Huang (2010) argues, are strategic investment decisions, which means they have significant upside, as well as downside wealth and performance consequences. This means that the consideration of whether or not to enter an M&A deal should be done based on comprehensive analysis of all the relevant factors that have a bearing on the overall success of the acquiring organization or the merging companies. Dorai & Patolahti (2010) reiterate that one of the fundamental reasons why acquisitions often appear attractive to top managers and some of the most successful CEOs is the fact that the M&A deals provides organizations with an opportunity to increase market power, accrue private synergies, or provide rapid growth for the firm.

The main theories that underpin this study are the differential efficiency theory and the synergy theory. According to the differential efficiency theory, mergers should be done where the one of the merging companies or one between the companies is more efficient than the other company, and that the company with more efficient management should acquire the other company (Jang & Yehuda, 2020). On the other hand, the synergy theory posits that the performances and value

of two companies/firms, when combined would be higher or more than the sum obtained separately by adding individual parts (Alexandridiset al., 2017). A synergy merge happens when merging companies create greater efficiency, and value accrues from the post-merger integration as Chalençon et al. (2017) explain.

In Kenya, the number of M&As has been on the rise in the past decade, and the question of whether or not they create value is still a fundamental question today. It is crucial to understand the motives of different stakeholders, since this is critical in the analysis of the potential creation of value. Carrying out this study is important because its findings will create insight as far as value creation using M&A strategies is concerned. The findings of this study will create knowledge and skills that could be fundamental not just in strategic management, but also financial management in different organizations.

1.1.1 Mergers and acquisitions (M&As)

Mergers and acquisitions can be defined as an aspect of corporate finance strategy that is associated with acquiring and merging of different organizations and other assets by other organizations (Hägg, 2020). Jokinen (2020) defines M&As as transactions that range from the purchase or sale of undertakings, alliances, concentration between undertakings, and management buy-out and buy-in among other transactions. The fundamental objective of entering M&A deals is to enhance value and improve the overall position of an organization in its bottom-line objective of increasing shareholder value. From these definitions, M&As can generally be defined as transactions that involve the transfer or consolidation of the ownership of companies, businesses, or their operating units with other entities.

M&A are often measured based on the success of merger and acquisitions, and this is done using the share price, the managers' subjective assessment of performance, and various accounting measures such as profits, sales, return on investments and returns on assets.

1.1.2 Market value

Market value is defined as an economic concept that reflects the value of the business (Campa & Hernando, 2004), or the value that a given company or business is worthy at a given period in time. Alexandridis, Antypas & Travlos (2017) define firm value as the amount of money that one would need to takeover or buy a given business entity. Firm value can, therefore be defined as the total value of a given business that is, in most cases, used as a comprehensive alternative to equity market capitalization. Firm value is measured by adding the claims of the shareholders and creditors. In other words, firm value is measured using the sum of the minority interest, market value of equity and debt.

1.1.3 Mergers & Acquisitions and Firm Value

Other studies such as Hitt, Ireland & Harrison (2001), however, have argued that acquisitions and/or mergers can play a key role in increasing the complexity of the firm, exacerbating information asymmetries, and enhancing managerial discretions. What, perhaps, makes the study of M&As interesting and relevant both in practice and in theory, is the fact that the upsides and the downsides of these deals affect all sectors and industries, and both in the developed and undeveloped world. Deng & Yang (2015) argues that in some cases, the acquiring firm benefits more than the acquired firm, but this situation can easily be the other way around. For example, there is almost always a positive combined investor response, but the target or the acquired company is often responsible for those responses, while the responses of the acquiring company often remain the same or even tend to move towards the negative side. What this implies is that

the investors are generally pessimistic about how the acquiring firms go about the M&A deals. The general view that investors will react negatively, on average, upon the announcement of an M&A deal, especially for the acquiring firm shows the skepticism around the value of these deals in the eyes of the investors.

Hägg (2020) argues that mergers and acquisitions can add value in various ways, and these include the improvement of existing services and/or products, change of direction or personality, they could be a gateway to foreign or new markets, and they give an acquiring the opportunity to also acquire intellectual property or talented people. These are certainly very compelling reasons why M&As add value, but as Hitt, Ireland & Harrison (2001) point out, very few actually add value. This is because, according to KPMG report, more than 50% of M&As destroy shareholder value, and about 33% of them have no effect or impact at all. Different studies such as Jokinen (2020) have argued that some of the reasons for this high failure rate include operational failures and tangible accounting, while others such as Dorai & Patolahti (2010) propose more complex reasons such as the inability to deal with people effectively, particularly in terms of culture and human emotion.

1.1.4 Mergers and acquisitions in Kenya

Merger and acquisition have often been connected to increase the performance of different organizations. The action has numerous benefits that make it very attractive to investors. From a global perspective, mergers and acquisitions have had significant contributions to the development of multinationals corporations. Additionally, its importance in boosting the global economy cannot be emphasized enough. While its importance to the global economy has been recognized, it is essential to examine its impacts on the local economy. Therefore, Mwanza (2012) seeks to provide an empirical of the possible impacts of these activities in a local setting.

In analyzing its impacts, there is a need to examine the trend in the mergers and acquisitions markets. According to Kenya's central bank, Kenya's economy was projected to grow by about 6% in 2020. However, this value was later revised to about 3.4% due to the unpredictability of global events. The revision of the economic growth also projects a decline in the GDP growth by about 2%. At the same time, mergers and acquisition activities were projected to slow down. The gradual decline was attributed to organizations or firms' to focus on employees' safety and the survival of business operations (Chambers & Partner, 2020).

