A SURVEY OF DUE DILIGENCE PRACTICES AMONG KENYAN FIRMS INVOLVED IN CORPORATE ACQUISITIONS, JANUARY, 2003 TO MARCH, 2009

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DECLARATION

This research project is my original work and has never been presented in another university or college for award of any degree or diploma or certificate

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

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DEDICATION

This work is dedicated to my parents, Nzuki. S. Mwania and Elizabeth. K. Nzuki, for their support and encouragement to me in all my endevours so far.

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ABSTRACT

This survey was carried out to determine the due diligence practices of Kenyan firms that have taken part in acquisitions. A self-administered questionnaire was sent to 40 firms sampled and follow-ups made by phone and email to ensure the maximum possible response rate. 15 firms responded, making the response rate 37.5%. Frequencies and percentages were mostly used to analyse the data as these were the most suitable for the type of information generated.

The following areas were considered during this study: Strategic due diligence, human resource due diligence, operational due diligence, financial due diligence, legal due diligence and IT due diligence. In each of these areas, the questions were tailored toward finding out the critical factors examined by the acquiring firms as they carried out due diligence as well as the crucial areas that were missed out.

Kenyan firms generally have good due diligence practices, especially in strategic due diligence. There are, however, areas that firms seem to have been glossing over and not examining fully during their due diligence. Two of these critical areas are human resource and IT where in some cases as few as 25% of the respondents said that they had examined these critical factors. Also, only 40% of the respondent firms had checked to ensure that cost-cutting measures undertaken by the target company in the period leading up to the acquisition were sustainable in the long run.

CHAPTER ONE: INTRODUCTION

1.1 Background

There are three main methods of strategy development in organizations. According to Johnson and Scholes (2002) these are internal development, joint ventures and strategic alliances, and mergers and acquisitions.

Internal development entails an organization developing its own competencies internally and using its own resources to grow. This process usually takes a long time and the organization may not be competitive when it finally rolls out the product. In other cases an organization may not have the capacity to develop and grow using its own internal resources (Johnson & Scholes,. 2002).

In strategic alliances, two or more organizations come together to share resources in order to achieve a common strategic intent. In this case, each organization retains its own identity and remains a separate entity from the rest but still contributes to the common objective. (Johnson & *Scholes, 2002).*

Mergers involve organizational growth and development through a 'marriage' in which two organizations join together to form a single, usually larger, organization. The merging companies take on a common identity and move in a common strategic direction as one organization (Johnson & Scholes, 2002).

In an acquisition, an organization develops by taking over another organization, usually through the purchase of a controlling stake. The acquiring firm gets additional organizational capacity that was beyond its reach before the acquisition (Johnson & Scholes, 2002). This study will focus on this form of organizational development.

1.1.1. Acquisition and Due Diligence: An Overview

An acquisition is simply the purchase of an organization. This may involve a total buy-out of 100% of the equity in that company, the purchase of a controlling stake in that company or the purchase of a stake large enough to warrant at least one seat on the Board of Directors of the acquired company.In this case, an organization identifies an acquisition target, usually another firm that has a competitive edge in the market segment of interest, enters into acquisition negotiations, carries out due diligence on the proposed acquisition target and, if agreeable, buys out the acquisition target (DePamphilis, 2008).

Due diligence is the process through which the acquiring company seeks to uncover and assess the risks and the opportunities of a proposed transaction (KPMG, 2009). A proper due diligence exercise should be able to verify the assets and liabilities of the acquisition target, identify and quantify the risks associated with the proposed acquisition, identify ways of mitigating the risks involved, identify the synergies likely to be realized by the acquisition and guide post-acquisition planning (Howson, 2003).

The information sought during due diligence generally concerns the following facets of the business: General corporate matters, Financial, accounting and taxes, Technology and intellectual property, Product / service offerings, Operations, Sales and marketing, Human resources and personnel, and Legal and regulatory matters (Shanberg, 2003).

1.2 Statement of the Problem

There is evidence that not all acquisitions end up achieving the strategic objectives for which they were undertaken. Henry (2002) showed in an analysis in *BusinessWeek* that 61% of acquisitions destroy shareholder wealth. He observed that a year after the acquisition, the losers' returns were 25% below those of their industry peers. 80% of firms in loss-making acquisition deals still showed negative returns after 24 months.

Moeller, Schlingemann and Stulz (2005) found that during the period between 1998 and 2001, acquiring-firm shareholders in the United States lost 12 cents for each dollar that their companies spent on acquisitions. On aggregate, these shareholders lost US$240 billion during that period. Without these acquisitions, the wealth of acquiring firm shareholders would have increased.

A key step in the acquisition process is carrying out of due diligence on the acquisition target. Flawed due diligence is a key contributor to failure in acquisitions. For an acquisition to be successful, the due diligence process must be very objective and judicious. However, in a survey carried out by Bain and Company on 250 international Mergers and Acquisitions (M&A) executives and published in the *Harvard Business Review* half the executives interviewed said that their due diligence processes had failed to uncover major problems affecting the deal. Another half found that their targets had been "dressed up" to make them appear more attractive to the acquirer. Two-thirds said they routinely overestimated the synergies expected to result from the acquisition. Only 30% of the executives interviewed said they were satisfied with the rigor of their due diligence processes. A third of these executives admitted not walking away from deals they had nagging doubts about it (Cullinan, Le Roux and Weddigen, 2004). With this revelation, it is not surprising that as shown in the research cited earlier, most acquisitions end up destroying shareholder wealth.

Another study by Haunschild, Davis-Blake and Fichman (2004) showed that managers tend to over-commit in the corporate acquisition process. Managerial over-commitment can manifest itself in flawed due diligence in which managers fail to identify or-simply ignore-alarming information that comes up during due diligence.

In view of the above information and with the current wave of acquisition deals by local companies, a very important question comes up: Just how judicious are Kenyan companies in carrying out due diligence during the corporate acquisition process? This study sought to survey due diligence practices carried out by some Kenyan companies that have taken part in acquisitions.

1.3 Research Objective

This study sought to determine the due diligence practices commonly used by Kenyan companies during the corporate acquisition process

1.4 Importance of the Study

In academia, this study will contribute to the general body of knowledge in strategic management. More specifically, it will shed some more light into an area that has not been studied a lot in Kenya – due diligence in the corporate acquisition process.

In industry, this study will establish the common due diligence practices used in Kenya. In this way, it will highlight areas in which due diligence practices in Kenya are at par with those recommended in management literature and expose areas in which Kenyan managers may be deviating from recommended due diligence practices. This will enable managers involved in the corporate acquisition process to see areas where they can improve in their due diligence practices so as to minimize the risk involved in corporate acquisitions.

CHAPTER TWO: LITERATURE REVIEW

2.1 Factors Driving Kenyan Companies to Acquisitions

With increasing competition, more Kenyan companies are opting for acquisitive growth as an approach to achieving their strategic objectives. Studies carried out to determine the factors leading firms to take part in acquisitions have grouped both mergers and acquisitions and have not dwelt exclusively on acquisitions. Muya (2006) identified the three main reasons that drive Kenyan companies to seek mergers and acquisitions as the desire to increase market share, the need to diversify and the aspiration to enter new geographical areas respectively. In a survey on the factors considered important by Kenyan companies undertaking mergers and acquisitions, Mukui (2003) established that the three most important factors were the ability of the merger or acquisition to lead to increased growth and revenues, to result in consolidation and be more competitive, and to achieve perfect fit/synergy respectively.

2.2 Some Key Reasons for Failures in Acquisitions

Market reactions to news of an impending acquisition are normally positive for the acquisition target, resulting in an increase in the target's stock price. This is because bidders pay high premiums for the stock of the acquisition target. As a result, acquisitions almost always result in increased wealth for the shareholders of the acquired company (Ali-Yrkko, 2002).

As noted earlier, there is strong evidence that most acquisitions end up dissipating shareholder value (Moeller et al., 2005). Henry (2002) showed that one of the reasons for this high rate of failure is the phenomenon that economists call "the winner's curse." The winner's curse refers to a phenomenon in which the acquiring firm pays too much for the target company's shares and the premium paid ultimately wipes out any gains made from the acquisition. The same paper also notes that CEOs offered on average 36% more than the market price of stocks on the stock exchange during acquisitions. This may explain why, as mentioned earlier, Ali-Yrkko (2002) found that acquisitions almost always result in increased wealth for shareholders of the acquired firm. Hence, only exceptional performance would mitigate this hefty pay-out and make the acquisition worthwhile. However, it is not always possible to achieve such exceptional performance as according to Henry (2002) majority (61%) of acquisitions end up destroying shareholder wealth. Paying too much for an acquisition is often as a result of flawed due diligence (Cullinan et al., 2004).

