# THE INFORMATION CONTENT OF MERGERS AND ACQUISITION ANNOUNCEMENT FOR LISTED COMPANIES AT NAIROBI SECURITIES EXCHANGE

**BY**

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# DECLARATION

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

**Signed………………………………………** **Date…………………………………**

**George G. Gitau - D61/63461/2011**

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

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# DEDICATION

This study is dedicated to my family for their certain moral support and to all the companies listed in the Nairobi Securities Exchange.

# ABSTRACT

Merger and Acquisitions of relatively large targets are more likely to achieve sizeable operating and financial synergies and economies of scale than small acquisitions, therefore leading to stronger post-acquisition operating performance. However, merger and acquisition failures are not uncommon. These failures may harm the companies, tarnish their credibility in the market, and ruin the confidence of their shareholders. The objective of the study was to examine the information content of mergers and acquisition announcement at NSE for the listed companies.

The study used descriptive research design. The population of this research consisted of all the companies that had undergone mergers and acquisition. Both stratified and purposive sampling techniques were used to design and select a representative sample size of five firms in financial and industrial sectors. In order to find out the impact of mergers and Acquisition on stock market researchers used the Standard Risk Adjusted Event study Methodology.

From the findings, information content of mergers and acquisition positively affect shareholders' wealth. Results indicated that generally, there was an increase in the volumes of shares traded when mergers and acquisitions were announced. This was especially so in the days around the mergers and acquisitions. On the mergers and acquisitions date, there were positive average returns which were significant at 0.05% level for the sampled companies. There was an increase in volumes of shares traded after the mergers and acquisitions as compared to those before the mergers and acquisitions. The study concluded that the abnormal returns around the declaration date of a mergers and acquisitions are explained by the information environment of the firm and that firms that mergers and acquisitions their stock tend to experience a reduced level of reversion in their earnings growth relative to a matched set of firms. Mergers and acquisitions provide a unique investment opportunity to shareholders and hence it is crucial to explore all possible methods to improve the overall performance of this investment. Other market conditions could have arisen, which had effects on the general activity of shares in the market and on the returns, hence the study recommends a need to make use of a market model.

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## ABBREVIATIONS

| | |
|---|---|
| AER- | Average excess return |
| ANOVA- | Analysis of Variance tests |
| CAER- | Cumulative average excess return |
| CEOs- | Chief Executive Officers |
| CIC- | Currency and Circulation |
| EBIT | Earnings Before Interest and Tax |
| EMT- | Efficiency Market Theory |
| EU- | European Union |
| FEM- | Foreign Exchange Market |
| GDP- | Gross Domestic Profits |
| IMM- | Inter-bank Money Market |
| M & A- | Mergers and Acquisition |
| NBK- | National Bank of Kenya |
| NSE- | Nairobi Securities Exchange |
| NOP- | Net Operating Profit |
| R & D- | Research and development |
| SPSS- | Statistical Package for Social Sciences |

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the study

Mergers can be defined as a combination of two or more organizations where all their assets and liabilities are combined to form one organization with a single name and legal entity. Merges thus are strategic alliances between two or more companies, where the partners in the alliance seek to add to their competencies by combining their resources with those of other firms with a commitment to reach an agreed goal (Brouthers et al., 2008). Acquisitions on the other hand occur when one company takes over another in terms of management or ownership. Acquisitions usually take place between big and small countries as well as between big manufacturing companies and small supplying ones, the main aim being guaranteeing the sources of supplying important inputs. Normally, the company being taken over consents to the takeover, however, hostile acquisitions do sometimes take place, where the bigger company takes over the smaller one without its consent (Jarrod, 2005).

Mergers and Acquisitions (M&A) in the broad sense, may imply a number of different transactions ranging from the purchase and sales of undertakings, concentration between undertakings, alliances, cooperation and joint ventures to the formation of companies, co-operate succession/ ensuring the independence of businesses, management of buy-out and buy-in, change in legal form, initial public offering and even restructuring (Picot, 2002). However, Nakamura (2005) explains that using a broad definition of M & A could lead to confusion and misunderstanding as it entails everything from pure mergers to strategic alliances.

Merger is the combination of two or more companies in a creation of a new entity or formation of a holding company (Gaughan, 2002; Jagersma, 2005). Acquisition is the purchase of shares or assets on another company to achieve a managerial influence (Chunlai et al., 2003), not necessarily by mutual agreement (Jagersma, 2005).

Many mergers and acquisitions involve privately-held companies or occur below the firm level (e.g., divisions of large, publicly-traded firms), which makes it virtually impossible to assess stock price or accounting profitability effects, except for transactions involving large, publicly-traded firms. Of course, these large deals constitute only a small percentage of overall merger and acquisition activity. Most transactions involve the sale of small, single-plant firms or the sale of a single plant or division by a larger firm (Siegel et al., 2005).

Mergers and acquisitions are aimed at improving profits and productivity of a company. Simultaneously, the objective is also to reduce expenses of the firm. However, mergers and acquisitions are not always successful. At times, the main goal for which the process has taken place loses focus. The success of mergers, acquisitions or takeovers is determined by a number of factors. Those mergers and acquisitions, which are resisted not only affects the entire work force in that organization but also harm the credibility of the company. In the process, in addition to deviating from the actual aim, psychological impacts are also many. Studies have suggested that mergers and acquisitions affect the senior executives, labor force and the shareholders.

### 1.1.1 Mergers and Acquisitions

Merger and acquisitions are widely used phrases that do not have exact definitions. For instance, Weston and Copeland (1992) describe a merger as a transaction between more or less equal partners, while acquisitions are used to denote a transaction where a substantially bigger firm takes over a small firm. Clearly, Weston and Copeland distinguish mergers and acquisitions on basis of firm size involving with the transaction. Datta and Pinches (1992) use another basis to describe the difference a merger and acquisition. They define a merger as a direct negotiation with the target firm's management and/or the board of directors and approved by them before going to a shareholder vote. On the other hand, acquisitions can take place in an unfriendly way, where the offer is made directly to the target firm shareholders.

According to Gaugham (2007), Depamphilis (2003), Scott (2003), a merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. In a merger, the acquiring company assumes the assets and liabilities of the merged company. An acquisition occurs when one company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm such as a manufacturing facility (DePamphillis, 2003). In other words, an acquisition is the purchase of an asset such as a plant, a division, or even an entire company (Scott, 2003). The meaning of "merger" and "acquisition" may not really matter, since the net result is often the same: two companies (or more) that had separate ownership is now operating under the same roof, usually to obtain some strategic or financial objective.

The perceived motivation drivers for mergers are generally considered to be the acquiring firms' desire to increase its returns by expanding geographically. This perception is similar to Stewart's premises of merger motivation. According to Stewart (2005), the actual motivating forces behind mergers should be the ones that will increase financial performance, financial benefits through borrowing against the seller's unused debt capacity or against an increase in the consolidated debt capacity, and tax benefits derived from expensing the stepped-up basis of assets acquired from the use of otherwise forfeited tax deductions or credits. Stewart's merger motivation theory of increasing financial performance (NOP) is largely accepted as being a merger motivator, especially in the banking industry. An increase in net operating profits may either be derived from cost savings or increase in revenue. Many of those involved in the mergers agree that cost savings are a significant reason for the activity.

Mergers and Acquisitions are intended to add shareholder value through economies of scale. The combined company can often reduce duplicate departments or operations hence lowering the costs of the company relative to theoretically the same revenue stream, thus increasing profit. The purpose of this study is to determine the underlying and driving forces or causation based upon examination of resent mergers and acquisitions in Kenya, with focus on the Nairobi security Exchange.

### 1.1.2 Information Content of Mergers and Acquisitions

Merger and acquisition (M&A) advisory services are one of the primary offerings of the investment banking profession. In offering these services to acquirers and targets, investment bankers ostensibly aid directors in negotiating offer prices and other merger terms by summarizing public market information and firm-specific private information, reducing information asymmetries between the buyer and seller, and valuing synergies and cost savings arising from the successful integration of the two firms. In the vast majority of negotiated mergers, investment banks aggregate this information and issue a fairness opinion. This opinion determines whether an offer price is “fair” to client shareholders “from a financial point of view.”

Existing empirical literature provides mixed evidence supporting the usefulness of fairness opinions. Bowers and Latham (2006) document that both acquirer and target directors are more likely to obtain opinions in cross-industry mergers and friendly mergers. They conclude that fairness opinions are sought more often for transactions in which information asymmetry or litigation risk is greater. However, they do not address whether fairness opinions effectively reduce valuation uncertainty. Kisgen, Qian, and Song (2007) observe a negative correlation between the presence of acquirer-side opinions and offer premia, which they interpret as evidence that acquirer-sought fairness opinions either improve transactions or screen out low quality mergers. Makhija and Narayanan (2007) document a negative relation between target side announcement returns and the presence of target-side fairness opinions. They conclude that the market discounts the value of fairness opinions due to an inherent conflict of interest on the part of advisors.

### 1.1.3 Nairobi Securities Exchange

NSE is the Africa’s fourth largest stock exchange in terms of trading volumes, and fifth in terms of market capitalization as a percentage of GDP. According to the NSE report (Dec, 2007), as a capital market institution, these plays an important role in the process of economic development: it helps mobilize domestic savings thereby bringing about reallocation of financial resources from dormant to active agents; long term investments are made liquid, as the transfer of securities (shares and bonds) among the participating public is facilitated; the exchange has also enabled companies to engage local participation in their shares ownership, thereby giving Kenyans a chance to own shares of reputable firms; companies can also raise extra finance essential for expansion and development.

To raise funds, a company issues extra shares, publishes a prospectus, which gives all pertinent details about operations and future prospects of a company, while at the same time stating the price per share of the Issue. A stock market also enhances the inflow of international capital; and stock markets also facilitate government's privatization programs.