The occurrence of deals in the capital market happened towards the end of 2019. The majority of these deals were attributed to the banking sector. With a drop in economic growth has been experienced, the central bank of Kenya continues to recommend consolidation in the banking sector via mergers. This recommendation's main reason is the need to develop or create resilient institutions to weather economic shocks. The highlight of mergers and acquisitions in the country was NIC Group and Commercial Bank of Africa. The resulting firm was the NCBA group. At the same time, there was an acquisition of National bank by Kenya Commercial Bank through a share swap (Chambers & Partner, 2020).

Further, trends indicate increasing transaction of private equity in the 2019/20 financial year. An example of such a transaction is the centum investment company disposing of its controlling stake in Almasi Beverages and Nairobi Bottlers. Also, Actus equity acquired 22.3% of the issued share capital of the Riara group of schools. This acquisition makes Actus holding the controlling share of the merger. Another example has been observed in the case of Rubies energies SAS. The foreign company was able to acquire KenolKobil Plc fully (Chambers & Partner, 2020).

Based on the examples, the market trends indicate that most mergers and acquisitions in the last five years have involved the banking industry. Firms in the oil industry have also been involved

in these mergers and acquisitions. However, many organizations outs the banking sector have opted to relinquish their organization's control during a merger or acquisition. While they have been critical in ensuring companies' survival, challenges of staff retention and international relations have emerged. Simultaneously, issues of fairness in the market are often compromised after the presence of mergers and acquisitions (Chambers & Partner, 2020).

In Kenya, the economy's growth largely depends on agriculture, the informal sector, and SMEs. Given the critical drivers of the economy, credit in the private sector is expected to grow following the reversal of interest rates. The market has been characterized by a progressive undertaking of new policies and administrative changes. The new moves have focused on adopting technologies and using online services. The annual financial review of 2019 indicates that capital markets have experienced continued to experience new deals. Out of 110 deals made in the East African region, at least 76 of them happened within the Kenyan economy. This value accounts for about USD 1.3 billion (Chambers & Partner, 2020).

1.2 Research problem

The primary objective of M&As is to create market value and other synergies that strengthen the position of an organization on the market. However, existing empirical scholarly research has revealed that most M&As in the world fail, and this is especially according to the FT Press book that puts the failure rate at least 50%. Other researches, however, have argued that there are many other factors in play as far as the success, or lack thereof, of an M&A deal is concerned. This poses an interesting subject for inquiry, especially when it comes to determining the appropriateness of an M&A deal while taking into account an organization's strategic needs.

Joash and Njangiru (2015) investigated how M&As influence the overall performance of Kenyan commercial banks. The authors found that, regardless of many M&A deals in Kenya over time,

studies on mergers and acquisitions in Kenya have generally failed to conclusively establish whether or not M&As add value. Studies such as Lole (2012) argued that M&As have no impact on profitability and overall of performance of the involved companies. Studies such as Mboroto (2013) focused on the Petroleum sector and also concluded that M&As have no significant effect on the financial performance of petroleum firms in Kenya. Mitema (2014), on the other hand, investigated the impact of M&As in the insurance industry and found that M&As have a positive effect on financial performance of insurance companies. Clearly, the results are mixed and inconsistent.

Aybar and Ficici (2009) investigated the impact of M&As on firm value in emerging market, with the sample constituting of multinationals in these economies, and established that international M&As have no impact on value creation in the emerging markets. The conclusion was made after examining 433 M&A deals between 1991 and 2004. Bianconi and Tan (2019), on the other hand, examined whether M&As have an impact value creation by focusing on 65, 521 M&A deals all over the world, and found mixed results of a positive instantaneous impact and a negative medium-term impact. Okofo-Dartey and Kwenda (2019) focus on companies listed in 10 emerging economies using data between the year 2000 and 2016, and also found out that M&As do not create value or opportunities with the first three years of the deal.

Clearly, the results about the importance or impact of M&As are mixed both in Kenya and internationally. The lack of consensus in how exactly M&As affect firm value creates a gap in literature, especially in terms of the lack of the most recent studies that use alternative methodologies to determine the impact of M&As on value.

The current study carried out an event study (event -history analysis) to analyze the impact of M&A deals on the value of Kenyan companies by focusing on security performance. The current

study focused on company stock in an effort to determine whether or not M&As have a significant impact on the performance of a company.

The current study, therefore, seeked to answer the following research question;

Are M&As profitable and should Kenyan companies enter such deals?

1.3 Research Objective

The main objective of this study is to establish whether M&As enhance or destroy value are value in Kenyan firms.

1.4 Value of the study

The mixed results in previous research about whether or not M&As can add value were one of the most important reasons for carrying out this study. Some studies have argued that M&As are value creating, while other believe they are value destroying, and these mixed results mean that there is not yet an academic consensus in this respect. To the best knowledge of the researcher, there is no study that empirically examines this problem in the Kenyan context and as such, there exists a gap in academic literature. By carrying out this study, the current study would have made important contributions to the body of academic literature. As far as contribution to practice is concerned, the findings of this study will help in determining whether or not the M&A deals add value, and as such, provide managers with the knowledge of whether or not to enter such deals. The Kenyan law has rules that govern certain aspects of supervision and regulation of the securities market. The Capital Markets Act is a section of legislation that plays this role. The findings of the current study would be key in informing such policy, especially in terms of the type of deals or transactions that should be allowed to take place.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter critically examines previous studies and explains the theoretical lens through which the study will be examined. The chapter is divided into two main sections; the theoretical review, which provides in-depth research theories underpinning the study, and the empirical section, which focuses on empirical studies that examined the research question.

