EFFECTS OF CROSS BORDER MERGERS AND ACQUISITIONS ON THE VALUE OF THE FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

GORDON HARRISON ODHIAMBO

REG. NO: D61/67574/2011

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

OCTOBER 2013
DECLARATION

STUDENT

I declare that this research project is my original work and has not been presented to any other university or institution for examination.


Signature …………………………………… Date ………………………………………

SUPERVISOR

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

MR. MIRIE MWANGI

Signed ……………………………………….. Date …………………………………….
ACKNOWLEDGEMENT

I wish to thank the Almighty God who has provided me with the wisdom and courage throughout my life and for being the source of inspiration while undertaking this project.

I also want to say a special thank you to the Department of Accounting and Finance of the University of Nairobi for giving me the opportunity to undertake my studies in this prestigious institution.

My sincere gratitude and appreciation to my supervisor Mr. Mirie Mwangi for his unlimited, invaluable and active guidance which enabled me finalize this project successfully.

Finally I pay glowing gratitude and tribute to my colleagues in the class of 2013 for being such a wonderful team. May God bless you in your future endeavors.
DEDICATION

This research proposal document is dedicated to my late father Mr. James Onyango, who taught me that the best kind of knowledge to have is that which is learned for its own sake.

It is also dedicated to my late mother Mrs. Jane Onyango, who taught me that even the largest task can be accomplished if it is done one step at a time.
ABSTRACT

This dissertation is a study on the effects of cross border mergers and acquisitions on the value of listed companies in Kenya. The study was undertaken to establish why organizations undertake the inorganic mode of expansion that is cross border mergers and acquisitions. The objective of this study was to focus the operating performance of the listed companies at the Nairobi Securities Exchange after going through the cross border merger and acquisition and comparing their performance before and after the merger thus deriving their values pre and post merger or acquisition. Since cross-border mergers and acquisitions are a fundamental mechanism of globalization and are considered as prime vehicles for business engagement across countries through the foreign direct investment, significant amounts of foreign funds are crossing international borders for acquisitions with the objectives of earning super normal returns. The analysis for this study was based on operating measures in relation to Kenyan based acquiring companies. To conduct a uniform research and arrive at an accurate conclusion, this study was restricted only to Kenyan companies which have been involved in the cross border acquisitions within the East African region. To get a broader perspective on Kenya, the study looked at all the cross border acquisitions that have been undertaken by listed companies. In this study, the researcher tested the hypothesis that cross border mergers or acquisitions improve operating performance of acquiring companies. An event study methodology was taken to evaluate the abnormal performance following a cross border merger or an acquisition. The study revealed that firms engaged in cross border mergers and acquisitions exhibit financial gains from these transactions. This study thus concluded that cross border mergers and acquisitions improves the financial performance of acquiring companies after testing key financial performance indicators. However, there is need to study the benefits of cross border and acquisition over a longer period of time to actually quantify the benefits of these transactions. Further studies also need to be done to determine the marketing, global and international benefits derived when companies venture outside of their resident companies borders. Since the main goal of any firm is maximization of shareholders returns, the study of whether the cross border venturing is in the interest of the existing shareholders is valuable. The movement in the value of the stock prices as a result of this undertaking would also be an interesting study area.
# TABLE OF CONTENTS

DECLARATION ........................................................................................................................................... ii

ACKNOWLEDGEMENT .............................................................................................................................. iii

DEDICATION ............................................................................................................................................... iv

ABSTRACT ................................................................................................................................................... v

ABBREVIATIONS ....................................................................................................................................... viii

CHAPTER ONE: INTRODUCTION ............................................................................................................... 1

1.1 Background of the Study ......................................................................................................................... 1

1.1.1 Concept of Mergers and Acquisitions ............................................................................................... 1

1.1.2 Cross Border Mergers and Acquisitions ......................................................................................... 4

1.1.3 The Value of the Firm ....................................................................................................................... 6