## 1.2 Research Problem

Mergers and acquisitions may seem to be beneficial, resulting in the amalgamation of two conglomerates. They have been found to lead to cost cuts and increased revenues. However, merger and acquisition failures are not uncommon. These failures may harm the companies, tarnish their credibility in the market, and ruin the confidence of their shareholders. Achieving acquisition success has proven to be very difficult, while various studies have shown that 50% of acquisitions were unsuccessful. The acquisition process is very complex, with many dimensions influencing its outcome.

Studies on mergers and acquisitions undertaken in Kenya include the following: Kiplagat (2006) studied the effects of mergers on financial performance of companies listed at the NSE; Barasa (2008) undertook a study on the effect of mergers and acquisitions announcements on share prices-evidence on the Nairobi Security Exchange; Maranga (2010) undertook a research on the effects of mergers and acquisitions on cost and scale of the efficiency of the combined commercial banks in Kenya; while Wanguru (2011) analyzed the effects of mergers on the profitability of firms in Kenya. In all these research, they did not focused on the information content of mergers and acquisition announcement at NSE for the listed companies.

Merger and Acquisitions of relatively large targets are more likely to achieve sizeable operating and financial synergies and economies of scale than small acquisitions, therefore leading to stronger post-acquisition operating performance. However, the acquirer of a relatively large target may face difficulties in integrating the target firm, which could lead to a deterioration of performance. There is empirical evidence in support of both conjectures, as reported by Linn and Switzer (2001) and Switzer (1996) provide evidence that acquisitions of relatively large targets outperform those of small targets. Report according to Clark and Ofek (1994) analyses those difficulties with managing a large combined firm outweigh the operating and financial synergies in large M&A which result in the deterioration of operating performance. However, most of empirical evidence reports no significant relation between the relative target size and post-M&A performance, as reported by Powell and Stark (2005); Moeller and Schlingemann (2003); Heron and Lie (2002; Sharma and Ho (2002) and Healy et al., (1992).

Kouhm (1975) observes that acquiring firms tend to faster growing than firms in their respective industries. This being the case, a merger of these two firms is expected to lead to improved performance. Hogarty (1970) constructed indexes of investment performance based on changes in stock prices. His sample consisted of 43 acquiring firms whose indexes of their respective industries. He concluded that mergers resulted in negative synergy; investment performance of acquiring firms was 5% less (significant at a 10% level) than their industries performance.

While studies attempt to infer the potential value of opinions, they do not address whether fairness opinions effectively reduce valuation uncertainty or provide a credible basis for a reduction in legal risk. Moreover, as discussed in more detail in the following section, existing studies fail to control for a selection bias that truncates the observance of acquirer-side fairness opinions in about two-thirds of all mergers. Given these shortcomings, this study examined the information content of mergers and acquisition announcement at NSE for the listed companies; guided by the following research question: What is the information content of mergers and acquisition announcement at NSE for the listed companies?

## 1.3 Research Objective

The objective of the study was to examine the information content of mergers and acquisition announcement at NSE for the listed companies

## 1.4 Value of the Study

The study adds value to different stakeholders; the management of firms listed on the NSE gains a better understanding of the importance of mergers in analyzing companies and also shareholders can be able to make informed decisions for or against mergers and acquisitions.

It is also of importance to business executives and managers as they make their strategic decisions that could include restructuring. Restructuring decisions are likely to impact current and future returns of a company. Such decisions affect prospective investors as to whether to invest in merged companies and also in which industries.

The Capital Markets Authority and Other Regulatory Bodies that are responsible for the licensing, regulation and supervision of operators in the capital markets, including policy formulation, monitoring and evaluation will make informed decisions on the basis of the findings when executing their mandates.

The study makes a significant contribution to the growing body of research on mergers and acquisitions. The findings may also be used as a source of reference for other researchers. In addition, academic researchers may need the study findings to stimulate further research in this area and as such form a basis of good background for further researches.

# CHAPTER TWO
# LITERATURE REVIEW

## 2.1 Introduction

This chapter comprises of information from other researchers who have carried out their research in the same field of study**.** The areas covered here are theoretical review and both global and local empirical evidence.

## 2.2 Theoretical Literature

Mergers and Acquisitions are explained by two main classes of theories, the "value-maximizing theories" and the "managerial theories" (Seth 1990). According to the value increasing school, mergers occur, broadly, because mergers generate synergies between the acquirer and the target, and synergies, in turn, increases the value of the firm (Hitt et al., 2001). The theory of efficiency suggests, in fact, that mergers will only occur when they are expected to generate enough realizable synergies to make the deal beneficial to both parties; it is the symmetric expectations of gains which result in a 'friendly' merger being proposed and accepted. If the gain in value to the target was not positive, it is suggested, the target firm's owners would not sell or submit to the acquisition, and if the gains were negative to the bidders' owners, the bidder would not complete the deal. Hence, if we observe a merger deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target. Banerjee and Eckard (1998) and Klein (2001) evidence this suggestion.

Trautwein (1990) identified several theories propelling the merger motive which take either the micro or macroeconomic perspective. The forms of these motives can be from purely financial to personal. In addition there exists the traditional cost efficiency theory based on the notion of economies of scale and scope, as well as the resource based view based on enhanced utilization of core competencies and resources (Prahalad and Hamel, 1990). Also other several theories have been advanced to explain the motives and reasons behind mergers and acquisitions. There is no single reason behind a merger, but rather a pattern of motives (Ravenscraft and Scherer 1987)

### 2.2.1 Efficiency Market Theory

The Efficient Market hypothesis, as defined by Ross (2008) can be divided into three forms: the Weak form, the Semi-Strong form, and the Strong form. The Weak form theory of EMT states that it is impossible for an investor to achieve a positive abnormal return by using past information on stock prices. The next theory of the Efficient Market hypothesis is the Semi-Strong form. Ross defines this form as a market that fully reflects all public information, making an investor unable to outperform the Market. This theory has been tested (Fama, Fisher, Jensen and Roll, 1969) numerous times by examining adjustment of the Market to publicly available information, such as announcements. The third form of Market Efficiency is the Strong form. The Strong form basically includes all information, public and private (Fama, 1965). Therefore it is expected that any type of information that may be relevant to the value of a stock, even if it is only known by one investor, will already be adjusted for in the Market. Even" inside information" is expected to be included. Ross (2008) gives the example of an insider knowing that a mining company had struck gold. The insider would not be able to realize an above normal gain compared to the Market, because the Market will have already realized what was going on and adjusted to it. Evidence shows that the Strong form is generally not true within the Market.

### 2.2.2 Random Walk Theory

This is the Weak form theory of EMT states that it is impossible for an investor to achieve a positive abnormal return by using past information on stock prices. If the Market is Weak form efficient then it is believed that the stock prices will already have incorporated this past information. The Random Walk theory (Ross, 2008) explains that investors may not always agree on the value of a stock and therefore its price will fluctuate up and down. The theory explains that even though its real value may be unknown, the price will wander around its intrinsic value, making the Market efficient. Scholars agree that this form of the EHM is a rather weak test because it fails to control for other factors that are unrelated to the acquisition such as systematic effects and other firm specific events (Bodie et al., 2009).

### 2.2.3 Prospect Theory

The empirically-motivated prospect theory of Kahneman and Tversky (1979) identifies a departure from preference specifications that emphasize levels of goods and wealth as the sole drivers of value or utility. Their theory holds that changes in status relative to particular reference points are also a carrier of perceived value. The reference point in their theory is derived from the context at hand. It may be influenced by normatively-irrelevant frames of reference, or it may be based on an aspirational level or expectation as opposed to the status quo (Kahneman, 1992).

Another component of preferences that Kahneman and Tversky emphasize is loss aversion. This refers to a kink in prospect theory's value function at its origin, specifically that losses are disliked more than equal-size gains are liked. Furthermore, they set the shape of their theory's value function to include convexity in the domain of losses and concavity in gains to help it explain finer features of observed choice. Anchoring and adjustment refers to a belief formation process (as opposed to a utility perception) under which one begins at a specific initial value, salient but perhaps entirely irrelevant, and then adjusts toward a final estimate based on other considerations. Kahneman (1992) notes that "negotiators commonly have an interest in misleading their counterpart about their reservation prices.… High claims and low offers are therefore made in the hope of anchoring the other side's view of one's true position…. The moral of studies of anchoring is that such efforts at deception can succeed … even when these messages are neither accepted nor even believed" (p. 309-310). The use of reference points among investors and other financial actors appears, for example, in Shefrin and Statman (1985), who note that prospect theory and loss aversion imply that investors have a "disposition effect" and are more reluctant to sell stocks showing paper losses than they are stocks showing gains, which is empirically confirmed in Grinblatt and Keloharju (2001); Grinblatt and Han (2005), and Birru (2009). Shefrin and Statman (1984) suggest a view of dividends based on loss aversion and framing effects. Barberis, Huang, and Santos (2001) discuss asset pricing implications of prospect theory, and Barberis and Xiong (2008) emphasize that the 52-week high is a price where investors are particularly willing to realize gains.

## 2.3 Event Study methodology

The event study methodology widely is used to measure the impact of a particular event on value of the firm such as earnings announcement (Ball & Brown: 1968), stock splits (Dolley 1933, Fama et al., 1969), dividend announcements (Asquith & Mullins 1983), and M&A announcements (Jarrel & Poulsen 1989) etc. While the applications possible with event studies are numerous, the general flow and approach of the analysis is the same (MacKinlay 1997).

First, the event of interest is identified and the event window is defined. Secondly, the sample set of firms to include in the analysis is selected. Thirdly, the "normal" return during the event window in the absence of the event is predicted, and the abnormal return within the event window is calculated, where the abnormal return is the difference between the actual and the predicted returns. Finally, it is tested whether the abnormal return is statistically different from zero. However, it is only appropriate to use event study method when an assumption of market efficiency is made (McWilliams & Siegel 1997).