2.2 Theoretical Review

This section explicitly reviews the theories the scholars have proposed in the area of study. Under this section the following are the theories that underpin the study. Several theories were considered to meet the objectives of the study. These theories include, differential efficiency theory, resource based view theory, synergy theory, and free cash flow theory. These theories will attempt to explain the intersections and interrelationships between the variables associated with M&A deals and the creation of market value.

2.2.1 The Differential Efficiency Theory

This theory was initially proposed by Joe Bain in 1953.According to the Differential Efficiency Theory, M&As take place because two companies/firms have different strengths/competencies and weaknesses/struggles at different efficiency levels (Leepsa & Mishra, 2016). When a firm's operating level falls below the optimum level, a takeover is assumed to raise the company's efficiency. The theory similarly suggests that management is inefficient in running a firm and therefore increases the chances of takeovers. However, Park (1984) declared a merger beneficial as it would mean that expansion would take place with minimum cash balances and its resources efficiently utilized. Difficulties would arise in the event that the company/firm that acquires the other overestimates its influence on its ability to enhance the performance of the acquired

company or the company. As a result, the acquiring firm will pay too much for the acquired company, with little or no improvement. This may lead to the acquiring firm paying too much for the acquired company with little to no improvement in performance to the anticipated level and value.

A merger can expose the acquiring firm to some risks. For instance, the acquiring firm develops financial problems if it spends too much for the merger and resources are underutilized in the forecasted manner. Mergers should be done in a company whose management is efficient in order to achieve value creation and positive returns. Value creation will also be enhanced when the firm with a more efficient management system acquires the other company (Jang & Yehuda, 2020).

2.2.2 The Synergy Theory

This theory was proposed by Ansoff in 1965. Ensign (1998) highlighted Ansoff's study of corporate strategy synergistic effects. The author noted that the strategy includes four elements, including market scope, snergy, development and competitive advanatge. Among the elements, synergy established the capability and opportunities of companies through matching relationships for the successful development of new businesses. Ansoff established the economic meaning of synergy, which is why the value of an entire company might be greater than sum the value of divided parts. The value incorporates tangible assets (such as equipment, plant, land and others) and intangible assets, such technology and corporate image. Itami (1987) made a more precise definition of synergistic effects by elaborating Ansoff's synergy into complementary effects and synergy effects claiming that strategy should cooperate three external user fields and two external user fields (organization and technology). The theory considers that a mergers and acquisitions has the potential of social benefits, where the effect is assumed to come from

management, finance and other businesses. As the theory holds, firm managers achieve efficiency gains from the combination of an effective target with their firms creating an improvement in performance.

The theory posits that the performance and value of two companies would be higher when combined, than when computed separately or individually (Alexandridiset al., 2017). Operational synergies create value through cost cutting through the elimination of duplicate departments and machinery. On the other hand, financial theory creates value through debt utilization, diversification and the purchase of undervalued target firms (Whitlock, 2016).

2.2.3 Free cash flow theory

This theory was proposed by Jensen in 1986. Managers that have easy access to free cash flow are more likely to take in mergers that have less benefit to the shareholders or those that destroy value (Brealey and Myers, 2009). If an acquisition is done without considering a stock, they take into consideration payment of resources to the shareholders this has the potential to create net benefits even in situations where the mergers may lead to operating inefficiencies (Shakina and Barajas, 2014). Companies with huge cash flows therefore have a high possibility to take part in mergers of low benefit. When an industry is on the decline, mergers within that industry lead to value gain while those outside the industry in most cases will have low or have negative returns on the investments (Wangombe, 2018).

2.2.4 Resource-based view RBV

This theory was proposed by Birger Wernerfelt. This is based on the idea that a company comprises a collection of capabilities. These capabilities make the company maximumly use the available resources for a better financial outcome. The performance of the companies differs because of the uniqueness of the resources and the capabilities shown by the company in the

industry (Hoopes, Madsen, and Walker, 2003). A company has capital, workers, experienced and knowledgeable managers, finances and resources an organization needs for the production process, they can either be tangible or intangible.

A collection of resources available in the company increases its profitability. A single resource may not necessarily help the company to gain a competitive edge but through synergy and a combination of competitive resources, an organization may perform financially better (David and Cynthia, 1995). The resource-based theory has attracted many studies to determine the correlation between the internal structure of the company and its performance. When different resources are put together it increases the financial performance. The way a company uses its resources is very important to performance. RBV supports that M& A are positively related to financial performance. Hoopes et al (2003) argue that companies take advantage of great cost efficiency to help businesses to grow.

Big companies have easy access to credit from commercial banks because they can pay and they enjoy economies of scale, they are more efficient resulting in a better financial performance. Big companies are more profitable than small ones because they enjoy economies of scale (Sudarsanam, 2013) and they have a good corporate reputation with the investors. Small companies are characterized by instability and financial institutions are unwilling to give them credit. Small companies show high growth rates that require credit while on other hand, big companies are stable and established.

2.3 Factors affecting firm value

Some of the factors affecting firm value as hinted in the previous sections include share price, free cash flows and profitability of a company. Share price affects firm value because is basically the amount it would cost for an investor to buy one share of a given company. Free cash flow on the other hand, is the idle cash that firms would have once they have paid for necessary expenses in order to maintain and develop assets.

2.3.1 Share price and Firm value

The study by Zhao (2013) study on the correlation between share price and firm value. The author used the business performance indicator ROE (Return of Equity) as a measure of firm value. The study revealed that share price gains and firm value have more significant positive relationships in developed stock markets. Companies in different industries have different industry cycles, market structures, and profitability; therefore, the share price gains and corporate performance should also be different. Zhao found a significant correlation between ROE and share price gains in Chinese Listed Companies. In developed economies, investors acquire firm value based on useful information to invest in stock markets. Thus, it is important to maximize firm value, since investors are usually attracted to companies with better stock performance.