2.3 Failure to Carry Out Proper Due Diligence

Cullinan et al. (2004) point out that once management set their sights on an acquisition target, the momentum of the transaction becomes hard to resist even when there are flaws in the deal. With their eyes firmly on the prize, these managers relegate due diligence to a simple exercise of "verifying the target's financial statements rather than conducting a fair analysis of the deal's strategic logic and the acquirer's ability to realize value from it." Successful acquirers are generally willing to walk away from the target if serious flaws are uncovered while carrying out due diligence or when the management of the target company becomes uncooperative in due diligence.

Many acquisition failures are as a result of failures in due diligence. Perry and Herd (2004) noted that the problem is not that that companies fail to carry out acquisition targets, but that they fail to do it well and this ultimately leads to failure of the acquisition. Haunschild et al. (2004)

showed that managerial over commitment does at times make managers ignore alarming information during due diligence, thus resulting in a flawed due diligence process.

Lovallo, Viguerie, Uhlaner and Horn (2007) noted that there are assumptions and inherent biases in managers that can damage a merger or acquisition deal because these biases lead to flawed due diligence. During the preliminary due diligence phase, several critical biases that managers need to beware of are identified. The first is the confirmation bias, where managers overwhelmingly tend to seek information that confirms their initial hypothesis on various aspects of the deal. The second is overconfidence, which causes managers to overestimate the revenue synergies that will accrue from the deal and underestimate the resultant cost synergies. Another assumption is that employees of the target company will fit well into the organizational culture of the acquiring firm. This assumption leads to underestimation of cultural differences between the acquiring firm and the target company and results in flawed cultural due diligence by human resource managers in the acquiring company. The fourth is the planning fallacy in which managers tend to underestimate the time, money and other resources needed to successfully complete post-acquisition integration.

Aiello and Watkins (2000) pointed out that flawed due diligence wipes off more value of acquiring firms' market capitalizations than lapses in any other part of the acquisition process. They also noted that one of the biggest mistakes that senior managers make is to glaze over at the acquisition prospect then leave the world of mundane fact-checking to business development staff, line managers, accountants, lawyers, and bankers. Indeed, according Doelback (2003) more American firms are now hiring experienced people and thus developing in-house expertise on due diligence instead of hiring advisors from Wall Street investment banks. Successful acquirers such as General Electric, PepsiCo and Johnson & Johnson have a long history of handling their own deals. It will therefore be critical in this study to find out among Kenyan companies who actually drives the due diligence process once an acquisition target is identified - is it the acquirer or is the due diligence left to external "experts" who then come back with findings that are only rubberstamped by the acquirer's management?

2.4 Due Diligence Best Practices

Due diligence in an acquisition transaction touches on each facet of the business. Due diligence can broadly be broken into legal, financial, operational, human resource, IT and strategic due diligence. Each of these areas will now be considered in-depth.

2.4.1. Strategic Due Diligence

In an article published by the global management firm Booz & Co. in its journal *Strategy+business,* Adolph, Gillies, and Krings (2006) pointed out that even the best financial and legal due diligence practices fail to uncover the whole story for a merger or acquisition prospect and that these two forms of due diligence by themselves do not guarantee success. There is therefore a critical third component in due diligence and this article calls it "strategic due diligence."

Deloitte Research (2007), a subsidiary of Deloitte Touché Tohmatsu, expressed similar thoughts to those of Adolph et al. (2006) when advocating the importance of strategic due diligence. Deloitte Research points out that it is critical to determine the strategic justification for a deal before making an acquisition. In making the strategic justification, the acquirer looks not only at the potential synergies likely to emanate from the deal but the implications that long-term business conditions could have on the business. Deloitte Research further recommends the importance of 'stress-testing' the deal against multiple scenarios. This means considering how the acquisition deal would stand up to possible external shifts that could fundamentally alter market-place dynamics. Ask "what if...?" then evaluate the implications of these various plausible scenarios on the acquisition. These scenarios should include a mixture of both positive and negative scenarios that are likely to occur in the environment.

In the same vein, Adolph et al. (2006) explain that strategic due diligence tests the strategic rationale behind the deal. In simple terms, strategic due diligence explores whether the acquisition deal being pursued–however enticing-is realistic. It thus acts as an important deal-screening filter. Strategic due diligence revolves around the following two key questions: "Is the deal commercially attractive?" and "Are we capable of realizing the targeted value?"

Adolph et al. (2006) further explain that in testing the commercial attractiveness of the deal, the company validates the target's financial projections as well as the synergies and competitive position of the combined entity against the backdrop of possible changes in the environment and resultant shifts in market dynamics. According to Deloitte Research (2007) these changes may include possible changes in political administration that may lead to shifts in policy and taxation, pressure from lobby groups and changes in antitrust/competition laws. Others may include expected harmonization of customs tariffs, reaction from competitors and new regulation from Government agencies.

2.4.2. Financial Due Diligence

Liu (2009) states that there is much disagreement about which elements of financial due diligence should receive the most attention. However, as mentioned earlier, Cullinan et al. (2004) pointed out that half the executives they interviewed said that they found that the management of the acquisition target had been "dressed up" to look better for the deal. For this reason, effective financial due diligence is more than an exercise of just verifying financial statements. Four examples of how executives dress up their finances to look more attractive to potential acquirers are stuffing of distribution channels to inflate sales in financial statements, inflating expected returns from investments in new technologies and other capital investments, disguising the head count of cost centres by decentralizing functions in order to hide the real cost and treating recurring items as extraordinary costs in order to get them off the Profit and Loss statement.

Liu (2009) states that in undertaking a financial due diligence, the acquiring firm must beware of what he calls "financial black holes." Financial black holes are operational arrangements or financial operations that give rise to risks and hidden liabilities. Although there are financial reporting rules and standards, the acquiring firm has to consider hidden liabilities that fall beyond what is covered in financial statements. One set of financial black holes is under-accruals. These are underestimated liabilities that may not be easily figured out such as product warranty obligations and under-funded pension commitments. The other set of financial black holes is off-balance liabilities. These include binding commitments, guarantees to accommodate possible losses by third parties and exposure to law suits. Financial black holes are useful in adjusting the price of the acquisition, planning post-acquisition integration and determining whether or not to proceed with the deal, especially if the black holes are due to dishonesty on the part of the target's managers.

2.4.3. Legal Due Diligence

Unkovic (2009) states that, apart from uncovering hidden risks, legal due diligence can streamline the negotiation process, provide potential acquirers leverage in negotiations and help them to prepare for the integration and management of the target. The most obvious benefit of legal due diligence is the identification of legal issues surrounding the target. These legal issues include exposure to litigation, contractual agreements, intellectual property rights ownership and/or violations, trademark rights and compliance with regulatory requirements among others. However, for the legal due diligence process to be effective, the legal team (whether contracted or directly employed by the acquirer) must understand the acquirer's business and the overall objectives of the acquisition so as to be in the best position to manage the legal due diligence process. Therefore, even when engaging professional legal firms as consultants to carry out due diligence, it is not enough to say, "We want to buy company X, please carry out legal due diligence and give us a report" but it is better practice to let the legal firm know the exact reasons behind the intended acquisition and the areas which they should give prime focus during due diligence. Their legal due diligence should, however, go beyond these prime focus areas.

Lajoux (2007) points out that an important part of legal due diligence is to review all liability insurance held by the target firm and, if there are any pending or threatened litigation cases, to determine which ones are covered by insurance. Alertness to possible litigation by various stakeholders is also key. These include customers, employees, regulators, shareholders and suppliers. Customers may sue over contract disputes, debt collection and restraint of trade among others. Employees may sue over breach of employment contract, defamation, discrimination, wrongful dismissal, and pension, welfare or other benefits. Regulators may initiate antitrust, environmental and occupational health and safety law suits. Shareholders may sue over executive compensation, contract disputes, insider trading, inadequate disclosure and contract disputes among other things. Suppliers may sue over contract disputes, deceptive trade practices, copyright/patent infringement and business interference among other issues.

2.4.4. Human Resource Due Diligence

Henry (2008) observes that before embarking on a full Human Resource (HR) due diligence, the HR team needs to understand the mechanics of the proposed acquisition and the rationale behind it. The main objective of HR due diligence is to identify key employees within the target company and come up with strategies and timelines for their retention.

In analyzing the capability of the management of the combined post-acquisition entity to realize the target value, Adolph et al. (2006) state that the acquirer is basically turning the spotlight on itself to see whether it has the resources required to deliver projected synergies. A failure to allocate the correct resources, financial or otherwise, or a lack of the necessary resources altogether may spell doom for the post-acquisition entity.

Shields (2000) argues that Human Resource (HR) due diligence during mergers and acquisitions should focus on the following four principle areas: HR policies and procedures, employee compensation, employee records and benefit analysis. A review of the target's HR policies and procedures should revolve around employee relations, dispute resolution, hiring practices, termination practices and use of consultants. HR due diligence should be done hand-in-hand with the finance and legal due diligence teams. It is important to look beyond titles and ask yourself how you would classify and pay these employees within your own organization. This is particularly important in private organizations as some people may have senior titles for which they are unqualified. A review of employment records entails going through HR, medical and immigration files as well as payroll records and any other records that would be useful. Employee benefits include all the benefits that employees get that are included in their employment contracts as well as those that are not.