The period over which the stock price of the firms involved in M&A announcement will be examined. Let ($T1$-$T_0$) denote the estimation period, $T_1$ +1 to $T_2$ the event window, and 0 the announcement day of the M&A. The estimation period denoted $T1$-$T_0$ of the present study encompasses 180 days immediately prior to the start of the event window. This length is based on Peterson (1989) and Armitage (1995), who argue that when dealing with daily studies an estimation period of 100-300 days are sufficient for satisfactory assessment of the parameters in statistical pricing models. Furthermore, consistent with MacKinley (1997), the event window is excluded from the estimation period to avoid that the event itself influences the estimation of the parameters.

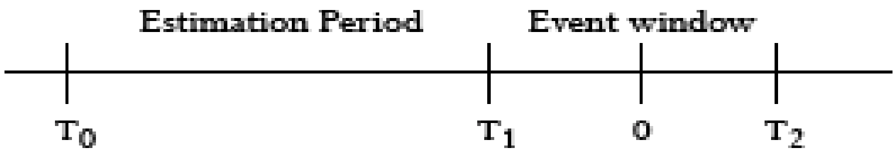



**Figure 2.1: Timeline**

Determination and correctly identification of the event date is critical. Brown & Warner (1980) emphasize this point because misidentification of an event can easily obscure the results of the event study method. To deal with this issue, the event date of this study is defined as the official announcement day of the M&A deal, as suggested by Dodd & Ruback (1977). Also, to minimize the problem of misidentification of the official event day, extensive cross-checking will be performed during the sample selection. In a perfectly efficient market it would be sufficient to restrain the window only to include the event day. In practice, the event window is often expanded to a couple of days. This is done to capture market reactions of announcements where it is unclear whether the market has the information during trading hours or whether information is available after the stock market closes (Masulis, 1980). Furthermore, the pattern of return for the days preceding the official M&A announcement day suggests that information leakage is a problem at a significant level up to 15 trading days prior to the announcement (Keown & Pinkerton, 1981). For that reasons, it is common to detect abnormal returns on both sides of the event day which rejects the strong form of the EMH. Based on this evidence, an event window spanning from 15 days prior to the announcement to 15 days after the announcement [-15 +15] is found to be appropriate for this study to maintain the statistical power of the event study methodology.

## 2.4 Efficiency motive of Bank Mergers and Acquisitions

Cohen-Cole and Kraninger (2007) suggest that the efficiency motivation for mergers can be divided into three categories: economies of scale, economies of scope, and managerial effectiveness. There are many studies on economies of scale and scope which lead to mix results. Some find no economies of scale and scope, while few others find a significant increase in cost economies with particularly megamergers in U.S banks. Regarding the managerial efficacy, it is reluctant to be categorized as value-maximizing motivation or non-value maximization in related to the agency problem.

### 2.4.1 Studies on scale and scope efficiency

Berger (1998) showed that cost economies of scale only exist for relatively small banks. One possible explanation is that by offering a wider range of financial product and services, large bank can capture higher market share. Again, many studies after that lead to the insignificant change in cost performance of bank mergers (Berger and Humphrey, 1991).

Recently, more applicable data from 1990s found that there were more notable scale and scope efficiency achieved from bank mergers. Bruner (2004) found the substantial cost scale economies on the order of about one-fifth of costs, for bank sizes over $10 billion in assets. Relating to the contradiction of results, Bruner (2004) argued that there are problems if using simple cost ratio in measuring the cost efficiency of bank mergers. The problem lied in the fact that output is taken as exogenous variable and the revenue effects on the cost performance are not considered and there is no way to solve from cost analysis separately whether the cost changes are greater than or less than the revenue performs. Base on this argument, Bruner (2004) had proven using profit function to find out the significant cost efficiency of “mega-bank” mergers. However, the data on mega banks were not pursuable to draw solid conclusions, but the evidences for cost efficiency or at least little or no losses from bank mergers appears to be greater overtime. According to Berger, Demsetz and Strahan (1999), this change may in part reflect technological progress and regulatory changes.

Berger, Demsetz and Strahan (1999) conclude that bank mergers also improve efficiency by diversifying the riskiness in the better conditions of a larger scale, a wider geographical spread of risks, a wide range of mix and complement products and services. Additionally, Milbourn, Boot and Thakor (1999) suggest that in the long term diversification from the bank mergers may also improve efficiency through the increasing in the management effectiveness. McAllister and McManus (1993) empirically studied on data of bank loans proved a significant decrease in the volatility of loan riskiness. Under macroeconomic cost of bank capital and liquidity requirements Roger, Jan (2011) suggests bank can reduce risky assets by shifting the composition portfolio towards less risky assets. Loretta (2005) suggest that merger motive by better diversification which is consistent to Benston, Hunter & Wall (1995) finding of US banks that bidders often bid more for the targets when they consider the significant achievement of diversification of the merger.

In addition, the objective of accessing to the financial asset safety net through consolidation is also remarkable motives for bank mergers. According to Berger, Demsetz and Strahan (1999), if financial institutions perceive to be “too big to fail”- that explicit or implicit government guarantees will protect debt holders or share holders of these organizations. Thus, merger may be driven by the incentives to increase the asset size, the shares' value, and lower the cost of funding (Sauders and Wilson, 1999). However, the financial crisis in 2007 which was turned out from U.S banking system has proved this motivation of to be "Too big to fail" less nontrivial.

### 2.4.2 Synergy effect of Bank Mergers and Acquisitions

To sum up, there are several motives that banks evolve in mergers and acquisitions. Generally "synergy" is one the most common motives. From the efficiency theory of banks mergers we have mentioned, two types of synergies which are corresponding to efficiency theory are operating and financial synergy. Thus, the operating synergy includes both economies of scale and economies of scope. Milbourn, Boot and Thakor (1999) has attempted to answer the question of why banks currently are so interested in strengthening their bank size and their scope of activities. One possible answer is that banking industry is getting more competitive, thus banks need to improve their cost efficiencies to compete more effectively by enlarging the scale to exploit economies of scale. Additionally, the competition in a given period squeezes margins making banks to look for other sources of profitability, especially in traditional commercial banking. Expanding scope means banks can offer a greater diversified products and services under a single brand.

Financial synergy is more applicable and questionable for bank mergers and acquisitions. It implies that the impact of a merge on the cost of capital to both acquirers and the merged partners should be lowered is financial synergy exists in that combination. Relating the managerial synergy forecasts, Houston, James and Ryngaert (2001) reported a positive stock price impact of projected synergy estimates for large bank mergers during the period from 1985 to 1996. Extensively, Dutordoir, Roosenboom and Vascocelos (2010) found that more than 50% of the acquiring firms' projected synergies are smaller than the takeover premium. This indicates that acquirer management s' concern for the litigation costs associated with overestimating synergy. That offsetting cost is possibly the main explanation of why not all firms choose to engage in voluntary synergy disclosure.

### 2.4.3 Studies on Managerial Motives

Simply, the managerial efficacy motivation as dictated by Cohen-Cole and Kranninger (2007) that superior management can create value by acquiring the assets of poorly managed institutions. Since the inferior management could not realize the bank's true inherent worth, the bank was perpetually undervalued. A plausible story, this explanation is very difficult to prove or disprove empirically.

Existing discussion of managerial motives generally center on empire building. By increasing bank assets through consolidation, CEOs can often increase their personal compensation dramatically. Managerial hubris is an agency issue which is difficult to be value-destroying mergers. Thus, free cash flow theory implies the value of shareholders of either mergers or takeovers are more likely to be detrimental, rather than to create values. Acquisitions are one way managers spend cash instead of paying it out to shareholders. Therefore, while Roll (1986) pointed out that mergers can be legitimized by efficient management taking over inefficient management; the hubris hypothesis is that the optimism of managers leads to incorrect beliefs about their own abilities.

Cheng, Gup, and Wall (1989) note that bank mergers are quite different than nonbank mergers because of the regulatory process involved. Before a bank merger can occur, prior approval from one of the three federal bank regulatory authorities and approval at the state level are required. If an approval is granted, there is a waiting period in which the merger is examined. A total of four months may pass before the merger is approved by the government. Therefore, managerial motives or hubris are too difficult to exist in banking industry as a rational motivation of M&As.

Mukele (2006) conducted a study on the factors that determine the choice of M & A partners in Kenya. He was looking to establish the determinants of choice of firms that had been through Mergers from 2001 to 2004. He concluded that the factors that determined the choice included knowledge transfer and management, cultural distance, organizational distance, resource redeployment and revenue based synergistic considerations. He found that the effects after M & A included asymmetry between the firms in terms of joint decision making and political process, location specific acquisition performance, management styles, reward and evaluation systems. Other findings in the study show that firms will get into an M &A with a partner who will facilitate transfer of knowledge based resources. It was concluded that anticipated economies of scale drive firms into M & A's. Resource deployment and revenue based synergistic considerations showed that M & A's expected increase in the market average through geographic cover and extension of production line.

### 2.4.4 Empire Building

Stillman (1983) and Eckbo (1981) analyzed the residuals of the rivals to firms participating in mergers. They sought to distinguish between the possible efficiency versus monopolization effects of mergers. They analyzed three events including; the announcement of the merger, the announcement of its challenge by the antitrust authorities, and the announcement of the government decision. The conclusions were analyzed on collusion and efficiency. They found that the effect of 30 major challenged horizontal mergers on the residuals of rivals was not statistically significant. It is argued that positive residuals should have been observed when the merger was observed both in relation to the original merger proposal and when it was challenged. Since the effect on rivals was not statistically significant, this casts doubt on the theories that argue that mergers were in fact viewed as opportunities for increased possibilities of collusion among the firm's major rivals in the industry.

### 2.4.5 Valuation

Houston & Ryngaert (1994) examined abnormal returns from four days before the target was initially declared a takeover candidate (by any bank) to the announcement day. In their sample of 153 mergers announced between 1985 and 1991, acquirers suffered a loss in value and targets enjoyed a gain. However, there was no significant aggregate effect on the overall value of the two organizations. The amount of value that was created was highest when acquirers were strong pre-merger performers and when substantial overlap existed. This relationship of value creation with the degree of overlap is consistent with the market expecting mergers best suited for improved efficiency and/or increased market power to experience the greatest level of post-merger benefits.