The findings were also supported by other previous studies, such as Ratemo's (2015) study on the link between share prices and company value of firms listed in the Nairobi securities exchange. The author demonstrated that share price is positively related to Return on Assets (ROA). Ratemo (2015) revealed that the share prices of companies that engage in sustainability reporting have a positive effect on company value. Similarly, Hubbard (2008) established that investors seek to invest in socially responsible investments (SRI) in the listed firms deemed to

observe good environmental and social practices. Naturally, sustainable companies will be less risky to invest in than those that are not.

Previous research by Ratemo (2015) also indicates that share price to be relative and proportional to the company's value. Thus, it only represents a percentage of the firm's value at any given point in time. Any change in change is share price often leads to an equal change in firm value.

2.3.2 Free cash flows (FCF) and Firm value

Previous research by Hubbard (2008) indicates a positive correlation between cash flows and firm value. Priors show that free cash flow is one of the factors that influence the firm value. Free cash flow is a measurement technique of firm value, and shows idle cash that firms would have once they have paid for necessary expenses in order to maintain and develop assets. Thus, it is crucial as it helps companies to identify opportunities that enhance firm value. Profita's (2016) article summarizes the impact of FCF on firm value. The study shows that the amount of cash flow generated during the accounting period determines the health of a company. Firms with excess free cash flow might record improved performance than others. This is because these firms can acquire an advantage over different opportunities that other companies might not obtain. If the company has excess free cash flow, it can decide on an approach to use to maximize firm value. Since the firm's sole purpose is to maximise the wealth of shareholders, some companies might opt to spend more capital if there are available new opportunities to increase the company's value.

Additionally, Profita (2015) noted that a company with free cash flow uses it to expand its business. The company will collect more revenue if the expansion is a success. Results show that increase in revenue translates to growth in firm worth. This would attract investors since the company has the ability to increase its share price in the future. The study demonstrated a positive and statistically significant correlation between firm value and free cash flow. Also, the findings demonstrate a link between agency problems, free cash flow, and firm value. They show that agency problems and their costs would be more severe in the presence of FCF under management control (Griffin et al., 2010). This would negatively affect Firm performance as a result.

2.3.3 Profits/profitability and firm value

Profitability is measured using ROA and ROE. It involves the capacity of the firm to utilize its resources in order generate profits. Profitability is regarded as a crucial aspect to investors since investors perceive it as a guarantee of investment on return. Analyses from previous research such as Ratemo (2015) established a significant and positive correlation between firm value and profitability. They reveal that share prices are likely to increase if the company has a high return on capital. Higher profitability translates to more distributable income for shareholders, hence increases firm value (Yang et al., 2010). The company's profitability increases the assignable profit, which in turn, increases the firm's value. Further, profitability was found to assess the ability of the company to generate profits from the implemented operational processes to make sure the company remains operational in the future. When the company generates higher profits, the investor's confidence would be raised to invest in the company, and the creditor's confidence would increase to provide loans. Thus, it can be argued that profitability impacts the capital structure. These findings are consistent with the Pecking Order Theory, which states that a higher

company's profitability is related to lower debt use. Thus, a company's profitability affects the firm value positively. However, the study of Murni (2015) does not support these findings. Murni (2015) established a negative link between value and profitability.

2.3.4 Foreign companies acquiring Kenyan companies

Business companies use different activities in pursuit to exploit potential opportunities (Mukele, 2006). The main aim of mergers is to give a business entity a joint venture to expand and grow its capital base through capital injection and knowledge adoption. A merger is an activity that creates an economic unit from two or more previously separate business entities. Mergers have become very popular because of increased competition, the need to break trade barriers, cross border flow of capital and business globalization because many restrictions are being lifted in some economies while others are being integrated (Kang and Johnsons, 2000). Consumers benefit from mergers because they make companies more efficient, although some are likely to reduce competition. This may lead to price increases, suppressed availability of goods or services, poor quality of goods, and lack of innovation. Some mergers create strong markets as others enable single businesses to raise funds (Berger et al.1999).

Many successful companies use different forms of M &A based on the opportunities and challenges. Even with good intention, it is hard to remain objective and completely clear of the rationale when the process is in progress (Grundy, 1995). Astrachan (2004) notes that M&A is an indication there is a change, for this reason, uncertainties lead to anxiety build up in people whose jobs may be affected. Rumours will move faster and believed in a place of facts. The success of acquisition depends on the pre-acquisition activities, the way they are handled more specifically, sharing information with the employees. Because of these challenges, it is not easy

to get value from the acquisition. Companies are unable to access classified information of the target firm beyond what is published financial information (Kathy, 2005). The information is often inadequate and, in some instances, unavailable.

Most M &As in Kenya of companies operating in the same industries is to consolidate to meet regulatory requirements (Mboroto, 2013). Some capacities are scrapped for better efficiency and competitiveness as they raise capital and structural capacity that the business entity has to meet. The consolidated bank of Kenya was formed as a result of the folding of many small banks to meet the minimum capital requirements as prescribed by the central bank of Kenya (Ombaka and Jangongo, 2018). Kenya has over 70 oil and petroleum companies, and to improve the financial performance and market presence some companies have taken part in M & A. for instance, OilLibya Kenya acquired Mobil, Chevron Kenya acquired by Total Kenya and Kenya oil merging with Kobil Kenya to form KenolKobil and just recently Shell Kenya acquired BP Kenya (Mailanyi, 2014).