2.4.5. Operational Due Diligence

Sarlitto and Roman (2006) define operational due diligence as the methodical process of investigating and evaluating the operational details related to a potential investment or business initiative in every functional area of the business. Operational due diligence reveals key interrelationships, disconnects and synergies between operations-based functions. For instance, if a company is seeking to acquire a single company belonging to a Group of companies, due diligence may reveal that lower operational costs in some functional areas of the business may be resulting from centralization of some aspects of these functions within the main holding company as it consolidates some functions to cut costs across the Group. As a result, the acquirer has to factor in increased costs when the target company becomes a full stand-alone business unit. They recommend that operational due diligence be carried out in three steps. The first is to gather critical operational-based intelligence using an integrated and repeatable process. The second step is to asses the business activities, processes and operations in a comprehensive manner. The final step is to align the due diligence activity and the availability of intelligence with the decision-making timeline and goals of the acquisition. By aligning operational due diligence with the decision-making timeline, the acquirer ensures that important information resulting from the first two steps of this process is used to negotiate the final sale price.

Gidwitz (2004) says that most acquirers do not understand the need for operational due diligence despite the fact that a well-executed operational due diligence exercise will almost always have a significant impact on the success or failure of an acquisition or a merger. Operational due diligence on a manufacturing facility, for instance, would include looking at the maintenance records of the manufacturing equipment, the percentage of orders that are executed on time and if not, why, quality control procedures, environmental self-audits, credit-control procedures and possibilities of merging some operations post-acquisition.

Rothenbucher and Niewiem (2008) point out that operational due diligence helps an acquirer to understand where value lies within the target company and to uncover hidden issues that might disrupt growth. They point out four areas that are an integral part of operational due diligence. These are: sales and marketing, procurement/purchasing, manufacturing and supply chain, and general services and administration. Operational due diligence should enable the acquirer to understand current operations and to identify hidden value such as growth and pricing opportunities, manufacturing network improvement and complexity reduction.

2.4.6. IT Due Diligence

Beckett (2006) says that IT due diligence entails carrying out a detailed investigation of the IT operations of a potential acquisition to verify exactly what the assets and liabilities are in terms of hardware, software, contractual obligations, processes, management and staff. This involves verifying the software licenses of the target company to ensure that the company has not been flouting copyright rules or intellectual property law. It also requires examining service level agreements and termination clauses in case of software purchases and outsourced IT functions. This paper points out an example of a company that acquired another only to discover that the software licence agreements in place could not be terminated without paying large penalties to the vendor.

McDonnell (2007) notes that in carrying out IT due diligence, the acquirer should ensure that the IT systems of both companies can be merged together successfully at reasonable cost after the acquisition. In carrying out IT due diligence, the acquirer seeks to establish, among other things whether the target's current IT infrastructure will be able to support future capacity requirements, whether the software is properly licensed, which IT staff members need to be retained for smooth operations to continue, what IT expenditure may be required to sustain the company's growth and whether technology resources of the two organizations can be shared to act as back-up systems for each other.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1. Research Design

This study used a survey design because in order to satisfy the research objective, it was necessary to compare the firms in the sample with respect to due diligence practices. The survey sought to find out from managers of companies involved in acquisitions in Kenya the general practices they followed when carrying out due diligence in the following areas: strategy, finance, legal, human resource, operations and IT.

3.2 Population of Study

Due to the small available pool of potential respondents available, judgmental sampling was used for this study. The population of this study was mainly be made up of companies that had submitted Merger Control Notification on intended acquisitions to the Commissioner for Monopolies and Prices between 1st January 2003 and 30th March 2009. A list of all the 101 companies that have submitted Notification to the Commissioner is attached as appendix. However, the law only requires that companies apply to the Commissioner when the companies involved produce substantially similar products. Hence, other companies not included in the list (because they do not produce substantially similar products) but that are known to have taken part in recent acquisitions were also surveyed.

Kenyan companies that have taken part in cross-border acquisitions are not included in the Merger Control Notification list as their acquisitions fall outside the jurisdiction of the Commissioner for Monopolies and Prices (which is the Republic of Kenya). These companies were also included in the survey. Firms that are local subsidiaries of multinationals and for which the acquisition was negotiated outside the country were omitted from the sample as it is unlikely that the people who negotiated the acquisition are in the Kenyan operation (these are global acquisitions involving multinationals as was the case for the global acquisition of Wyeth by Pfizer). Finally, firms involved in both mergers and acquisitions apply for approval to the Commissioner. For the purpose of this study, only firms involved in acquisitions were considered.

Upon judgmental sampling, a sample of 40 companies was selected to serve as respondents. A list of the companies surveyed is attached as appendix.

3.3. Data Collection

The data collection method used was a structured self-administered questionnaire comprising both open-ended and close ended questions. Efforts were also be made to conduct face-to-face interviews, particularly when some of the information in the returned questionnaire was not clear. The questionnaire sought to survey due diligence practices and was consequently split into the following seven areas: general information, strategic due diligence, financial due diligence, legal due diligence, human resource due diligence, operational due diligence and IT due diligence. The questionnaires were sent by courier along with self-addressed envelops bearing a return address for filled questionnaires. Follow-up calls were made to all recipients of these questionnaires to request them to participate in the survey. The questionnaire that was used is attached as appendix.

3.4. Data Analysis

The data collected was coded to allow for easy entry into a Microsoft Excel worksheet. For each section of the questionnaire, the questions were numbered as they are but each response was assigned a code between 1 and 5 depending on the number of options available in that question. This was meant to enable better analysis as data on each area of due diligence covered (legal, financial, operation, human, IT and strategic due diligence) was to be analysed independently of the other areas. Descriptive analysis and frequency analysis of the data were done using the Analysis Tool Pack in Microsoft Excel. Only the relevant statistical parameters were, however, extracted from this software for analysis.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1. Introduction

The purpose of this study was to survey due diligence practices among Kenyan firms that have taken part in corporate acquisitions. Self-administered questionnaires were sent by courier to 40 firms and follow-ups were made by phone and personal visits to ensure the maximum-possible response rate. Responses were received from 15 firms (constituting a 37.5% response rate) and these were analysed during the research.

4.2. Profile of Respondent Organizations

The following is a summary of the survey respondents by Industry:

Table 1: Distribution of Respondents by Industry

Industry	Frequency	Percentage
Advertising	1	6.67%
Banking	2	13.33%
Energy	3	20.00%
Financial Services	1	6.67%
Horticulture	2	13.33%
Manufacturing	3	20.00%
Media	1	6.67%
Pharmaceuticals	1	6.67%
Telecommunications	1	6.67%
TOTAL	**15**	**100.00%**

Two thirds (or 66.67%) of the respondents operate in the banking, energy, horticulture and manufacturing industries. The remaining five Industries represented in the survey (advertising, financial services, pharmaceuticals and telecommunications) had one respondent each, forming only one third (33.33%) of the survey respondents.

Table 2 shows the distribution of the size of acquisitions carried out by the respondents:

Table 2: Distribution of Respondents by Size of the Acquisition

Size of the acquisition	Frequency	Percentage
Not revealed	3	20.00%
Less than KSh. 50 million	0	0.00%
Between KSh. 50 million and 100 million	4	26.67%
Between KSh. 100 million and 500 million	3	20.00%
Between KSh. 500 million and 1 billion	1	6.67%
Over KSh. 1 billion	4	26.67%
TOTAL	**15**	**100.00%**

Only 20.00% of the respondents failed to reveal the size of the acquisition they had taken part in. 53.34% of the respondents had been undertaken acquisitions involving over KSh. 100 million.

The survey also sought to find out the perception of the respondents on whether the quality of due diligence carried out can determine the success or failure of the acquisition. Table 3 summarises these results.

Table 3: Perceived Quality of Due Diligence as A Determinant of Success or Failure of the Acquisition

Perception	Frequency	Percentage
Strongly disagree	1	6.67%
Disagree	0	0.00%
Neither disagree nor agree	0	0.00%
Agree	1	6.67%
Strongly agree	13	86.67%
TOTAL	**15**	**100.00%**

An overwhelming majority (93.34%) of the respondents either agreed or strongly agreed that the quality of due diligence carried out on an acquisition target can determine the eventual success or failure of the acquisition. These results show that Kenyan firms understand the importance of due diligence as one of the key determinants of the success of an acquisition.

4.3. Due Diligence Practices Carried Out By Kenyan Firms Taking Part in Acquisitions

A key part of the survey was to determine the perception of respondents on the best-placed persons to carry out due diligence, whether senior executives from within the company, external consultants/consulting firms, or other groups. A summary of these perceptions is presented in Table 4.