Korir (2006) carried out a study on Effects of Mergers on Financial Performance of Companies listed at the Nairobi Stock Exchange. The objective of this study was to find out the effects of mergers, if any on performance of companies listed at the NSE. The timeframe observed was from 1994-2005. The population used in this study was 48 companies listed on the Nairobi Stock Exchange. Shares of some of these sampled companies were heavily traded at the NSE. A sample of 20 listed companies was contacted, it consisted of 10 companies that merged and 10 that never merged and were in operation for the period counterparts were merged. Measures of performance used were turnover, volume, market capitalization and profit. They were analyzed on the basis of descriptive statistics. Descriptive statistics describe data on variables with single numbers while analysis of variance (ANOVA) tests for any significance difference between mean values of variables. It was concluded that mergers improves performance of companies listed at the NSE. This is explained by low variation in paired t-test below 0.005 for turnover, volume, market capitalization, and profit.

## 2.5 Empirical Review

In the current scenario, all over the world the activity of Merger and Acquisitions (M&A's) is becoming the reality for almost all kinds of companies as the execution of cross-border M&A transactions helps in boosting the value, efficiency, profitability and synergy of their businesses (International Business Report, 2008).

Whenever the announcements of successful mergers are made to the public, it is generally proved to be beneficial for the shareholders. By employing the combine efforts company could reduce its cost and can maximize its profitability. Moreover, by the combination of two competitors the company could achieve more market power and increased market shares (Gersdorff and Bacon, 2009). Many studies have been made on testing the efficiency of Indian Stock Market in relation to event announcement like dividend, bonus, right issue, option listing, stock split, block trading, annual earning, Merger and Acquisitions (M&A's) etc.

Critical reviews of significant studies by the Researchers are as follows; Ormos (2002) empirically tested the efficiency of Hungarian Capital Market in its semi-strong and strong form. The study focused to examine whether the Hungarian Capital Market was efficient in the semi-strong form. The investigation was based on the capital market data over the period 1991 to 2000 which was analyzed by employing event study. The study concluded that strong form of efficiency of capital market does not completely hold true, thereby supporting that Hungarian Capital Market is semi strong form efficient. Vandana (2003) tested the semi-strong efficiency of the Indian Stock market over the period 1995 to 2000 by employing event study. The study involved a sample of 145 bonus issues, in order to examine the announcement effects of bonus issues on equity share prices in India. The study concluded that the Indian Stock market was semi-strong form efficient.

Mishra (2005) examined the reaction of the stock price to the information content of bonus issues over the period 1998 to 2004. For the purpose of the study samples of 46 stocks listed on the NSE were analyzed by employing event study using 180-day event window. It was found that stocks show abnormal return before eight or nine days of announcement, thereby supporting the evidence that Stock market is efficient in its semi-strong form.

Iqbal and Mallikarjunappa (2007) tested market reaction to quarterly earnings announcement of 149 companies listed on the Bombay Stock Exchange for September 2001 by employing both parametric and nonparametric tests. It is observed that during event window, runs test are not significant at 5% level, which signifies that abnormal returns occur randomly. On the other hand, t-test rejects the existence of abnormal returns on daily basis, which provides an opportunity to beat the market and earn abnormal returns. The study concludes that Indian stock market is not efficient in semi-strong form.

Yalama, Abdullah and Selik (2008) investigated semi-strong form efficiency in Istanbul Stock Exchange Market (ISE-100), Foreign Exchange Market (FEM) and Inter-bank Money Market (IMM) in respect to changes in Currency and Circulation (CIC). The data consist of the daily frequency over the period 1990-2008 which was analyzed by employing Toda Yamamoto Causality method. The study concludes that there is the causality relationship running from CIC to FEM and CIC to IMM. However, there is no causality relationship running from CIC to ISE-100. This result implies that in Turkey money market is semi-strong form efficient while capital market is not.

Dhar, Satyajit and Chhaochharia (2008) analyzed the impact of the information relating to the announcement of stock split and bonus issue on stocks listed on National Stock Exchange (NSE) by employing event study. Both the events, that is stock split and bonus issue reflect significantly positive announcement effect. For bonus issues, the abnormal return was about 1.8% and for stock splits, it was about 0.8%. Thereby the study supports the view that Indian Stock Market is efficient in semi-strong form.

Gersdorff and Bacon (2008) made an attempt to empirically examine the efficiency of the market with respect to the announcement of the mergers and acquisitions by US Company on stock prices risk adjusted rate of return using twenty recent mergers as of 31st Aug 2007. This study uses the Standard event study methodology test. The weak, semi-strong and strong form efficient market hypothesis which test an investor's ability to earn a positive abnormal return on the basis of merger announcements are examined. Specifically, this work focuses on the semi-strong form test in an effort to test the efficiency of merger announcement public information. Evidence here supports semi-strong market efficiency along with a positive signal exhibited by the sample of acquiring firms during the event period. Evidence of lingering excess returns after the merger announcement was also observed.

Murithi (2010) conducted a study on an investigation into the effects of mergers and acquisitions on financial performance of companies in Kenya (2003 - 2007). The research covered all the companies in Kenya that had undergone mergers and acquisitions between the year 2003 and 2007. The researcher used purposive sampling where he took 40% of these companies for the study to obtain a sample of 28 companies. From the findings, the study found that that mergers and acquisitions increase the market share of companies the firms entered into new geographical areas, diversify business growth, acquire states of art and technology, comply with new legislation, acquire brand loyalty and overcome entry barriers. Mergers and acquisitions also assisted in the attainment of returns on investment in companies. The study also established that there exist positive relationships between merger and acquisition and predictor factors which are market share, profitability of the company, diversification of risk, achievement of synergy and return on investment.

Mwancha (2012) did a study on the information content of mergers and acquisitions announcement for companies quoted at the Nairobi Securities Exchange. The objective of this study was to establish whether Nairobi Securities Exchange market reacts to merger and acquisition announcements. The study was conducted based on twelve listed companies that had undergone mergers and acquisition within a period of 10 years beginning 1st January 2001 to 31st December 2010. The study found that there was weak relationship between company returns for the period before and after the mergers and acquisition announcements. The regression analysis also revealed that the relationship between the returns and the dummy variables was not statistically significant. The analysis of the difference between the projected and the realized returns for the period after the mergers for the companies was significant recording a Z-value of -50.13 whose absolute value is higher than the critical value of 1.96.

Kinyua (2011) conducted a research on the information of mergers and acquisitions on financial performance of oil companies in Kenya. This study took on a causal research design. In this study the target population was the oil companies in Kenya with keen interest on those that have gone through mergers and acquisition. The process of data collection involved self administered drop and pick questionnaires distributed to management and employees of the oil industries involved. The use of audited accounts enhanced the data received from respondents.

A Chi-Square test was used to establish the relationship between pre and post merger/acquisition and linear regression model enhanced the analyses of the effects of merger and acquisition on financial performance. According to the model, mergers and acquisition, respondent Opinion about M & A, and financial performance were positively correlated with financial performance after merger. A unit increase in mergers and acquisition would lead to increase in application of financial performance by factor of 0.166. This was a clear indication of the firms performing better financially after the resulting merger and/or acquisition.

## 2.6 Summary of literature review

Some of the pertinent literature is scanned by the Researches through various research papers which show that many research studies have been conducted to test the efficiency of the stock market with respect to the announcement effect. In the developed countries, many research studies have been conducted with respect to analyzing the impact of announcement effect of any event on the efficiency of the stock market. Very few studies have been conducted test the efficiency of the stock market with respect to the announcements (like dividend, bonus, stock split, merger, acquisition etc.).

These studies have been conducted by taking different industries, and analyze the different types of announcement effects over the stock market with different time period. Present study is an attempt to examine the information content of mergers and acquisition announcement for listed companies at Nairobi Securities Exchange.

# CHAPTER THREE
# RESEARCH DESIGN AND METHODOLOGY

## 3.1 Introduction

This chapter sets out various stages and phases that were followed in the study. It involves a blueprint for the collection, measurement and analysis of data. The chapter highlights the following subsections; research design, target population, sampling techniques, sample size and the data collection and procedure that were used in this study.

## 3.2 Research Design

A research design according to Zikmund (2003) is a framework for conducting the business research project. It details the procedures necessary for obtaining the information needed to structure or solve business research problems.

The study used descriptive research design. Phil (1996) says that descriptive research studies are designed to obtain information concerning the current situation and other phenomena and wherever possible to draw valid conclusion from the facts discussed. This was a survey research to explore the existing status of two or more variables at a given point in time. In this study, the researcher carried out a study on the information content of mergers and acquisition announcement for listed companies at Nairobi Securities Exchange. This design was suitable for this study since through data collection and analysis it drew conclusions based on the findings.  The research focused on firms that have exercised mergers and acquisition and are listed on the NSE.

## 3.3 Population of the Study

According to Mugenda & Mugenda (2003), a population is a well-defined set of people, services, elements, and events, group of things or households that are being investigated. The population of this research consisted of all the firms that have undergone mergers and acquisition and are listed in the NSE.

## 3.4 Sample and sampling Method

Sampling procedure may be defined as a systematic process of individuals for a study to represent the larger group from which they are selected (Cooper and Schindler, (2003), Robson (2002). Both stratified and purposive sampling techniques were used to design and select a representative sample size. Stratification ensured representativeness of population subgroups while purposive sampling techniques allowed the researcher to use cases with required information with respect to study objectives (Mugenda & Mugenda, 2003). Listed firms were stratified into agricultural, commercial, financial, industrial and alternative sectors. The criterion for purposive sampling was the occurrence of M &A between 1999 – 2011 on each stratum. Muia (2011) utilized the same criteria. Five firms within financial and industrial sectors were selected. Table 3.1 below shows the study's sampling frame. The list is attached in the appendix.