Technological change makes many companies merge or be acquired. Fast-growing technology and increased expenditure force many companies to enter into M & A to share the innovation costs to align to the technological advancements and increase the capacity of the company to maintain an edge in the market. Companies that have superior information technology will look to acquire other entities to increase their market presence and increase their competitive advantage (McGrath, 2013). The growth of common customer needs and marketing approaches makes companies want to merge or be acquired to access certain sections of the market they were not able to access on their own. For instance, the merge between Smith Kline and Glaxio to form GlaxoSmithKline that now higher market presence as opposed to the separate single entities that existed before (Lane and Probert, 2003).

Some Kenyan companies see mergers and acquisition as a strategy to penetrate some foreign market according to the chief executive officer of opportunity Kenya (Koech, 2012). There is a need to increase the competitive advantage by tapping into knowledge and production skills, branding, market capabilities and geographically diversify and increase market presence. The company standing is increased through a merger because big companies can easily raise capital as opposed to small ones. M & A can be a strategy some companies may use to raise capital by pooling resources together to increase their capacity. A company may identify a strategic partner to introduce ideas in the same line of business to improve their financial performance by injecting more capital and coming with more knowledge and skills (Kiplagat, 2006).

When a company is also threatened by negative equity, increased losses, and customer desertion can opt to merge or be acquired by another entity (Miller and Segall, 2017). When companies merge, they will have a combined size making it cheaper to offer services on a wider scale. More experts are brought on board bringing new skills and knowledge and increased staff capacity. The contact time with the customers is increased lowering the travel time. Because the asset base of a company is increased in M &A, the balance sheet is restructured and deal with any negative equity position.

However, this does not come without challenges, when companies merge or acquired there is a human resource challenge. Workers are forced to apply for the same jobs they were holding increasing the staff anxiety leading to the loss of workers and managers, in turn, losing knowledge skills and experience. Staff are left in confusion not sure which human resource policies apply to them. When Wedco acquired SUN LINK, the wedco staff were entitled to monthly pension contribution excluding former SUN LINK staff (Njoroge, 2011). Merger and acquisition is a concept seen by business players to continue maintaining and better their market

edge. This has to be handled carefully so that it does not turn out counterproductive. The agency theory should also be dealt with so that managers will not only pursue their own interest but interest of the shareholders.

2.4 Empirical Studies

This section examines how variously M&A deals done by different organizations could affect the market value of these organizations. The section also examines these studies in the Kenyan context, as well as in the global context. Global studies are those studies that have studied other populations other than the Kenyan population. The purpose of this section is to provide an overview of the extent of the research problem globally and in Kenya.

2.4.1 Global studies

Badreldin and Kalhoufer (2009) examined the impact of M&A on Egyptian commercial banks. The authors used ROE to evaluate liquidity and financial performance of banks, and used debt and profitability to assess M&A. They found M&A to have a positive impact on financial performance of banks. Emy and Sahibzada (2016) examined the effects of M&A on companies in the United States involving 100 companies from 2010 to 2015 and concluded that M&A resulted in an enhanced stakeholder value which increases the demand for dividends and market share at the same time.

Altunbasand Ibanez (2004) conducted a research on the effect of M&A on the performance of commercial banks. The aim of the study was to establish the effect of fiscal consolidation on the performance of banks in Europe. The study findings show that mergers led to increased return on capital in banks in the European Union. The results show that domestic agreements like merging different organizations were extremely expensive this was based on the size of the company, debt cost, earnings, strategies and deposits. M&A across the borders and the

differences in the merging partners, their credit risks including loan strategies are factors that affected the performance of a company. The findings were that there is a considerable relationship between liquidity, competences in management, and the size of the company return on assets ROA after M&A.

Research by Momodou and Masazing (2017) on the effect of M&A on the financial performance of the London stock exchange LSE. The study was done on 40 companies listed on the LSE that had merged in 2011. The result reveals the existence of a positive relationship between M&A and ROE and earnings per share. These studies were done in the settings of the global market which is different from the local settings. The impacts on firm value was positive but not significant. Firm value was measured by the sum of the firm's market value of debt and equity.

2.4.2 Local studies

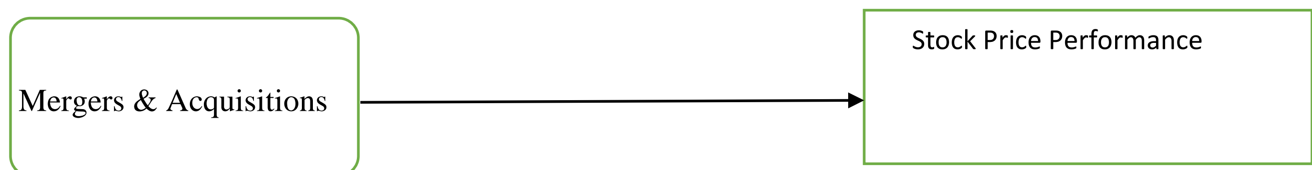
Njoroge (2012) conducted a study to establish the link between financial performance and M&As in Kenyan financial organizations. These organizations include mergers or those that acquired sourcing data from the central bank of Kenya. A pre-and-post merger study was conducted to determine the financial performance, more specifically in investment, returns and liquidity. The results show that the return on investments ROI and the return on assets ROA reported a considerable difference and debt-equity ratio and ROE showed considerable difference after merger and acquisition. Mboroto (2013) investigated the relationship between merger and acquisitions and financial performance of petroleum companies in Kenya in 36 companies listed on the Nairobi stock exchange NSE for five years based on secondary data concluded that mergers and acquisitions had less effect on ROA before M&A but after M&A there was a better outcome in terms of ROA. The study also finds a significant positive impact

on firm value after the M&A deal, which led to the conclusion that M&As significantly influence firm value.