Table 4: Perception of Respondents on the Best-Suited Persons to Carry Out Due Diligence on the Acquisition Target

PERCEPTION	Frequency	Percentage
Senior executives from the acquiring company	6	40.00%
External consultants/consulting firms	6	40.00%
Other	3	20.00%
TOTAL	**15**	**100.00%**

From the table above, there is an equal split (at 40%) in the opinions of respondents on whether due diligence should be carried out by senior executives from the acquiring company or by external consultants. All of the respondents that chose "other" (20%) were of the opinion that due diligence should be carried out by a team comprising both external consultants and senior executives from the company. There is a danger in the perception that due diligence should be carried out by external consultants instead of either executives from within or a combined team comprising both executives from within and external consultants:

the due diligence process may become the "job" of experts with senior executives from the acquiring company only awaiting the experts' reports. The acquisition process needs to be owned by the acquiring company even when external consultants are called in.

The survey asked respondents whether they had "stress-tested" the future combined post-acquisition entity to determine how it was likely to be affected by various possible changes in the environment. Table 5 shows the factors that these firms considered:

Table 5: Factors Considered By Firms During Strategic Due Diligence

Factors considered by firms during strategic due diligence	Frequency				Percentage			
	Yes	No	Not sure	Total	Yes	No	Not sure	Total
Possible future changes in political administration / government policy	12	2	1	**15**	80.00%	13.33%	6.67%	**100%**
Possible future changes in tax regimes	10	4	1	**15**	66.67%	26.67%	6.67%	**100%**
Proposed harmonization of customs tariffs within EAC and/or COMESA	7	7	1	**15**	46.67%	46.67%	6.67%	**100%**
Possible reaction from competitors	13	1	1	**15**	86.67%	6.67%	6.67%	**100%**
Possible reaction from shareholders, trade unions, lobby groups and other stakeholders	13	1	1	**15**	86.67%	6.67%	6.67%	**100%**
Possible future changes in customer needs and expectations	15	0	0	**15**	100.00%	0.00%	0.00%	**100%**
Possibility of anti-trust/other lawsuits	11	2	2	**15**	73.33%	13.33%	13.33%	**100%**
Checked that the target had been allocating resources in line with strategic objectives	10	5	0	**15**	66.67%	33.33%	0.00%	**100%**
Acquirer had very clear Strategic justification for the acquisition	15	0	0	**15**	100.00%	0.00%	0.00%	**100%**

80% of the respondents considered possible future changes in political administration / government policy when conducting strategic due diligence. One of the two firms that did not consider this factor was involved in a cross-border acquisition and the target was therefore located outside Kenya. The period captured by the survey (2003 to March 2009) included the period immediately after the 2002 general elections in which a new political administration came in and the period after the 2007 general elections which were followed by uncertainty and violence. It is therefore not surprising that majority of acquiring firms considered possible future changes in political administration.

In the period between January 2003 and March 2009 (the survey period), the government also introduced a number of policies that affected many industries. During the period covered by the survey, new rules were introduced on the capitalization of commercial banks, the administration of retirement benefits schemes, occupational health and safety regulation, and regulation of industries like the media industry among others. These new regulations affected the banking, financial services, manufacturing, media and other industries from which the respondents came. With these changes taking place, it is reasonable that firms would consider possible future changes in government policy during strategic due diligence. Indeed, as evidenced during literature review, this is in line with recommended best practice during acquisitions.

Two thirds (66.67%) of the respondents considered possible future changes in tax regimes. Changes in tax regimes can affect industries adversely, hence the concern by respondents. However, not all industries feel the same impact on changes in taxes. Some industries may pass any increase in taxes to the consumer with ease while at the same time maintaining their operating margins. Other industries, however, may not be able to fully pass on the added taxes to their consumers, leading to depressed margins. This is the case in industries that have been plagued by counterfeits and those that have to compete against imported products. This difference in how diverse industries are affected by changes in taxation may explain why over a quarter (26.67%) of respondent firms did not consider possible future changes in tax regimes during their acquisitions. On the other hand, this may be an oversight by these firms if impending changes in tax regimes was likely to affect them.

Proposed harmonisation of customs tariffs across common regional markets was considered by 46.67% of the firms with an equal proportion saying that they did not consider this factor. This difference could be due to the fact that such harmonisation of tariffs directly affects firms competing with others within the region a lot than it does firms competing against local competitors.

The vast majority of firms (86.67%) considered possible reaction from competitors and other stakeholders to their acquisition. Reaction from these two quarters could include lawsuits and other negative actions that may affect the ability of the company to complete the acquisition. An example is BOC's attempted acquisition of Carbacid investments which has undergone a long delay after some stakeholders filed complaints with the Capital Markets Authority. However, it is a point of concern that 6.67% of firms did not consider this critical element of strategic due diligence. Unexpected reactions to the acquisition by competitors and/ore stakeholders can lead to failure of the acquisition.

All the firms that responded (100%) mentioned that they considered possible future changes in customer tastes and expectations before the acquisition. In this regard, managers of acquiring firms in Kenya are well at par with internationally-accepted best practice.

One third (33.33%) of the respondents did not check whether the target company had been allocating resources in line with its strategic objectives. This is a point of concern because the fact that a firm is allocating resources to achieve its strategic objectives shows that the management has confidence both in the company, the business and the future outlook for the company. It is, therefore, very important to confirm that the target firm has been allocating resources and working to achieve its strategic objectives. If sufficient resources have not been channelled toward the firm's strategic objectives, it is important that the acquiring company find out the reason why this has not been the case. It may well be that while the target company's management portray a picture of sound fundamentals for the business, they have lost confidence in it and are actually milking it. This knowledge enables the acquiring firm determine the whether to proceed with the acquisition and if so to offer the right price to avoid overpaying.

Four firms (26.67%) mentioned that there were other important factors that they examined during strategic due diligence which they felt were not adequately captured by the questionnaire. These factors were: the discovery of oil in Uganda, brand equity of the target company, laws governing the transaction and the ability to retain members of the senior management from the target company after the acquisition.

Another area of due diligence examined was financial due diligence. Firms were first asked how long they had examined financial statements of the target company. Table 6 shows the findings:

Table 6: Period Over Which the Target's Financial Statements Were Examined

Period over which the target's financial statements were examined	Frequency	Percentage
No response	2	13.33%
One to 2 years	0	0.00%
Three to five years	10	66.67%
More than five years	3	20.00%
Total	**15**	**100.00%**

The respondents who answered this question (86.67%) all indicated that they had examined the target company's financial statements for at least three years. This lengthy period of examination would enable the acquirer to pick up trends that may reveal any "dressing up" of the targets books of accounts in preparation for the acquisition.

The firms surveyed were also asked whether they had examined the target's books for possible "dressing-up" of the entity to make it more attractive for acquisition. Table 7 summarises the responses from the respondent firms in this regard.

Table 7: Factors Examined In the Acquisition Target's Books of Accounts to Rule Out "Dressing up" Of the Entity for Acquisition

Factors checked to rule out "dressing up" of books by the target in readiness for the acquisition	Frequency				Percentage			
	Yes	No	Not sure	Total	Yes	No	Not sure	Total
Under-accruals / under-estimation of liabilities	13	1	1	**15**	86.67%	6.67%	6.67%	**100.00%**
Undeclared off-balance liabilities e.g. guarantees	14	1	0	**15**	93.33%	6.67%	0.00%	**100.00%**
Some recurring expenses treated as extraordinary costs	9	3	3	**15**	60.00%	20.00%	20.00%	**100.00%**
Distribution channels being stuffed to inflate sales	11	1	3	**15**	73.33%	6.67%	20.00%	**100.00%**
Exaggeration of expected returns from investments in view of market conditions	13	1	1	**15**	86.67%	6.67%	6.67%	**100.00%**
Recent cost-cutting measures that could not be sustained in the long run	6	7	2	**15**	40.00%	46.67%	13.33%	**100.00%**
Exaggeration of exchange rate gains	8	5	2	**15**	53.33%	33.33%	13.33%	**100.00%**

86.67% of respondent firms said that they had examined the target's books for under-accruals / underestimation of liabilities. This is one common method used by target companies in acquisitions to mislead the potential acquirer on the target's financial obligations. That a high proposition of respondent firms examined this factor is a strong indication that they are aware that under-accruals / underestimation of liabilities can be used to conceal crucial financial information.

93.33% of the firms that responded also confirmed that they had checked the target for undeclared off-balance liabilities e.g. guarantees. Although these off-balance liabilities may not be captured in the books of accounts, they constitute legal obligations that can have great financial implications on the target company. The high affirmative response rate by respondent firms as having checked for these liabilities may be an indication that Kenyan managers involved in acquisition transactions are aware of the potential minefield that can be posed by these liabilities especially when they are hidden from the books of accounts only to be discovered after the acquisition.

Only 60% of firms confirmed that they had checked to confirm that recurring expenses had not been treated as extra-ordinary costs. 40% of the managers of the firms that responded said that their firms did not check for this factor or that they were not sure if it was checked. This is an area that more firms involved in mergers and acquisitions may need to check more carefully because treating recurring expenses as extra-ordinary costs during the accounting process may lead one to wrongly conclude that the target firm's anticipated recurring expenses are a lot lower than they actually turn out to be after the acquisition. The result of this would be lower profitability for the acquired entity than projected and the realisation that the price paid for the acquisition was too high relative the returns from that investment.