**Table 3.1: Sample**

| **Sector** | **Population** | **Number to be sampled (Proportion)** |
|---|---|---|
| Financial | 15 | 3 (20%) |
| Industrial | 17 | 2 (11.7%) |
| **Total** | **32** | **5 (15.6%)** |

## 3.5 Data Collection Method

Data collection is gathering empirical evidence in order to gain new insights about a situation and answer questions that prompt undertaking of the research (Flick, 1998). The data used was secondary, which was obtained from NSE website. The data collected was quantitative in nature comprising of stock price (Current and previous day close share price) as well as values of market Index.

## 3.6 Data Analysis Techniques

The whole process which starts immediately after data collection and ends at a point of interpretation and processing data is data analysis (Cooper & Schindler, 2003). Chandran (2004), defines statistics as a discipline that provides the tools of analysis in research and one which refers to facts, information or data and to a system of data collection and analysis.

Quantitative and qualitative techniques were applied. The data was analyzed using descriptive statistics to describe the variables under investigations. Descriptive statistics describe data on variables with single numbers such as arithmetic mean, median, maximum, minimum, standard deviations, percentages and rankings. Statistical Package for the Social Sciences (SPSS) software was used. This is a powerful tool in prediction of numerical outcomes. Comparative analysis was carried out using t-test to assess industry difference. Healy et al. (1992) successfully used the same data analysis technique.

In order to find out the impact of M & As on stock market researchers uses the Standard Risk Adjusted Event study Methodology. The required historical financial data regarding adjusted stock price of various companies and values of market Index (NSE share index) was obtained from NSE website

To test the efficiency of stock market with respect of announcement effect of bank's Merger and Acquisitions on and around the date of announcement of the event period, Standard Risk Adjusted Event Study methodology was used and the following steps were undertaken.

1. The historical stock price of the sample companies and NSE share index for the event study duration of -165 to+15 days (with days -15 to days +15 defined as the event period and the day of announcement of Merger and Acquisitions used in post period.

2. Then, holding period return of companies (R) and the corresponding NSE share index ($R_m$) for each day in this study was calculated using the formula:

$$R = \frac{(\text{Current Day Close Price} - \text{Previous Day Close Price}) \times 100}{\text{Previous Day Close Price}}$$

$$R_m = \frac{(\text{Current Day Market Close Price} - \text{Previous Day Market Close Price}) \times 100}{\text{Previous Day Market Close Price}}$$

R= Current Daily Return

$R_m$= Current Daily Market Return

A regression analysis was performed using the actual daily return of each bank (R) as dependent variable and the corresponding NSE share index ($R_m$) of as independent variable over the pre-event period (days -165 to -15 or prior to the event period of days -15 to +15) to obtain the intercept alpha and standardized beta for each sample bank separately.

For the study, in order to get the normal expected return, the Risk-Adjusted Method was used. The expected return of each stock for each day during the event period from (day -15 to +15) was calculated as: E(R) = Alpha + Beta ($R_m$), where $R_m$ is the return on the market. i.e. NSE share index

2. Then, the Excess Return (ER) was calculated as:

ER= the Actual Return(R) – Expected Return E(R)

3. Average excess return (AER) was calculated from days -15 to days +15 by simply averaging of all excess returns for all the companies for given day.

AER= Sum of all Excess Return for given day/n

Where n= number of sample companies i.e. 5 in this case for the study.

4. Cumulative average excess return (CAER) was calculated by adding AER for each day from -15 to +15.

5. Graphs of AER and CAER were plotted for the event period

## 3.7 Significance test statistics

The Quantitative analysis was done in order to analyze how quickly and accurately market reacts to the information like Merger and Acquisitions of companies. Standard Risk Adjusted Event Study was conducted to measure whether any abnormal return has been earned by share holders around the Merger and Acquisition's announcement period. The basic assumption of the standard risk adjusted event study is that the information is communicated publicly and this type of information surprising content that the abnormal return occurs at the time of event.

Abnormal return of stock price indicates the impact of the particular event on the stock price. After obtained the value of alphas and betas, finds the expected average return and compared it with actual average return. The actual average return and expected average return within the event period should differ in order to know the possibility to outperform the stock market with respect to Merger and Acquisitions announcement. A paired sample t-test was conducted and to ascertain if the announcement of mergers of companies have any significant effect on the risk adjusted stock price.

# CHAPTER FOUR
# DATA ANALYSIS, RESULTS AND DISCUSSION

## 4.1 Introduction

This chapter provides an analysis of data collected from the field. The results are presented in tables to highlight the major findings. They are also presented successively on the information content of mergers and acquisition announcement for listed companies at Nairobi securities exchange. This chapter provides various sections. Section 4.2 provides trading activity ratio against days around mergers and acquisitions, and section 4.3 presents quantitative analysis Tests and Results while 4.4 presents discussion of findings.

## 4.2 The Trading Activity Ratio of Mergers and Acquisitions

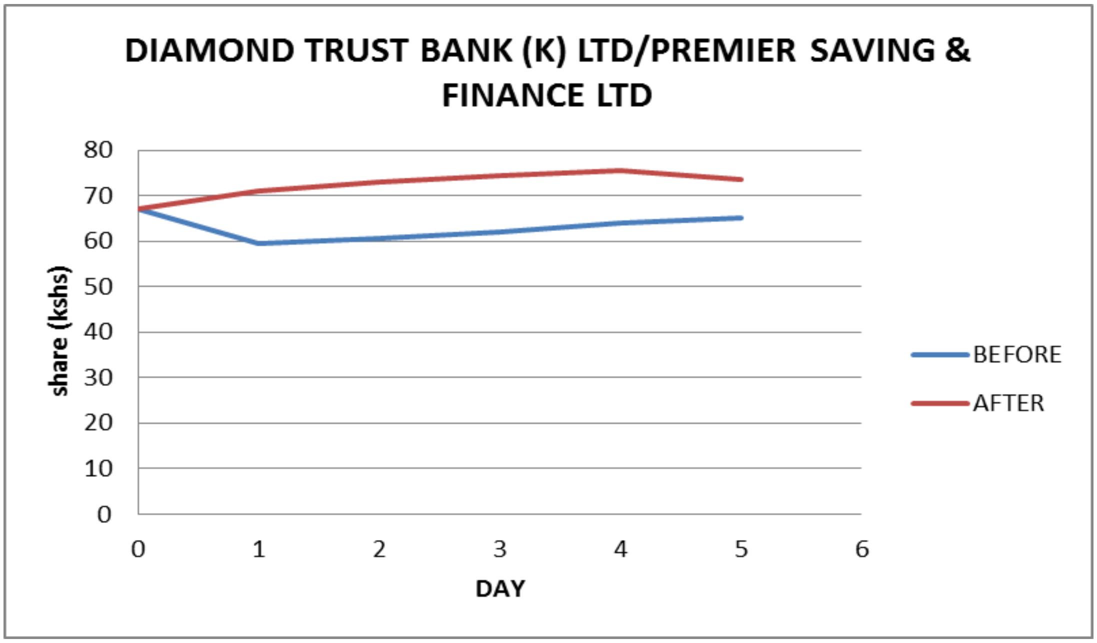
The study made use of daily adjusted prices for sample stocks for the event window consisting of 5 days before and 5 days after the event date. The event study methodology was used to assess if there was any abnormal market reaction to mergers and acquisitions of banks. This was done by comparing the trading activity ratio of companies sampled before and after the mergers and acquisitions. The trading activity ratio (TAR) was calculated as:

$$\text{TAR} = \frac{\text{Number of shares traded}}{\text{Number of tradable shares issued}}$$

The study also made use of the Nairobi Stock Exchange Daily Price Index as a proxy for computing market return. This was done by getting the logarithm of the daily return to avoid serial correlation. The abnormal return observations were aggregated through time and across securities to draw an inference on the mergers and acquisitions event.

The cumulative abnormal return for the event window was then calculated to accommodate the multiple periods. The graphs plotted are for percentage trading activity ration around mergers and acquisitions.

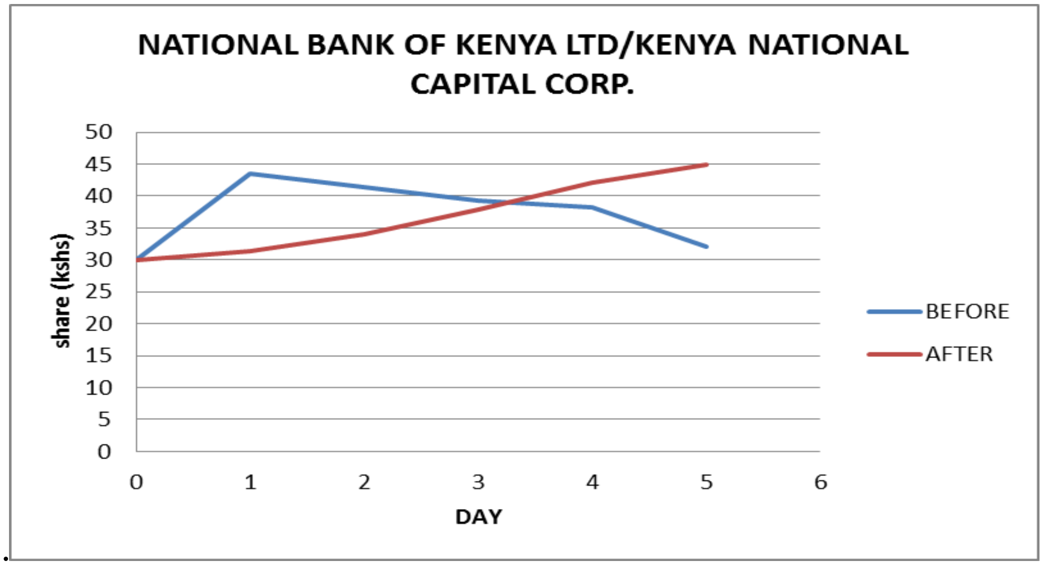
**Figure 4.1: Trading Activity Ratio for diamond trust bank and premier saving & finance ltd**




**Source: Research Findings (2013)**

Figure 4.1 shows a plotted graph of price per share traded in Kshs against days around mergers and acquisitions for diamond trust bank and premier saving & finance ltd. It shows how the market reacted on days before and after the mergers and acquisitions. Trading activity was seen to increase from day 5 after the mergers and acquisitions to day 5 after the mergers and acquisitions. There is also decrease in trading activity from day 4 to day 5 before the mergers and acquisitions and thereafter there is an increase. The graph shows that there was a significant increase in shares traded after the mergers and acquisitions as compared those that before the mergers and acquisitions.