Kavindu (2013) investigated the impact of M&A on commercial banks' profits in Kenya. The author discovered that financial organizations with weak asset and capital base merge intending to form synergies to take advantage of the economies of scale because this has the potential to enhance profitability contrary to listing on the Nairobi stock exchange NSE which initially is an expensive undertaking. Mwanza (2016) investigated the impact of M&A on financial outcomes in Kenyan insurance firms. The author analyzed financial statements of acquired and merged companies and concluded that in post-merger ROA and return on capital used significantly increased, therefore this means M&A increased ROA in insurance companies.

A study was done by Akenga and Olang (2017) on the effect of M&A on the profitability in commercial banks analyzing 42 commercial banks and concluded that M&A have a significant financial performance. M&A are also positively related to the ROA, as concluded by the study by Akenga and Olang (2017), who also argued that the overall firm value improved after M&A deal.

Figure 2.1: Conceptual Model



2.5 Summary of the Literature Review

The review of literature demonstrated that there are mixed findings in terms whether or not M&As are value creating, and this was also the same for global studies, which showed that the results on the efficiency of M&As are mixed as well. Most studies examined in this study investigated how M&As impact the overall financial performance of banks, and established that despite the many M&A deals in Kenya over time, studies on mergers and acquisitions in Kenya have generally failed to conclusively establish whether or not M&As add value.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlighted the data collection and analysis procedure that the researcher adopted by explaining the research design, the methodology and the data collection procedures. The study used event study methodology described in this chapter, since the current study sought to investigate the impact of an event of M&A on financial performance of firms.

3.2 Research Design

Kothari (2004) defined a research design as the overall strategy that a researcher uses to collect and analyze the data so as to find the solution to the research question. The research design highlights the logic and the integration of different components to address the research problem. The current study took a descriptive research design, and the reason for choosing this design was to facilitate the accuracy and systematic description of a phenomenon or a situation, which is what the researcher did in this study. This research design answered the what, where, when and how questions.

3.3 Population

The study population in this study constituted M&A deals in Kenya. The study seeked to investigate whether or not these deals created value for the Kenyan firms. The study selected an M&A and investigated whether or not it created value. The key dependent variable that was investigated in this study was stock prices of the M&A. The source of data used in this study was Reuters.com. The M&As considered were those that had taken part in M&A deals between 2017 and 2020.

3.4 Sample Design

A simple random sampling design was used to describe research to perform critical analysis or diligent inquiry of a given phenomenon (Mugenda and Mugenda, 2003)

Mackenzie and Knipe (2006) recommended the use of simple random sampling as the most preferred sampling technique, and this is because this sampling technique minimizes subjective bias. This is due to the fact that every item has equal chances of being in the sample being investigated. Using simple random sampling, the researcher selected one M&A deal and carried out an event analysis to investigate whether or not this deal had an impact on the firm's value. The use of one M&A deal was because event analysis is a long and cumbersome process, and investigating more deals would not be feasible with the time and resources available for the researcher. However, at the end of the study, the researcher made recommendations for future research to incorporate more M&A deals in the analysis.

3.5 Data Collection

The data collected in this study was on stock prices of an M&A deal before and after the deal had been done. Apart from Reuters.com, other data sources were company's annual reports. The company included in the sample had taken part in M&A deals between 2017 and 2020. This study period was used since it captured the latest trends in M&A performance in Kenya.

3.6 Event Study Methodology

The event study methodology investigated the effects of an event on a particular dependent variable. In this study i studied the changes of stock price over a period of time. The event study seeked to investigate whether or not there was an abnormal stock price effect that were associated with M&A event. The key assumption such cases was that the market must be

efficient, and as such, it was expected that the effects of the event were instantaneously reflected in the stock performance.

The event analysis was done in 5 key steps, and the steps summarized as follows;

Step 1- Identified the event in question, which in this case was using one of the sampled company on the event analysis.

Step 2- Identified the estimation event, as well as post event windows, and in this case, the event window was 436 days before the M&A deal and 194 days after the deal. This means that the event window was between 01/01/2018 and 17/04/2020.

Step 3- The estimation of parameters using the data estimation window.

Step 4- Measured the abnormal returns in the event window, and this involved considering the constant mean model and the market model.

Step 5- The determination of the cumulative abnormal returns (CAR) or the aggregate returns.

CARi (T1, T2) = $\sum_{k=Ti}^{T2}$ ARit

Step 1:

Once the event investigated had been decided, data on the company (ies) of interest was collected. The data in this case, was the stock prices and the data of the announcement of the M&A. The data covered both dates before and after the M&A. The announcement date was 2nd September 2019.

Step 2:

Identified estimations made were stated, and this is where the researcher decided the period over which the stock prices of the company (ies) involved were analyzed, and this is referred to as the event window. The event window was 436 days before the M&A deal and 194 days after the deal. This was not too short or too long; one that is too short could not display the full economic effects while one that is too long might have been inaccurate in the sense that it might have included the impacts of an array of other events apart from the event.

Step 3:

The estimations made at this stage, and the expected returns were determined during the event window.

Step 4:

CAPM was used to determine the expected earnings as follows; (Ri = Rf + B(Rm-Rf), and to obtain the abnormal returns, the difference between the expected returns and the actual returns was computed.

Step 5:

The answer obtained from the above step 4 (the abnormal returns) were then summed over the entire period to obtain the CAR or the cumulative abnormal returns. The researcher then plotted a graph of the abnormal return and cumulative abnormal return over the period of interest.

This helped in checking the effects of the event on returns.

CHAPTER 4: RESULTS AND ANALYSIS

4.1 Introduction

This chapter focuses on data analysis, and it shows the findings of the event analysis, as well as the interpretations of the data obtained from the study. This chapter is important as far as answering the research question is concerned, since it empirically examines the overarching research question.