1.1.4 Effects of Cross Border Mergers and Acquisitions on the Value of the Firm ............................... 7

1.1.5 Cross Border Mergers and Acquisitions by listed firms in Kenya .............................................. 8

1.2 Research Problem .................................................................................................................................. 9

1.3 Research Objective ............................................................................................................................... 11

1.4 Value of the Study ................................................................................................................................ 11

CHAPTER TWO: LITERATURE REVIEW ................................................................................................. 12

2.1 Introduction .......................................................................................................................................... 12

2.2 Theories of Mergers and Acquisitions ................................................................................................. 13

2.2.1 Efficiency Theories ......................................................................................................................... 13

2.2.2 Valuation Theory ............................................................................................................................. 15

2.2.3 Process Theory ................................................................................................................................ 17

2.3 Empirical Evidence ............................................................................................................................... 18

2.4 Summary of Literature Review ............................................................................................................ 22

CHAPTER THREE: RESEARCH METHODOLOGY ................................................................................ 23
## ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBA’s</td>
<td>Cross Border Acquisitions</td>
</tr>
<tr>
<td>CBM&amp;As.</td>
<td>Cross Border Mergers and Acquisitions</td>
</tr>
<tr>
<td>DFI</td>
<td>Direct Foreign Investments</td>
</tr>
<tr>
<td>DMC’s</td>
<td>Domestic Market Corporations</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
</tr>
<tr>
<td>MNC’s</td>
<td>Multi-National Companies</td>
</tr>
<tr>
<td>OECD</td>
<td>The Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>SME’s</td>
<td>Small and Medium-Sized Enterprises</td>
</tr>
<tr>
<td>TPS</td>
<td>Tourism Promotion Services</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>EBIT</td>
<td>Earnings Before Interest and Tax</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Assets</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Earnings Before Interest Tax Depreciation and Amortization</td>
</tr>
<tr>
<td>ROS</td>
<td>Return on Sales</td>
</tr>
<tr>
<td>CF ROA</td>
<td>Cash Flow Return on Assets</td>
</tr>
</tbody>
</table>
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

1.1.1 Concept of Mergers and Acquisitions

Mergers and Acquisitions (M&A) refers to the aspect of corporate finance strategy and management dealing with the merging and acquiring of different companies and other assets by another company. Defined differently, Mergers and Acquisitions (M&A) 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, corporate succession to ensuring the independence of businesses, management buy-out and buy-in, change of legal form, initial public offerings 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 alliance.

Mergers and Acquisitions (M&A) seem to be one of the preferred means of acquiring critical mass and economies of scale (Belcher and Nail, 2002) as it is viewed as a viable and realistic form of restructuring activity. Two decades back, few companies made mergers a key element of their growth strategy. Mergers were an afterthought. Today, many companies look to achieve over 50 percent of their growth from Mergers and Acquisitions (Thomas and Weston, 1992). The central strategy for most firms seeking Mergers and Acquisitions (M&A) is to seek to become the leading player in the product-market area of the strategic business unit.
We shall define for the purpose of this paper M&A in a narrower sense as follows. For a start merger is the combination of two or more companies in creation of a new entity or formation of a holding company (European Central Bank, 2000, Gaughan, 2002, Jagersma, 2005) while acquisition is the purchase of shares or assets of another company to achieve a managerial influence (European Central Bank, 2000, Chunlai Chen and Findlay, 2003), not necessarily by mutual agreement (Jagersma, 2005).

Domestic and cross border mergers and acquisitions are of great importance for companies who would want to survive in the ever increasing and dynamic competitive global commercial scene. The success or failure of M&A transactions are of great significance and have enormous consequences for the companies as well as for the other constituencies in them (Sudarsanam, 2010).

In a merger, two firms combine their assets and operations and share their resources to establish a new legal entity and achieve common objectives. In most cases, the two companies’ shareholders remain as mutual owners for the newly combined entity. In an acquisition, the acquirer firm purchases the shares or assets of the target firm, with the control of these assets and operations being transferred to the acquirer firm, while the shareholders of the target firm end their ownership of the firm and the acquired firm becomes an affiliate or subsidiary of the acquirer (Sudarsanam, 2003).