**Figure 4.2: Trading Activity Ratio for National Bank of Kenya Ltd and Kenya National Capital**

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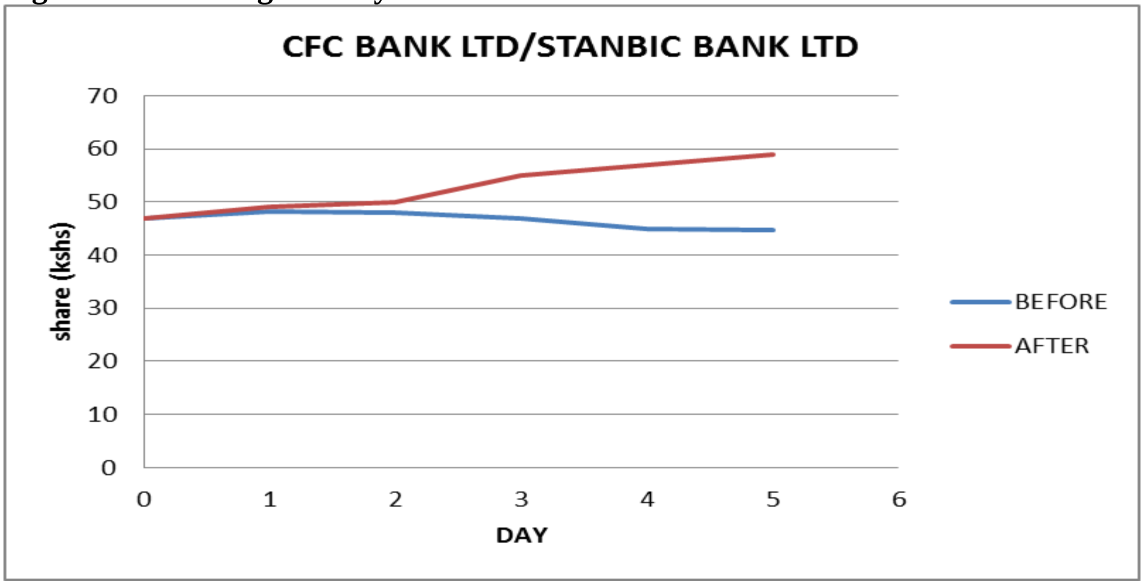
**Source: Research Findings (2013)**

The results present price per share traded against days around mergers and acquisitions for National Bank of Kenya Ltd and Kenya National Capital Corp. The percentage trading activity ratio was calculated and this is plotted on the graph represented by Figure 4.2. The findings show how the market reacted on days before and after the mergers and acquisitions. The graph shows that there was an increase in shares traded especially in days around the mergers and acquisitions.

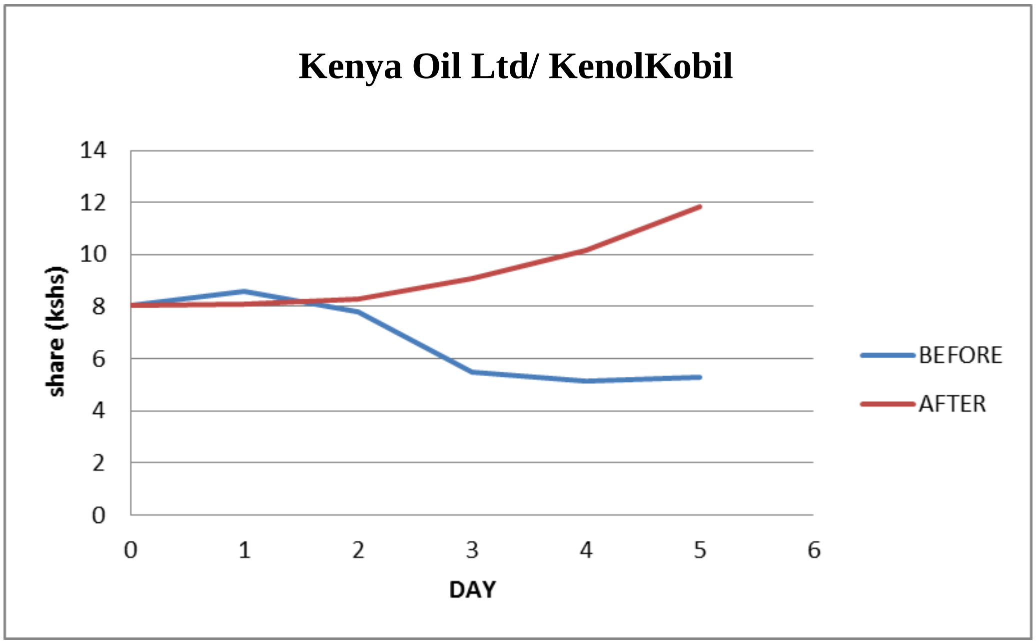
**Figure 4.3: Trading Activity Ratio for CFC Bank Ltd and Stanbic Bank Ltd**




**Source: Research Findings (2013)**

Figure 4.3 shows a plotted graph of price per shares traded against days around mergers and acquisitions for CFC Bank Ltd and Stanbic Bank Ltd. It shows how the market reacted on days before and after the mergers and acquisitions. The graph shows that there was minimal increase in shares traded especially around 5 days after the mergers and acquisitions. Trading activity of the shares of CFC Bank Ltd and Stanbic Bank Ltd before and after the mergers and acquisitions was found to be almost the same but slightly higher in the fourth day. The graph shows that on days immediately around the mergers and acquisitions, the trading activity was not so high.

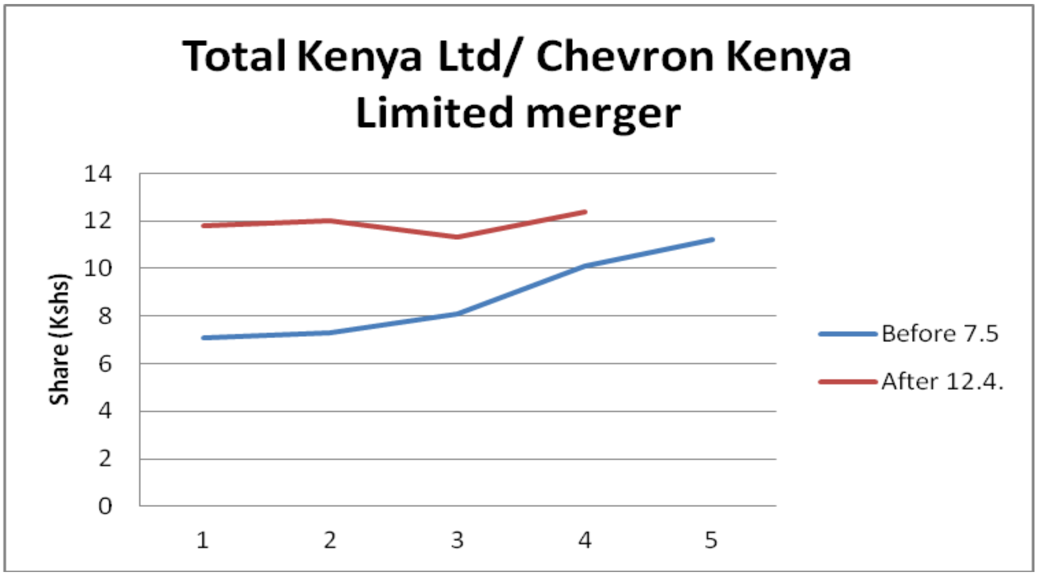
**Figure 4.4: Trading Activity Ratio for Kenya Oil Ltd/ KenolKobil**




**Source: Research Findings (2013)**

From the results presented on price per shares traded around 5 days before and 5 days after the mergers and acquisitions by Kenya Oil Ltd  and KenolKobil, the percentage trading activity ratio is calculated and this is plotted on the graph represented by Figure 4.4. It shows how the market reacted in days before and after the mergers and acquisitions. The graph shows that initially there was a decrease in trading activity about 2 days before and after the mergers and acquisitions. Activity is then seen to increase from about 2 days around the mergers and acquisitions to 10 days after the mergers and acquisitions.

**Figure 4.5: Trading Activity Ratio for Total Kenya Ltd/ Chevron Kenya Limited**




**Source: Research Findings (2013)**

Figure 4.5 shows a plotted graph of price per shares traded against days around mergers and acquisitions for Total Kenya Ltd and Chevron Kenya Limited. The graph shows that there was a significant increase in shares traded around 5 days after the mergers and acquisitions. The graph indicates a high increase from Kshs 7.5 to 12.5 after mergers and acquisitions, depicting significant trading activities.

## 4.3 Quantitative Analysis Tests and Results

The Quantitative analysis has been done in order to analyze how quickly and accurately market reacts to the information like Merger and Acquisitions of banks. Standard Risk Adjusted Event Study was conducted to measure whether any abnormal return has been earned by share holders around the Merger and Acquisition’s announcement period. The basic assumption of the standard risk adjusted event study is that the information was communicated publicly and this type of information surprising content that the abnormal return will occur at the time of event.