4.2 Event analysis

The event analysis focused on the calculation of abnormal returns, as well as the corresponding CAR (cumulative abnormal returns), and the calculations are shown in excel on the appendix. The analysis used daily returns of the KCB Group and an average of the returns of other M&As in Kenya.

The analysis did a 5-day CAR, 15-day CAR, 25-day CAR, and 100-day CAR. From the table on the appendix, the 5-day CAR was = -0.00137, 15-day CAR was =0.13402, the 25-day CAR =0.12324, and the 100-day CAR was = 0.04268.

Hypotheses

H0= the announcement of the M&A deals did not have a statistically significant impact on the returns.

Ha= the announcement of the M&A deals had a statistically significant impact on the returns

To test the above hypotheses, t test statistics were used, and the decision rule is as follows;

If the t statistic (calculated) >1.96, or < -1.96, then it is concluded that there is statistical significance and thus, the alternate hypothesis is supported.

T statistics is calculated as ARt/ δ , where the δ = 0.050297752

T statistics at time =-100 = 0.000471409/ 0.050297752= 0.009372367

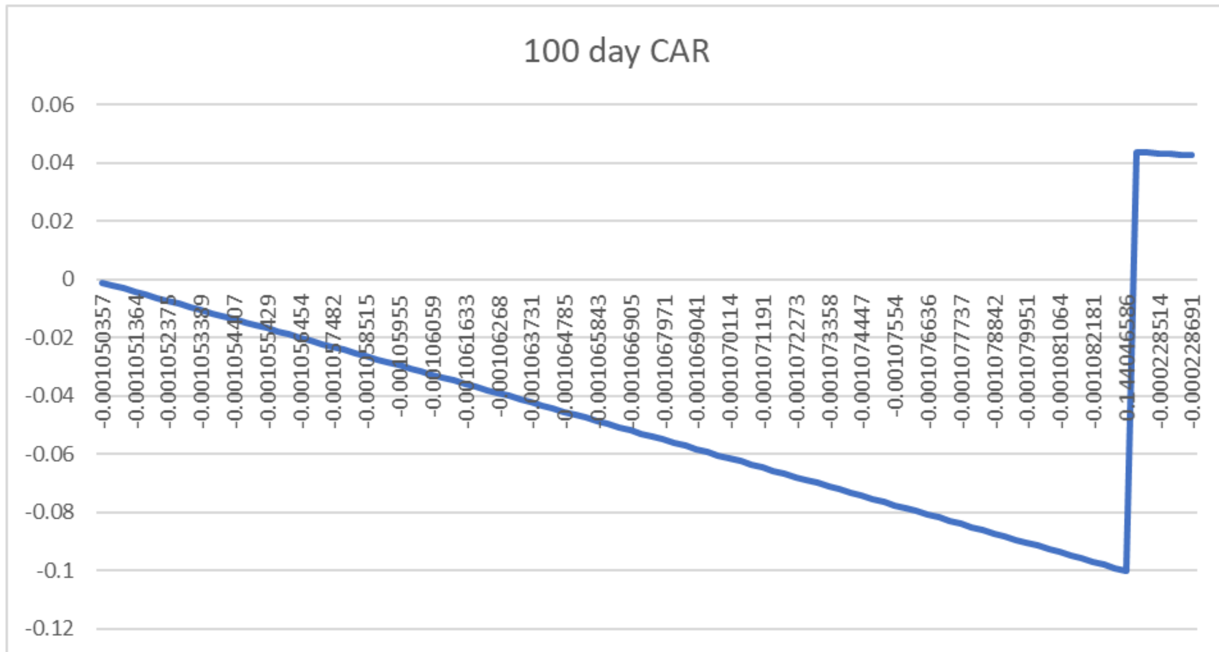
T statistics at time =-25 = 0.000471409/ 0.050297752=0.009372

T statistics at time = -15 = 0.000471409/ 0.050297752=0.00937

T statistics at time = -5 = 0.000471409/ 0.050297752=0.009372

According to the decision rule, the null hypothesis is supported, and the conclusion made is that the announcement of the M&A deals did not have a statistically significant impact on the returns.

Plotting the graph of cumulative abnormal returns against abnormal returns, we have the following graph, and the graph shows an overall negative relationship between these two variables.



CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings of the study, provides the conclusions, and the limitations of the study. It sums up the answers provided to the research question, and based on the findings, makes recommendations for future research.

5.2 Summary of findings

It is often assumed that merging of different companies would enhance their financial performance, profits and their market competence, and perhaps, this is the reasoning behind the upsurge of M&A deals in many parts of the world. In some cases, mergers positively impacted the success of companies in M&A dealing, confirming the opinion that companies flourish by merging than by operating on their own. There is just as much literature on the contrary as has been seen in previous research. The current study established that M&As do not significantly improve the returns and the value of the company outside the sum of the individual values of the companies.

Some previous research such as Akenga and Olang (2017) and Momodou and Masazing (2017) among others suggested why M&As might not be as effective in creating value as anticipated by focusing on the downsides such as the impact on employees. If not well prepared, employees are likely to experience shocks associated with change in culture, and become less productive, absent in their line of duty and in some cases, staff turnovers. Employees may cause the acquisition to fail at the integration stage as a result of poor strategic planning, miscommunications and differences in company values. Companies' cultures vary and that makes each unique in their operations, therefore, good cultural values are essential to the success

of companies' because employees are motivated to perform well, which is essential to companies' success'.