Almost three-quarters (73.33%) of firms surveyed confirmed that they had checked with customers to ensure that distribution channels had not been stuffed prior to the acquisition in order to inflate sales. Managers of firm that did not check for stuffing of distribution channels (6.67%) said that the firm had been involved in a joint venture involving the acquired firm before the acquisition (in which they bought the shares of their joint venture partner) and knew the acquired firm's sales operations even before the acquisition. The remaining 20% of respondent firms were not sure whether this factor had been checked prior to the acquisition.

86.67% of respondent firms checked to confirmed that the claimed expected returns from investments by the target company had not been exaggerated in view of market conditions. The firm that did not check this (6.67%) was the one mentioned above that bought shares from its joint-venture partner.

A bit worrying is the fact that only 40% of firms confirmed having checked to ensure that recent cost-cutting measures were sustainable in the long-run. A firm being targeted for acquisition may engage in restructuring and cost-cutting (e.g. through retrenchment of staff) in order to show improved cash flows and profitability in the short term. Upon acquisition, however, the acquirer may discover that the cost cutting and restructuring measures put in place are not sustainable in the long run if the firm is to operate optimally and that some of the costs cut before the acquisition need to be re-introduced for optimal efficiency. Without this knowledge, the firm may end up overestimating the profit synergies expected from the acquisition and grossly underestimating the future costs of the entity to be acquired. This would be a recipe for disaster.

Only 53.33% of firms confirmed that they had checked foreign exchange transactions to ensure that the gains off these transactions were not exaggerated by playing around with the exchange rates. This is a very important factor to consider particularly when the target company either makes purchases, sales or other transactions in foreign currency. This consideration is, however, irrelevant where the target company operates purely using local currency as was the case with at least three out of the five firms (60%) that confirmed not having checked this factor. Apart from the factors in the questionnaire, two of the respondent firms considered other important factors that they indicated. These are: an *examination of on-going client contracts* (1 firm), and evolution of working capital over the last 5 years and spread per business line (1 firm).

This survey also sought to find out whether the firms had a maximum "walk-away" price for the target before they started negotiations. Table 8 shows the responses

Table 8: Presence or Absence of a Maximum "Walk-Away" Price for the Target Before Starting Negotiations

Did you have a maximum "walk-away" price before you started the acquisition negotiations?	Frequency				Percentage			
	Yes	**No**	**Not sure**	**Total**	**Yes**	**No**	**Not sure**	**Total**
	12	2	1	15	80.00%	13.33%	6.67%	**100.00%**

80% of respondent firms confirmed having a maximum "walk-away" price before starting negotiations for the acquisition. As with any other purchase, it is important to have a budget informed by the perceived value of the target entity before starting negotiations for an acquisition in order to avoid overpaying. On the other hand, the acquiring firm should be willing to reconsider its bid as it comes across hitherto unknown information during due diligence.

Legal due diligence is another critical component of the due diligence process that was considered. The respondents were asked whether they had examined exposure that the company had to litigation and whether they had gone through all major legally-binding contracts that the target had with bankers, insurers, customers, employees, suppliers and other stakeholders before the acquisition deal was sealed. The responses are summarised in Table 9.

Table 9: Factors Considered During Legal Due Diligence

Legal due diligence	Frequency				Percentage			
	Yes	No	Done after acquisition	Total	Yes	No	Done after acquisition	Total
Exposure of company to litigation examined	13	2	0	**15**	86.67%	13.34%	0.00%	**100.00%**
Legally-binding contracts the target had with different parties examined	11	2	2	**15**	73.33%	13.33%	13.33%	**100.00%**

The two companies that did not examine exposure of the acquisition target to litigation (13.34%) were already in joint ventures involving the acquisition targets and it may therefore not have been necessary to consider this factor. Slightly over a quarter of the respondents (26.66%), however, said that they had not gone through all major legally-binding contracts between the acquirer and other parties before the acquisition. Finding out legally-binding information on the target after the acquisition is done may not be a remedy as any costs resulting from these agreements have to be met. It is therefore important to examine these contracts before, not after the acquisition is executed.

This study also surveyed human resource due diligence (sometimes simply known as human due diligence) by Kenyan firms taking part in acquisitions. In this section, the researcher sought to find out whether the human resource team working on the acquisition had been briefed on the strategic rationale behind the deal, whether key people in the target firm had been identified and strategies for their retention laid out before the acquisition, and whether the human resource team had advised on the cost of laying off any employees who might have had to be let go after the acquisition. Respondents were also asked whether they had determined the exact human resource capital needed to actualise the synergies expected from the acquisition before closing the deal and whether they had examined cultural differences between the two organizations and determined ways of minimising organizational culture shock for employees of the acquired firm. Table 10 summarises the responses.

Table 10: Factors Considered During Human Resource Due Diligence

Human resource (HR) due diligence	Frequency				Percentage			
	Yes	No	Done after acquisition	Total	Yes	No	Done after acquisition	Total
HR team briefed on the strategic rationale behind the acquisition	12	3	0	**15**	80.00%	20.00%	0.00%	**100.00%**
Key people in target company identified and strategies for their retention laid out before sealing the acquisition	11	3	1	**15**	73.33%	20.00%	6.67%	**100.00%**
Cost of laying off excess staff in any resultant staff rationalisation determined before closing the acquisition	8	5	2	**15**	53.33%	33.33%	13.33%	**100.00%**
Human resource team had advised on the resources needed to hire any additional employees needed to actualise synergies from the acquisition	7	5	3	**15**	46.67%	33.33%	20.00%	**100.00%**
Cultural differences identified and ways of minimising cultural shock devised before closing the acquisition	11	4	0	**15**	73.33%	26.67%	0.00%	**100.00%**

One fifth (20%) of the respondents answered that their human resource team had not been briefed on the strategic rationale behind the acquisition. The importance of briefing the acquirer's human resource team on the strategic rationale behind the deal cannot be over-emphasised. The human resource team is key in determining the employees who are needed for the synergies expected from the acquisition to be realised. The team cannot, however, effectively plan forward on the anticipated human resource requirements of the organization if they have not been briefed on the strategic rationale behind the acquisition.

More than a quarter of respondents (26.67%) of the respondents also admitted that their human resource teams had not identified the key people in the target company and planned strategies for their retention before the close of the acquisition deal. This leaves a worrying lacuna in which the acquirer may end up buying the target company but losing very key employees within the target company. Times of acquisition are periods of very great uncertainty for employees and without proper pre-planned retention strategies, many key employees may opt to leave.

Only slightly over half (53.33%) of the respondents said that their human resource teams had determined and advised on the cost of laying off any excess employees in any staff rationalisation program implemented following the acquisition. This means that if indeed there were lay-offs following the acquisition as is often the case, then almost half the companies (46.66%) that responded to the questionnaires sealed acquisition deals without a critical cost detail in most acquisitions. Although firms would only consider this factor when the acquisition deal is accompanied by lay-offs, staff rationalisation normally accompanies most acquisitions. The cost of staff lay-offs after an acquisition can be quite high depending on the employment contracts entered to by the target company with its employees. At times, the acquirer may have to negotiate the send-off package for excess employees with the staff trade union. If the lay-off exercise is not handled properly, the acquirer leaves himself open to industrial action and lawsuits, some of which may seek court orders to halt the acquisition. It is therefore critical that the human resource team have a clear picture of the cost of laying off any staff and the issues that might result and advise the acquirer's top management accordingly before the acquisition deal is closed. It should be kept in mind that the cost of lay-offs is part of the overall cost of acquisition.

More than a quarter (26.67%) of the respondents said that they had not examined cultural differences between the two organizations and ways of minimising these in the period following the acquisitions. Cultural differences may make some employees quit their jobs if steps are not taken to minimise the shock. The employees who are most likely to consider leaving are the ones with skills that are in demand by competitors as it is easier for them to find employment elsewhere. In three of the four firms (75%) that did not consider this factor, however, the acquired firm was let to continue as a stand-alone unit with essentially the same structures and workforce and the fourth firm bought a company with skeletal staff as the target was a distressed asset. The proportion of the companies that did not examine cultural differences (26.67%), if looked at only on the face of it, may be misleading.

With regard to operational due diligence, the survey sought to find out whether the acquirer had carried out systems audits on the target in the main operational areas (including sales &

marketing, procurement & supply chain, manufacturing, and general services and administration). Respondents were also asked whether they had determined which operational areas they could merge, dissolve or outsource in order to cut cost after taking over the target company. The summary of the responses is given in Table 11.