Abnormal return of stock price indicates the impact of the particular event on the stock price. After obtained the value of alphas and betas, finds the expected average return and compared it with actual average return. The actual average return and expected average return within the event period should differ in order to know the possibility to outperform the stock market with respect to Merger and Acquisitions announcement. Table 4.2 presents the findings;

**Table 4.2: Result using paired sample t-test**

| **Acquiring Name** | **Mean** | **Std. Deviation** | **t-stat** | **P value** |
|---|---|---|---|---|
| Diamond Trust Bank of Kenya Ltd | 1.02366 | 0.54837 | 3.729 | .020 |
| National Bank of Kenya Ltd. | 1.85142 | 0.74337 | 2.778 | .0190 |
| CFC Stanbic Bank Ltd. | 1.19137 | 2.64072 | 2.217 | .0182 |
| KenolKobil | 1.36943 | 0.44046 | 4.527 | .000 |
| Total Kenya Ltd | 1.10350 | 0.11944 | 3.613 | .025 |

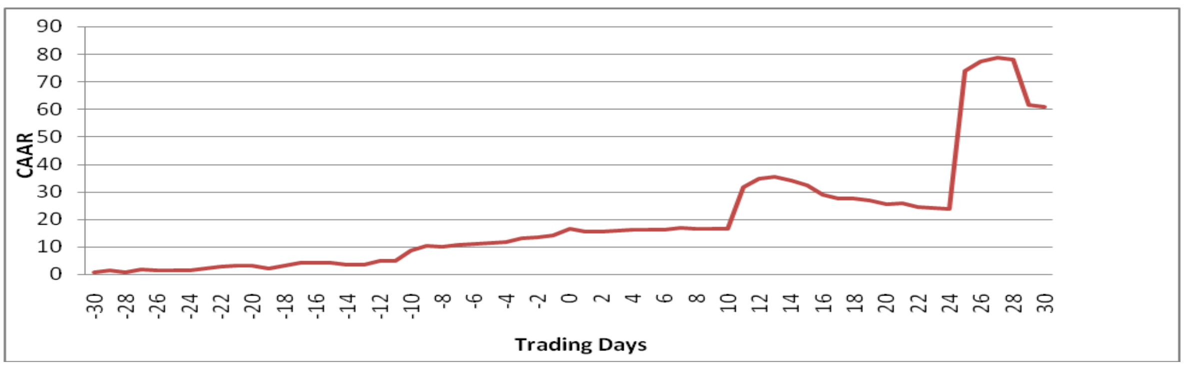
**Source: Research Findings (2013)**

A paired sample t-test was conducted and finds that the announcement of mergers has a significant effect on the risk adjusted stock price. Table 4.2 shows mean, standard deviations, t-stat and p-value which concluded that announcement of mergers have an effect on the stock prices, and shareholders earn abnormal return from the market.

The majority of companies' mergers create the abnormal return to the shareholders. The share holders of sample companies' were able to earn above normal risk adjusted return by the information of Merger and Acquisitions around the announcement date, as defined by the event period. Therefore we concluded that the market is efficient in strong form respect to merger and acquisitions announcement as investors are able to earn abnormal return before or after the announcement.

The study also analyzed the cumulative abnormal return over time for each company and presented the data in figure 4.6 to 4.10.

**Figure 4.6: Cumulative Average Abnormal Returns (Diamond Trust Bank of Kenya Ltd)**




**Source: Research Findings (2013)**

Figure 4.6 shows that the abnormal return for  Diamond Trust Bank of Kenya rose steadily but less steepy between t-30 to t-10 which then rose steepily towards the end of the event window.

**Figure 4.7: Cumulative Average Abnormal Returns (Total Kenya Ltd)**

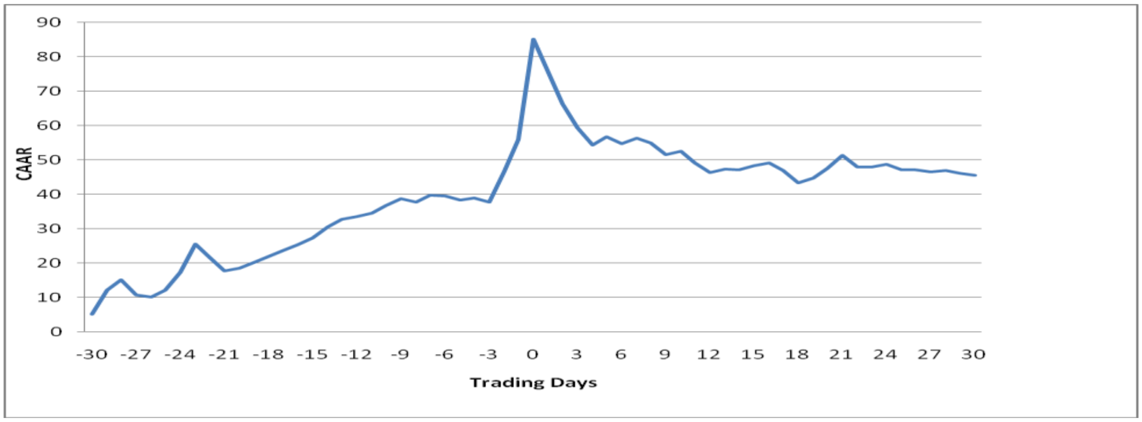
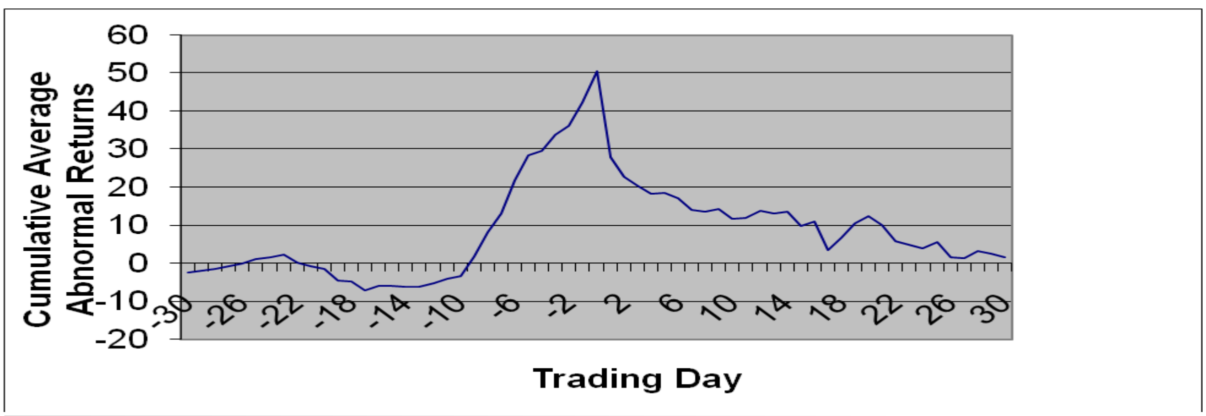



Figure 4.7 shows the findings of the price reaction to M&A for Total Kenya. Innitially between t-30 and t0 there was an increase in abnormal return which steadily declined following the M&A announcement.

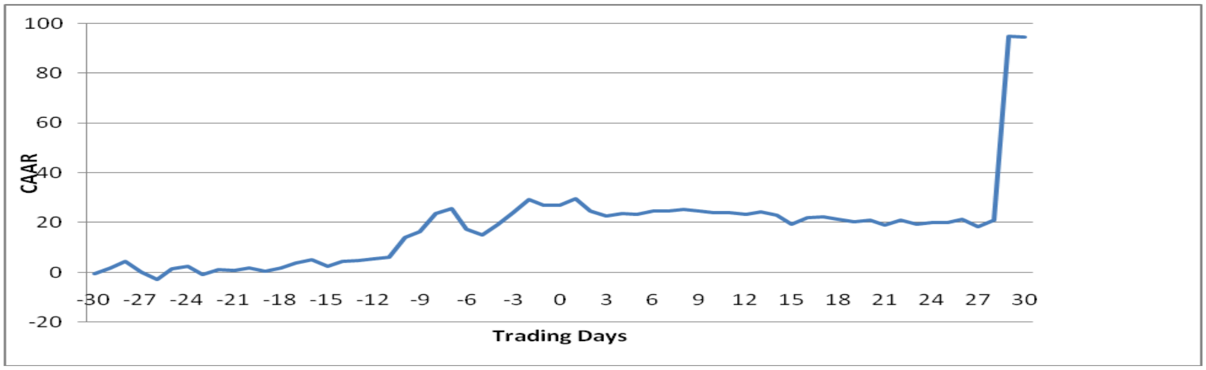
**Figure 4.8: Cumulative Average Abnormal Returns (KenolKobil)**




**Source: Research Findings (2013)**

For KenolKobil there was a negative abnormal return pre-M&A anouncement which rose steadily between t-10 and t0. Following the announcement, the abnormal returns fell drastically as shown above.

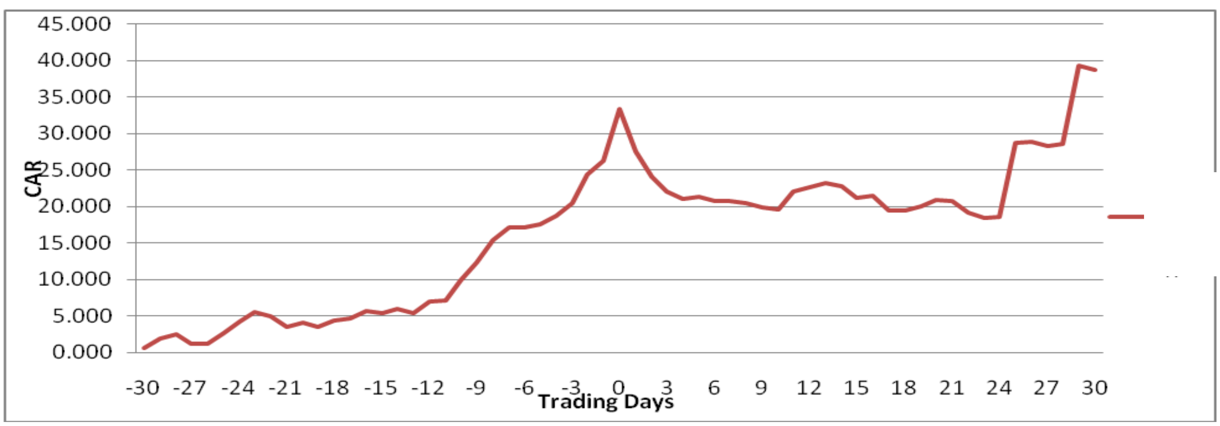
**Figure 4.9: Cumulative Average Abnormal Returns (National Bank of Kenya Ltd.)**




**Source: Research Findings (2013)**

Figure 4.9 show that there was infinitesimal changes to abnormality in returns following M&A which was followed by a sharp increase in abnormality of stock returns for National Bank of Kenya.