Odhiambo (2013) explores the reasons why listed companies in the Nairobi Securities Exchange choose to participate in cross-border mergers and acquisitions. Cross-border mergers and acquisitions are important in foreign direct investments due to the foreign funds in the acquisitions with the aim of making exceptionally high returns and improving their operating and financial performance. Odhiambo (2013) found that cross-border mergers and acquisition may not necessarily benefit the shareholders and resident companies than the acquisition company which will benefit on a global level due to the value of stock prices increasing after the merger and acquisition. Factors determining merger and acquisition partners include; transfer and management of companies' resources, revenue and resource reconstitution, among others. The factors are dependent on the type of mergers or acquisitions companies choose from for their positive financial performance.

5.3 Conclusions

Evidence from previous research revealed that most M&As in the world fail, with the failure rate estimated at 50%. The number of M&A deals in Kenya and elsewhere, however, keep rising, and this is why the current study sought to understand how M&As impact firm value in the Kenyan context. Previous research also shows positive instantaneous impact of M&As and a negative medium-term impact. The current study establishes that the announcement of the M&A deals did not have a statistically significant impact on the returns among the M&A deals that were investigated in the Kenyan context.

Some of the proxies of M&A performance from previous research were share price, free cash flows, and profits, and a correlation analysis revealed that free cash flows has a significant

positive correlation with firm value of M&As, while profits showed a significant negative correlation with firm value of M&As, which is an indication that share prices are likely to increase with firm value, and that larger M&As are likely to be less profitable. These proxies were used to determine whether or not the announcement of the mergers significantly impacted the value of merging companies. Since the analysis finds no statistical significance in the event analysis in the short, medium and long term, it can be concluded that M&As are neither value creating nor destroying based on the sample investigated. In other words, M&As do not have significant effects on the value of the merging companies apart from their combined capitalization.

5.4 Limitations of the study

One of the major limitations of the current study was unavailability of data. The researcher had to deal with many instances of missing datapoints, partly because some of the companies in the NSE do not publish their data in the correct formats or do not publish their data at all. For some organizations, their data was not available publicly. The consequence of this was using a small sample size, particularly because the researcher's efforts to obtain data directly from the companies also failed.

Event analysis is a long and cumbersome process that involved lengthy calculations and computations, and as such, within the time and resources available for the researcher, it was only possible to do event analysis for one company.

5.5 Recommendations

The current study establishes that the announcement of the M&A deals did not have a statistically significant impact on the returns among the M&A deals, and as such, the study recommends that Kenyan companies should be more cautious in entering M&As deals, since

most of these are more likely not important as far as creating value is concerned. Based on the analysis, M&As are neither value creating nor destroying, which implies that, perhaps, Kenyan companies should use other strategies to create synergies. From the findings of this study, managers can now know the relationship between M&As and value, and as such, they have sufficient knowledge to determine whether or not to enter such deals.

The study recommends a careful consideration by the managers before entering any M&A deal. The Capital Markets Act should also take these findings into account when deciding the type of deals or transactions that are allowed to take place.

5.6 Suggestions for Future Research

Taking into account the massive limitations especially in terms of data access and availability, the current study recommends that future studies use larger samples that will enhance generalizability of the findings, and as such, have comprehensive and conclusive findings on whether or not M&As are value creating.

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APPENDIX

https://www.reuters.com/companies/KCB.NR/profile

Event analysis output

5-day CAR	15-day CAR	25-day CAR	100-day CAR
			-0.00105
			-0.0021
			-0.00315
			-0.0042
			-0.00525
			-0.00631
			-0.00736
			-0.00841
			-0.00946
			-0.01052
			-0.01157
			-0.01262
			-0.01368
			-0.01473
			-0.01579
			-0.01684
			-0.0179
			-0.01895
			-0.02001
			-0.02106
			-0.02212
			-0.02318
			-0.02424
			-0.02529

			-0.02635
			-0.02741
			-0.02847
			-0.02953
			-0.03059
			-0.03165
			-0.03271
			-0.03377
			-0.03483
			-0.03589
			-0.03695
			-0.03801
			-0.03908
			-0.04014
			-0.0412
			-0.04227
			-0.04333
			-0.04439
			-0.04546
			-0.04652
			-0.04759
			-0.04865
			-0.04972
			-0.05079
			-0.05185
			-0.05292
			-0.05399
			-0.05505
			-0.05612

			-0.05719
			-0.05826
			-0.05933
			-0.0604
			-0.06147
			-0.06254
			-0.06361
			-0.06468
			-0.06575
			-0.06682
			-0.06789
			-0.06897
			-0.07004
			-0.07111
			-0.07218
			-0.07326
			-0.07433
			-0.07541
			-0.07648
			-0.07756
			-0.07863
			-0.07971
		-0.00108	-0.08078
		-0.00215	-0.08186
		-0.00323	-0.08294
		-0.00431	-0.08402
		-0.00539	-0.08509
		-0.00647	-0.08617
		-0.00754	-0.08725

		-0.00862	-0.08833
		-0.0097	-0.08941
		-0.01078	-0.09049
	-0.00108	-0.01186	-0.09157
	-0.00216	-0.01294	-0.09265
	-0.00324	-0.01402	-0.09373
	-0.00432	-0.01511	-0.09481
	-0.00541	-0.01619	-0.09589
	-0.00649	-0.01727	-0.09697
	-0.00757	-0.01835	-0.09805
	-0.00865	-0.01944	-0.09914
	0.135394	0.124611	-0.10022
-0.00023	0.135165	0.124382	0.043826
-0.00046	0.134937	0.124154	0.043598
-0.00069	0.134708	0.123925	0.043369
-0.00091	0.13448	0.123697	0.043141
-0.00114	0.134251	0.123468	0.042912
-0.00137	***0.13402***	***0.12324***	***0.04268***