Table 11: Factors Considered During Operational Due Diligence

Factors considered during operational due diligence	Frequency				Percentage			
	Yes	No	Done after acquisition	Total	Yes	No	Done after acquisition	Total
Systems audits carried out in the main operational areas including sales & marketing, procurement & supply chain, manufacturing, general services and administration	9	3	3	**15**	60.00%	20.00%	20.00%	**100.00%**
Operational areas which could be merged, outsourced or dissolved in order to cut cost determined before the acquisition	10	3	2	**15**	66.67%	20.00%	13.33%	**100.00%**

40% of respondents did not perform systems audits on the target prior to the acquisition. Although half of these (20%) said they did so after the acquisition, details checked after the acquisition do not constitute due diligence because the purchase has already been made and even if unpleasant findings were to be made at this stage, it would not be possible to reverse the decision. Without carrying out systems audits, it would be almost impossible to determine the operational efficiency of the target company prior to acquisition. Correcting operational inefficiencies may be costly after the acquisition, hence the need to carry out systems audits before the acquisition.

Two thirds of he respondents (66.67%) had already determined operational areas that could be outsourced, merged or dissolved in order to cut cost by the time they sealed the acquisition. Determining these areas beforehand puts the acquirer in a better position to handle post-acquisition integration more efficiently while avoiding value leakages that may occur at this point. It also gives the acquirer valuable information on steps that can be taken to increase the profitability of the acquired organization.

The final area covered by the survey is IT due diligence. Respondents were asked whether they had checked the software being used by the target firm to confirm that it had been properly licensed, whether the IT systems being used by the target were compatible with their own or whether they needed replacement and if so, at what cost, and finally whether they knew the cost of terminating any running software licences before the acquisition was sealed. Table 12 presents a summary of the responses.

Table 12: Factors Considered During I.T. Due Diligence

Factors considered during IT due diligence	Frequency				Percentage			
	Yes	No	Done after acquisition	Total	Yes	No	Done after acquisition	Total
Checked that the software being used by the target company was properly licensed	7	6	2	**15**	46.67%	40.00%	13.33%	**100.00%**
Determined whether the IT systems in use by the target company were compatible with those of the acquiring entity or whether they needed to be replaced	7	4	4	**15**	46.67%	26.67%	26.67%	**100.00%**
Determined the legal and financial implications of terminating any running software licences	6	6	3	**15**	40.00%	40.00%	20.00%	**100.00%**
Determined the cost and time needed to replace any IT systems that needed replacement after the acquisition (either hardware or software	4	4	7	**15**	26.67%	26.67%	46.67%	**100.00%**

Less than half (46.67%) of the respondents confirmed that the software in use by the target company before the acquisition was properly licensed. This is a potential minefield. Any use of unlicensed software may lead to payment of huge fines and/or large sums as it is replaced with genuine software. Also, less than half of the respondents (46.67%) had determined whether the software in use by the acquisition target was compatible with theirs or it would need to be replaced after the acquisition. Any software replacements after the acquisition may be costly, hence the need to countercheck the compatibility of both sets of software before closing the acquisition.

Only 40% of respondents had examined the fine print of software contracts and determined the cost and legal implications of terminating these contracts. It can be very costly to suddenly terminate running software contracts after the acquisition and this cost needs to be determined before closing the acquisition. Otherwise the acquirer may end running unneeded software because it is very costly to terminate existing contracts.

Finally, only about a quarter (26.67%) of respondents admitted that they had ample information on how much time and money it would cost them to replace any software and hardware that needed replacement before they closed acquisition. The cost and time taken to replace unneeded software and hardware can be immense and this would definitely add up to the total cost of the acquisition. It is salient factors like these which at times lead to failure of acquisitions.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The objective of this study was to survey due diligence practices among Kenyan firms that have taken part in corporate acquisitions. Self-administered questionnaires were sent by courier to 40 firms and follow-ups were made by phone and personal visits to ensure the maximum-possible response rate. 15 firms responded, constituting a response rate of 37.5%. Frequencies and percentages were the principal method used because these were deemed most suitable to analyse the type of data that was produced. This chapter summarises the findings and conclusions drawn from the study. It also highlights the limitations of this study and gives some suggestions for further research.

5.2. Summary

15 firms operating in 9 different industries participated in the survey. The industries represented are advertising, banking, energy, financial services, horticulture, manufacturing, pharmaceuticals and telecommunications. 20% of the respondents declined to reveal the size of the acquisition they participated in, 26.67% said that the acquisition was between Ksh. 50 million to Ksh.100 million, 20% between 100million and 500 million, 6.67% between 500 million and 1 billion and 26.67% over KSh. 1 billion.

93.33% of the respondents either agreed or strongly agreed that the quality of due diligence carried out on a target company can determine the success or failure of an acquisition. There was an even split between the firms that opined that due diligence should be carried out by senior executives of the acquiring company and those who thought it should be carried out by external consultants (at 40% each). The remaining 20% said that it should be a combination of both.

All the respondents said that they examined possible future changes in customer expectations during strategic due diligence. Other factors considered were possible reactions from competitors and various stakeholders to news of the acquisition (86.67%), possible changes in government and political administration (80%), possibility of antitrust and other lawsuits (73.33%) and possible future changes in tax regimes (66.67%). The least important factor for consideration seems to have been proposed harmonisation of customs tariffs within EAC and/or COMESA, with only 46.67% of firms taking it into consideration. This is likely because most of the respondents do not export their products to these regions and their competitors are local (within Kenya).

Two thirds (66.67%) of the respondents said that they examined the target's financial statements for the past 3 to 5 years and another 20% for over 5 years. Two respondents (13.33%) declined to comment on the period of examination.

The factors considered by most firms during financial due diligence of the target's financial records are undeclared off-balance liabilities (93.33%), under-accruals and underestimation of liabilities (86.67%), exaggeration of expected returns from investments in view of market conditions (86.67%) and stuffing of distribution channels to inflate sales (60%). Only 40% of the respondents considered recent cost-cutting measures to see whether they would be sustainable in the long run. As mentioned earlier, this may be an area that more firms need to be careful about because the firm may be required to put in more resources into the target company to ensure optimum operation and this would be costly. 80% of the firms that responded to the questionnaire said that they had a maximum "walk-away" price before starting negotiations on the acquisition deal. This is important to avoid "overpaying" for the asset.

86.67% of the respondents examined the exposure that the target company had to litigation and 73.33% went through all major legally-binding contracts that the target company had prior to the acquisition. This is important to avoid possible lawsuits for breaches of contract or other legal violations.

While 73.33% of firms said that they had identified the key people within the target organization and laid out strategies for their retention prior to closing the acquisition, only 53.33% of firms knew the exact cost of laying of any employees that would need to be let go during the resulting staff rationalisation programs carried out post-acquisition. Further, only 46.67% had been advised on the additional human resources that needed to be injected post-acquisition in order to actualise the synergies envisioned from the acquisition. This is an oversight that may lead to failure to realise the full potential of the acquisition as time due to delays in post-acquisition integration.

Two thirds (66.67%) of the respondents said that they had determined operational areas where costs could be cut by outsourcing, merging or dissolution before the acquisition. As mentioned earlier, failure to consider these factors can lead to value leakages during post-acquisition integration. From the results we got, less than half the respondents (46.67%) did some form of IT die diligence before the acquisition. Further, only 40% checked the legal and financial implications of terminating any running software contracts and only about a quarter of respondents (26.67%) had determined the cost of replacing any hardware and/or software that needed replacement before sealing the acquisition deal. From the above statistics, IT due diligence seems to be one area that acquiring firms in Kenya seem to be glossing over, yet as mentioned earlier, this can have significant financial repercussions.

5.3. Conclusion

Overall, the respondents understood the importance of well-executed due diligence. While they had very clear grasp of the strategic rationale behind the deal and the importance of checking salient aspects in financial statements, acquiring firms in Kenya still need to practice better due diligence practices to ensure that they capture vital information regarding human resources and IT infrastructure before the closing the acquisition deal. In most of the other areas, however, the due diligence practices of most respondent firms took into consideration vital elements in line with best-practice outlined in various literature as discussed in the literature review section.

5.4. Suggestions for Further Research

A lot still needs to be done in research in the area of corporate acquisitions. This study dwelt only on due diligence. Other suggested areas for further study are:

1. It would be interesting to see the results of a study on the success rate of acquisitions in Kenya
2. This study only touched on the key areas of due diligence: strategic, human resource, IT, legal, operational and financial. Each of these areas can be studied in a lot more depth by researchers in each of these fields

3. A study on post-acquisition integration and what Kenyan companies do to avoid value leakages in this phase of the acquisition process would come up with useful, likely hitherto unknown, information

5.5. Limitations of the Study

Due to the confidential nature of the information sought during the study, only 15 out of the 40 firms surveyed (37.5%) responded. It is therefore not be possible to draw very accurate conclusions pertaining to all the acquisitions that took place in Kenya during the survey period. Although the questionnaires were sent to Chief Executives in the organizations surveyed, those that responded had this task delegated to middle-level managers who may not have had all the information sought thus leaving some questions blank. Finally, each acquisition is unique in that it has a specific strategic goal and is executed differently. Thus, while the conclusions drawn are general, they may not be applicable to each acquisition transaction in this study. Getting specific information for each acquisition would be very time-consuming and one is unlikely to get a lot more detailed information due to concerns on confidentiality of the information.