**Figure 4.10: Overall Cumulative Average Abnormal Return** (CFC Stanbic Bank Ltd.)




**Source: Research Findings (2013)**

The findings shows also that between t-9 to t0 period there is positive abnornal returns for CFC Stanbic Bank which reduced and later rose following the announcement (between t8 to t30). The

It is clear that from the above findings that there was significant abnormal return with slight variations almost all the days (from days -15 to days+15) surrounding the mergers announcement. The value of cumulative average excess return (CAER) was low on the very first day and but later rose significantly. It is clear that the Merger and Acquisitions announcement did cumulative average excess return. It reveals that M&As announcement in the listed Kenyan companies meet the significant reaction on the security prices in the Kenyan capital market.

## 4.4 Discussion of Finding

Generally investors will view the announcement as something positive. This study has empirically examined the informational efficiency of the Kenyan Stock Market with regards to the announcement of Merger and Acquisitions in various Sectors. Moreover, by the combination of two competitors the company could achieve more market power and increased market shares (Gersdorff and Bacon, 2009). After testing, the study shows that the expectations of share holders of sample companies to avail the excess return can actually be realized with public information and they are able to earn abnormal return either before or after the announcement of M&A's.

The results indicates that the effect of mergers and acquisitions to the shareholders wealth is significance since after the announcement of mergers and acquisitions the shareholders wealth for the selected companies tend to increase for a shorter period before the price reduce to the trend level it was before the announcement date . This has been shown by the increase in trading activity before and after the mergers and acquisitions. Mishra (2005) results found that stocks show abnormal return before eight or nine days of announcement, thereby supporting the evidence that Stock market is efficient in its semi-strong form.

The finding shows that on days immediately around the mergers and acquisitions, the trading activity was high. Kinyua (2011) found that mergers and acquisition, M & A, and financial performance were positively correlated with financial performance after merger where a unit increase in mergers and acquisition would lead to increase in application of financial performance. The trading activity is seen to increase from around 5 days after the mergers and acquisitions. Merger and Acquisition is the useful tool for growth and expansion in most companies. It is helpful for survival of weak firms by merging into organization.

# CHAPTER FIVE
# SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.1 Introduction

This chapter presents summary of findings as discussed in chapter four and interpretations of the data analysis, conclusions and recommendations based on the findings. The aim of the study was to explore the information content of mergers and acquisition announcement for listed companies at Nairobi Securities Exchange.

## 5.2 Summary

In general, the findings information content of mergers and acquisition positively affect shareholders' wealth. Prior research on targets and the combined performance of acquirers and targets, on the other hand, reports significantly positive returns for both samples. Results indicated that generally, there was an increase in the volumes of shares traded when mergers and acquisitions were announced. This was especially so in the days around the mergers and acquisitions. Trading activity was also seen to generally increase after the mergers and acquisitions as compared to that before the mergers and acquisitions. In both cases, there was a much higher trading activity immediately following the mergers and acquisitions. The results showed a positive announcement effected shares traded as a result of mergers and acquisitions.

On the mergers and acquisitions date, there were positive average returns which were significant at 0.05% level for the sampled companies. The Cumulative Average Excess Returns (CAER) findings depict the return on adjusted stock price during the event period, which shows that the mergers announcement had a positive impact on the stock prices of acquiring company and suggest that the merger announcement had positive significant impact on the stock price of the companies immediately on the first day after the announcement of mergers.

Geographical focus doesn't affect acquirer's value according to our results, although there seems to be some minor evidence that cross-border deals destroy value. Regarding the targets, our results point out that deals announced in the pre-crisis period generate positive returns. As with the acquirers, no influence could be detected from geographical focus. Nevertheless, significant positive target returns are reported for cross-border deals in one event window. Obviously, certain deal characteristics do influence stock market prices.

The research was designed to answer the following research question, "What is the information content of mergers and acquisition announcement at NSE for the listed companies?" The study found that generally, the Kenyan market reacted positively to mergers and acquisitions announcements. There was an increase in volumes of shares traded after the mergers and acquisitions as compared to those before the mergers and acquisitions. This was found to be in agreement with the study by Copeland (1979) which suggested that companies mergers and acquisitions their stock to bring it back to an optimal price, which in turn increased demand.

Managers of the companies sought to mergers and acquisitions stock to encourage investors to purchase their stock which appeared cheaper. This study showed that there were positive mean returns with respect to mergers and acquisitions. This was similar to the results reported by Grinblatt *et al.* (1984) who found that mergers and acquisitions realized positive results around the mergers and acquisitions announcement dates. The study was also in agreement with the signaling hypothesis which stated that managers of companies mergers and acquisitions their stock to act as a means of passing information to stock holders and potential investors. Brennan and Copeland (1988) believed that managers only mergers and acquisitions their stock if they were optimistic that their future prices would rise, or at the very least not decrease.

## 5.3 Conclusion

The study concludes that there is a positive announcement effect on shares traded as a result of mergers and acquisitions. The trading activities  was found to be high after the mergers and acquisitions date was found to be much higher than that before the mergers and acquisitions.  To track abnormal returns over a number of trading days, the cumulative abnormal return was computed throughout the event period.

The result supports the conclusion that mergers and acquisitions are more likely to be motivated by the fact that EPS forecasts increase by 2-3% around the announcement of a mergers and acquisitions. This finding is further supported by the fact that the abnormal returns around the declaration date of a mergers and acquisitions are explained by the information environment of the firm and that firms that mergers and acquisitions their stock tend to experience a reduced level of reversion in their earnings growth relative to a matched set of firms.

The main incentive that drives M&A activity is the expected performance gains, leading to shareholder wealth creation.  However, previous literature suggests that the largest part of M&A benefits goes to the target companies, while acquiring companies do not gain from consolidation activity. The study proved that Kenyan stock market shows that the market is efficient in its strong form as both the historical and publically available information are disseminated in the stock prices and investors are able to earn abnormal/excess return.

This study had empirically testing the market efficiency of Kenyan stock market with respect to merger and acquisitions announcement after released the information in the market and examined the effects of mergers announcement on stock price of companies.

## 5.4 Recommendations

The analysis of the takeover effects in isolation from other influences over a long-term period is a crucial issue within this study. Next to this both periods are influenced by financial crisis to some extent, as the following three years of each period are also taken into account to measure the long-term profitability on acquisitions. For further research it could be of interest to adjust the sample selection and to account for some other M&A deal characteristics that would provide some new insights

Mergers and acquisitions provide a unique investment opportunity to shareholders and hence it is crucial to explore all possible methods to improve the overall performance of this investment. Therefore toeholds can be seen as a valuable strategic tool within the bidding process, but it cannot be concluded that toeholds also have a positive influence on the post-merger profitability of the acquiring company.

There was an inclusion of firms with simultaneous earnings and dividend announcements in the sample. Although the mergers and acquisitions announcement already contained information regarding future earnings and dividends expectations by management, the inclusion of these firms could have resulted in an overstatement of the effect of the mergers and acquisitions announcement on shareholders wealth. The comparisons done were based purely on price trends and did not account for changes in the overall market conditions. Other market conditions could have arisen, which had effects on the general activity of shares in the market and on the returns, hence there was need to make use of the market model.

Mergers and acquisitions were found to be relatively new in the Nairobi Stock Exchange. However, many companies intending to distribute their shares do so by use of bonus issues. Large bonus issues are not so different from mergers and acquisitions. There is need to find out how the market reacts to bonus issues especially for bonus issues larger that are 25%.

## 5.5 Limitation of the Study

This study encountered the following limitations; the limitation of time and financial constraint, which made has concentrate on a very narrow aspect of mergers and acquisitions. In addition we could not carry an in-depth analysis of the data collected. The fact that perceptions are dynamic in nature and tend to fluctuate when other variables are introduced. As such, our research findings are subject to frequent alterations as well as different opinions.

The event study methodology depends on the assumption of an efficient market. This assumption is not valid in many situations. The length of time required for individual investors to respond to event signals is random and therefore, the implication is that markets could exhibit market inefficiencies because prices do not instantly or fully reflect all available information.

Another difficulty has to do with interpreting the results. Interpretations are more difficult in the context of international standards than from domestic perspective because the number of confounding factors multiplies when moving out of a strictly domestic setting.

## 5.6 Suggestions for Further Research

This study made use of a simple methodology based on the market model to determine abnormal returns. There is need for further study in this area and a need to include more independent variables such as those relating to firm size and dividend expectations so as to determine whether when other factors are considered there market would still react positively to mergers and acquisitions announcements.

The study looked at theories relating to why companies mergers and acquisitions their stock. The reasons why companies mergers and acquisitions; their stock were to achieve an optimal trading range, to achieve an optimal tick size and to signal managements' confidence in the future stock price. There is need to carry out a research to find out whether the same reasons are true for the Kenyan Market.

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# Appendix 1: List of Companies

| | Institution | Merged with | Current Name | Date approved |
|---|---|---|---|---|
| 1 | CFC Bank Ltd. | Stanbic Bank Ltd. | CFC Stanbic Bank Ltd. | 01.06.2008 |
| 2 | Diamond Trust Bank of Kenya Ltd | Premier Savings & Finance Ltd. | Diamond Trust Bank of Kenya Ltd | 12.02.1999 |
| 3 | National Bank of Kenya Ltd. | Kenya National Capital Corp. | National Bank of Kenya Ltd. | 24.05.1999 |
| 4 | Kenya Oil Ltd | KenolKobil | KenolKobil | 12.01.2007 |
| 5 | Total Kenya Ltd | Chevron Kenya Limited | Total Kenya Ltd | 02.05.2009 |