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APPENDIX

QUESTIONNAIRE

SECTION 1: GENERAL INFORMATION

1 Our company operates in the ___________________________ sector of the economy (optional)

2 The size our our acquisition was: (optional)

a. Less than Ksh. 50million ☐
b. Between Ksh. 50million and 100million ☐
c. Between Ksh. 100million and 500million ☐
d. Between Ksh. 500million and 1billion ☐
e. Over KSh. 1 billion ☐

3 The quality of due diligence carried out on the acquisition target can determine the success or failure of an acquisition

a. Strongly disagree ☐
b. Disagree ☐
c. Neither disagree nor agree ☐
d. Agree ☐
e. Strongly agree ☐

4 The best people to carry out due diligence on a company that we want to acquire would be

a. Senior executives from our company ☐
b. External consultants/consulting firms ☐
c. Other (Pls specify) ____

SECTION 2: STRATEGIC DUE DILIGENCE

5 Before our acquisition, we "stress-tested" the future combined entity by considering how it was likely to be affected by the following possible changes in the environment and resulting shifts in market-place dynamics:

a. Possible future changes in political administration/government policy

Yes ☐ No ☐ Not sure ☐

b. Possible changes in tax regimes

Yes ☐ No ☐ Not sure ☐

c. Proposed harmonization of customs tarrifs within EAC and/or COMESA

Yes ☐ No ☐ Not sure ☐

d. Possible reaction from competitors

Yes ☐ No ☐ Not sure ☐

e. Possible reaction from shareholders, trade unions, lobby groups and other stakeholders

Yes ☐ No ☐ Not sure ☐

f. Possible future changes in customer needs and expectations

Yes ☐ No ☐ Not sure ☐

g. Possibility of anti-trust/other lawsuits

Yes ☐ No ☐ Not sure ☐

h. Other factors considered (Please specify) ______________________________

____

6 Before the acquisition, we evaluated the target company's strategic plan and confirmed that the company had consistently been allocating resources to achieve this plan

Yes ☐ No ☐ Not sure ☐

7 We had a very clear strategic justification for the acquisition before we started negotiations

Yes ☐ No ☐ Not sure ☐

SECTION 3: FINANCIAL DUE DILIGENCE

8 Before the acquisition, we examined the target's financial statements over the past

a. One to two years ☐

b. Three to five years ☐

c. More than five years ☐

9 We carefully checked the following to confirm that the target company had not "dressed up" its books to appear more attractive for acquisition:

a. Under-accruals / under-estimation of liabilities

Yes ☐ No ☐ Not sure ☐

b. Undeclared off-balance liabilities e.g. guarantees

Yes ☐ No ☐ Not sure ☐

c. Some recurring expenses treated as extraordinary costs

Yes ☐ No ☐ Not sure ☐

d. Distribution channels being stuffed to inflate sales

Yes ☐ No ☐ Not sure ☐

e. Exaggaration of expected returns from investments in view of market conditions

Yes ☐ No ☐ Not sure ☐

f. Recent cost-cutting measures that could not be sustained in the long run

Yes ☐ No ☐ Not sure ☐

g. Exaggeration of exchange rate gains

Yes ☐ No ☐ Not sure ☐

h. Other factors considered (Please specify) ______________________________

____

10 Before we started negotiations we had a maximum "walk-away" price beyond which we could not pay for the acquisition

Yes ☐ No ☐ Not sure ☐

SECTION 4: LEGAL DUE DILIGENCE

11 Before the acquisition we examined (either directly or through a contracted law firm) exposure that the target company had to litigation

Yes ☐ No☐ Done after acquisition ☐

12 We went through all major legally-binding agreements that the target company had with bankers, insurers, customers, employees, suppliers and other stakeholders to determine the implications of each agreement before we sealed the acquisition

Yes ☐ No☐ Done after acquisition ☐

SECTION 5: HUMAN DUE DILIGENCE

13 The human resource team working on the acquisition was fully aware of the strategic rationale behind the deal

Yes ☐ No☐ Not sure ☐

14 Before we sealed the acquisition, the human resource team had identified key people in the target company and devised strategies for their retention

Yes ☐ No☐ Done after acquisition ☐

15 Before we sealed the acquisition, the human resource team knew exactly how much it would cost us to lay off any excess employees in staff rationalization during post-acquisition integration

Yes ☐ No☐ Done after acquisition ☐

16 Before we sealed the acquisition, the human resource team had determined and advised us on the resources needed to hire any additional employees needed to actualize the synergies expected from the acquisition

Yes ☐ No☐ Done after acquisition ☐

17 Before we sealed the acquisition, the human resource team had identified the cultural differences between the two organizations and advised on the best way of minimizing cultural shock for key employees of the acquisition target

Yes ☐ No☐ Done after acquisition ☐

SECTION 6: OPERATIONAL DUE DILIGENCE

18 Before the acquisition, we carried out operational systems audits of sales & marketing, procuremeny & supply chain, manufacturing, general services and administration and other operational areas within the target company

Yes ☐ No☐ Done after acquisition ☐

19 By the time we sealed the acquisition, we had already determined which operational areas we would merge, oursource or dissolve in order to cut cost

Yes ☐ No☐ Done after acquisition ☐

SECTION 7: I.T. DUE DILIGENCE

20 Prior to the acquisition, we confirmed that all software used by the target company was properly licensed

Yes ☐ No ☐ Done after acquisition ☐

21 Before closing the acquisition, we had determined whether the IT systems in use by the target company were compatible with ours and whether they needed to be replaced

Yes ☐ No ☐ Done after acquisition ☐

22 Before closing the acquisition, we had examined the fine print in the target company's software license contracts and determined the legal and financial implications of terminating these licenses

Yes ☐ No ☐ Done after acquisition ☐

23 Before closing the acquisition, we had ample information on how much time and money it would cost to replace any IT systems (both hardware and software) that needed replacement

Yes ☐ No ☐ Done after acquisition ☐

SECTION 8: OTHER RELEVANT INFORMATION

24 Kindly provide any other relevant information that you considered during the acquisition process which you consider relevant but has not been captured above

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____

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Thank you for your response. Asante sana

FIRMS SURVEYED DURING THE STUDY

npany Name	Acquired Firm
vn Berger (K) Ltd	Unibuilt Kenya Ltd
Africa Packaging Industries	Canadian Overseas Packaging Industries
obi Bottlers Ltd	Anspar Beverage Limited
Healthcare International Limited	Shelly's Pharmaceuticals Limited
ander Forbes Financial Services (EA) Ltd	Corporate & Pension Trust Services Ltd
verwings (K) Ltd	Ectoville Investments Limited
nscentury Ltd	Cable Holdings Ltd and Avery Kenya Ltd
Security Group	EARS Group,Radio Sentry Limited and Todor Security Services
negrown (K) Ltd	Kijabe Ltd
lisel Kenya Limited	Dawa Pharmaceuticals Ltd
nia International Ltd	Polysynthetics E. A. Limited
nmerical Bank of Africa	First American Bank
Outdoor Advertising	Monier 2000 Ltd
ya United Steel Co. Ltd	SRM Ltd
a Oil Kenya Ltd	Mobil Kenya Holdings
C Kenya Limited	attempted acquisition of Carbacid Investments
ya Shell Limited	BP
ngroup Limited	Redsky
er Brands Ltd	Haco Industries
es Finlay Limited	Homegrown (K) Limited
nbasa Salt Works Ltd	Krystalline Salt Ltd
per (K) Ltd	Bulk Medicals Limited
genta EA Ltd	Kenya Cuttings Ltd
bank Kenya Ltd	EABS Bank
freight Logistics Limited	Starfreight Logistics by PWC Logistics International
vel News (K) Ltd	East Africa Magazines Distribution Ltd
nbasa Maize Millers Ltd	Milly Grain Millers Ltd
nanchi Online Limited	Lion Cable Television Network
onal Oil Corporation of Kenya	Somken Petroleum Company Ltd
okside Dairy Ltd	Spin Knit Dairy Ltd
l (K) Ltd	Chevron (K) Ltd
Standard Group	Toads Media Group Ltd
ess Kenya Group	Sartori Soultions Ltd and Openview Business Systems Ltd
ricom Limited	One Communications Ltd
perative Bank of Kenya	Bob Mathews Stock Brokers Ltd
NIC BANK	Savings and Finance Commercial Bank - Tanzania
ity Bank Limited	Uganda Microfinance Limited
l Bank Limited	Bank one Limited, Mauritius
Insurance Co. Ltd	United Assurance
ndard Chartered Bank Kenya	First Africa Capital

COMPANIES THAT SUBMITTED MERGER CONTROL NOTIFICATION BETWEEN 1ST JANUARY 2003 AND 30TH MARCH 2009

	2003	
1	CROWN BERGER (K) LTD	UNIBUILT KENYA LTD
2	SC JOHNSON WAX	BAYER
3	BRAC BUDGET RENT A CAR INTERNATIONAL	AVIS EUROPE (PLC)
4	EAST AFRICA PACKAGING INDUSTRIES	CANADIAN OVERSEAS PACKAGING INDUSTRIES LTD
5	EUSTOMA (K) LTD	PENTA TANCOM LTD T/A PENTA FLOWERS
6	MANU SPICES & MILLERS LTD	SPICE WORLD LTD
7	ICL (K) LTD	SAMEER ICT LTD
8	RESORT (K) LTD	FAMILY TOWN 2002 LTD
9	NAIROBI BOTTLERS LTD	ANSPAR BEVERAGE LTD
10	BETA HEALTHCARE INTERNATIONAL	SHELLY'S PHARMACEUTICALS LTD
11	ALEXANDER FORBES FINANCIAL SERVICES (EA) LTD	CORPORATE & PENSION TRUST SERVICES LTD
12	FLOWER WINGS (K) LTD	ECTOVILLE INVESTMENTS LTD
13	PAN AFRICA GENERAL INSURANCE LTD	APOLLO INSURANCE COMPANY
14	KINGSHOLME LTD	HOMEGROWN (K) LTD
	2004	
1	GROUP 4 FALCK	SECURICOR PLC
2	TRANSCENTURY LTD	CABLE HOLDINGS LTD
3	BANK OF AFRICA (K) LTD	CREDIT AGRICOLE INDOSUEZ KENYA BRANCH
4	KK GUARDS SECURITY GROUP	EARS GROUP LTD
5	MTN INTERNATIONAL MAURITIUS LTD	KENYAN TELECOM B.V. KENCELL
6	KEMIA INTERNATIONAL LTD	POLYSYNTHETICS E. A. LTD
7	SAMEER TELECOM BV	KENYAN TELKOM B.V.
8	SHELL AND BP MALINDI	OILCOM
9	HOMEGROWN (K) LTD	KIJABE LTD
10	DAWA PHARMACEUTICALS LTD	MEDISEL (K) LTD
11	FRESH DEL MONTE PRODUCE INC.	DEL MONTE (K) LTD
12	COAST SILOS (K) LTD	KENYA PORTS AUTHORITY
13	AMERICAN LIFE INSURANCE CO.	CFC GROUP
14	COMMISSIONER	CERES ESTATES LTD (IN RECEIVERSHIP)
	2005	
1	TOWN AND COUNTRY SECURITIES	CBA CAPITAL LTD
2	LONRHO AFRICA PLC	KINGDOM KR-5-181 LTD
3	TRANSCENTURY LTD	AVERY KENYA LTD
4	FIRST AMERICAN BANK OF KENYA	COMMERCIAL BANK OF AFRICA
5	KAMOTHO & MAIYO ADVOCATES	MBAITA & CO ADVOCATES
6	MONIER 2000 LTD	A1 OUTDOOR (K) LTD
7	CLASSIC CAMPS & LODGES	HILTON INTERNATIONAL (K) LTD
8	HOLIDAY RESORT LTD T/A NEPTUNE BEACH HOTEL	SENTRUM (K) LTD AND NOVA HOTELS LTD

9	WANANCHI ONLINE LTD	ISP (K) LTD
10	KENYA PAPERMILL LTD	CHANDARIA INDUSTRIES LTD
11	KENYA UNITED STEEL CO	SRM LTD
12	AFRICAN LIFE ASSURANCE LTD	SANLAM LTD
13	PETROL OIL KENYA	SOMKEN PETROLEUM FILLING STATIONS
14	GIRO COMMERCIAL BANK LTD	STATE BANK OF INDIA
15	TOURISM PROMOTIONAL SERVICES	TPS EAST AFRICA
16	BOC (K) LTD	CARBACID INVESTMENTS
17	TATA CHEMICALS LTD	HOMEFIELD PVT (K) LTD
	2006	
1	MUCHUGU & ASSOCIATES	LAMBUI GATHUTHI & ASSOCIATES
2	SHELL PETROLEUM CO	BP AFRICA
3	RADIO SENTRY LTD	KENYA KAZI LTD
4	TODOR SECURITY SERVICES	KENYA KAZI SERVICES
5	EQUITORIAL BEACH PROPERTIES LTD (IN RECEIVERSHIP)	KENGA EQUITORIAL HOTELS LTD
6	KENYA PIPELINE COMPANY	ASSOCIATION OF KENYA INSURERS
7	PETRO OIL (K) LTD	TRITON PETROLEUM COMPANY LTD
8	HILLCREST INTERNATIONAL SCHOOLS	BARCLAYS BANK OF KENYA
9	EAST AFRICAN MALTINGS LTD	MALTEUROP SCA
10	TAMOIL AFRICA HOLDINGS LTD	MOBILE KENYA HOLDINGS
11	SOLVO CHEM	SHELL CHEMICALS
12	TATA STEEL	CORUS GROUP (IN UK)
	2007	
1	CFC BANK LIMITED	STANBIC BANK (K) LTD
2	KENYA CUTTINGS LTD	POLLEN LIMITED
3	REDSKY LTD	SCANGROUP LTD
4	JAMES FINLAY LTD	HOMEGROWN (K) LTD
5	MOMBASA SALT WORKS LTD	KRYSTALLINE SALT LTD
6	COOPER (K) LTD	BULK MEDICALS LTD
7	TODAY'S ONLINE LTD	COMMUNICATION SOLUTIONS LTD
8	AFSAT COMMUNICATIONS LTD	MWEB AFRICA LTD
9	KOBIL PETROLEUM LTD	KENYA OIL COMPANY LTD
10	RELIANCE INDUSTRIES MIDDLE EAST DMLL	GAPCO (K) LTD AND TRANSENERGY (K) LTD
11	PROPOSED SALE OF ARM SHARES	
12	NIC CAPITAL LTD	SOLID INVESTMENT SECURITIES LTD
13	ATMT (HOLDINGS) LTD & RICHARD WILLIAM BELL	MITSUMINET CABLE VISION LTD
14	ATMT (HOLDINGS) LTD & RICHARD WILLIAM BELL	SIMBANET COM LTD
15	CDC GROUP & HOUSING FINANCE	EQUITY BANK
16	PRIME CAPITAL & CREDIT LTD	PRIME BANK LTD
17	FIRST COMPUTERS LTD	COMPUTECH LTD
18	SWIFT GLOBAL (K) LTD	KENYA DATA NETWORKS LTD & ALLIED TECHNOLOGIES LTD

	2008	
1	PKF KENYA	BALU COMPANY
2	ECOBANK TRANSNATIONAL	EAST AFRICA BUILDING SOCIETY
3	STARFREIGHT LOGISTICS LTD	PWC LOGISTICS INTERNATIONAL
4	EAST AFRICA COURRIER LTD	ABLE LOGISTICS GROUP FZCO
5	EAST AFRICA MAGAZINES DISTRIBUTION LTD	TRAVEL NEWS (K) LTD
6	CROWN CREAMERIES LTD	GREENLAND DAIRY LTD (IN RECEIVERSHIP)
7	TRUNKING SYSTEMS LTD & WILIFE NETWORKS LTD	RICHARD WILLIAM BELL
8	CMAGM AGENCIES WORLDWIDE LTD	NEW CO
9	STEADMAN GROUP HOLDINGS LTD	SYNOVATE HOLDINGS LTD
10	MOMBASA MAIZE MILLERS LTD	MILLY GRAIN MILLERS LTD & MAIZEND MILLERS
11	WANANCHI ONLINE LTD	LION CABLE TELEVISION NETWORK
12	MICROENTERPRISE DEVELOPMENT SERVICES LTD	OPPORTUNITY INTERNATIONAL WEDCO LTD
13	SOMKEN PETROLEUM COMPANY LTD	NATIONAL OIL CORPORATION OF KENYA
14	FRESH DEL MONTE PRODUCE INC.	DEL MONTE (K) LTD
15	BROOKSIDE DAIRY LTD	SPIN KNIT DAIRY LTD
16	EAST AFRICAN BREWERIES	GUINNESS
17	SPECIALISED ENGINEERING COMPANY LTD	SPECIALISED ENGINEERING COMPANY (E.A.) LTD
18	TOTAL OUTRE MER	CHEVRON (K) LTD
19	STEFANO CHELI & ELIZABETH CHELI	ALITAKI SAFARIS LTD
20	TAMIMI LTD	GIRAFFE MANUR LTD
21	KENYA COMMERCIAL BANK LTD	SAVINGS & LOAN (K) LTD
	2009	
1	WAB HOTELS LTD	MR. JAMES KANIIYA
2	GITHONGO & COMPANY, GITHONGO & ASSOCIATES LTD, CITIZEN LTD	DCM ASSOCIATES, DCDM ADVISORY SERVICES & DCDM REGISTRARS
3	MWEB AFRICA LTD	TELKOM INTERNATIONAL (PROPRIETORY) LTD
4	TOADS MEDIA GROUP LTD	STANDARD GROUP LTD
5	ACCESS (K) LTD	SARTORI SOLUTIONS