To further obtain a clear definition of Mergers and Acquisitions, this paper emphasizes on the model developed by Nakamura (2005) which provides a clear understanding about the definition of M&A in a narrow concept as shown below.
Table 1.1: Mergers and Acquisitions

Source: Adopted from Nakamura (2005, p.18)

In Kenya, Mergers and acquisitions (M&A) follow the usual paths adopted in other countries. Most of the cases involve private companies, with relatively few transactions involving public listed companies, (Harney and Khan, 2010). The Restrictive Trade Practices, Monopolies and Price Control Act Chapter 504 is Kenya’s competition law statute and has specific reference to takeovers and mergers that require vetting by the Monopolies and Prices Commission (MPC) and approval from the minister of finance. With regard to companies listed in stock exchange in Kenya, the relevant legal
framework on M&A is the Capital Markets Act, Cap. Although it is key at looking at the positive side of M&A, it is limited in that it does not regulate merger and acquisition directly. Instead, it gives power under section 12 of the Act, to the Capital Markets Authority to make rules, regulations and guidelines on regulation of mergers and acquisitions among listed companies hence the enactment of Capital Markets (Take-overs and Mergers) Regulations, 2002 which came into operation in the July 2002. The rules define merger as an arrangement whereby the assets of two or more companies become vested in or under the control of one company.

Examples of recent Mergers and Acquisitions that have taken place recently in Kenya include the merger of Universal Bank with Paramount Bank, the takeover of TPS (Uganda) Ltd by TPS Eastern Africa Ltd, Nation Media Group with the Monitor Newspaper in Uganda and that of the Heritage Insurance Company with Africa International Insurance Company.

**1.1.2 Cross Border Mergers and Acquisitions**

Cross-border merger refers to a transaction in which the assets and operation of two firms registered in different countries are combined to establish a new legal entity, while cross-border acquisition refers to the control of assets and operations of a local firm to a foreign company, with the former becoming an affiliate of the latter.

Cross-border M&As are often used as a means for gaining entry into a foreign market, a method for engaging in a dynamic learning process, or a value-creating strategy (Shimizu, Hitt, Vaidyanath, & Pisanto, 2004). Although both cross-border and domestic
M&A’s have common characteristics, cross-border M&A’s have distinctive and important differences (Shimizu et al., 2004).

In a cross border merger and acquisition scenario, acquiring companies outside of one’s own country carries “liability of foreignness”, that is the costs incurred by a firm operating in a foreign market in addition to what a local firm would incur (Zaheer, 1995). Cross-border M&As also have the challenge of double culture effect where the national culture must be integrated in addition to organizational culture (Barkema, Bell, & Pennings, 1996). Despite these challenges, cross-border M&A’s continue to gain popularity as a viable and long term business strategy.

In East Africa, Kenyan firms have gained regional attention with several ambitious high profiles cross border mergers and acquisitions. These emerging firms have become strong contenders in the cross border acquisition market. Initially they were targets for acquisitions by developed country acquirers. However, in the last decade they have turned acquirers, expanding their presence in the regional scene by acquiring firms in neighboring countries some through share swaps. These firms include Equity Bank, Nation Media Group and TPS Serena among others. Examples of recent Cross-Border share swap involved South African Breweries (SABCO) and East African Breweries and more recently a share swap of TPS (Uganda) Ltd with TPS Eastern Africa Ltd.

Cross-border mergers and acquisitions (M&A) have long been an important strategy to expand abroad. Cross-border M&A is now included among the fundamental mechanisms of industrial globalization. The overwhelming share of flows of foreign direct investment, which are the prime vehicle for deep-rooted business engagement across international
borders, now consists of mergers and acquisitions rather than Greenfield Investment. Direct investment undertaken by foreign firms in a host country (i.e., the country of the target firm whose assets are being acquired) can take the form of either Greenfield Investment or mergers and acquisitions (M&As), depending on whether the transaction involves mainly newly created assets coming under control of the foreign firms, or just a transfer of existing assets from local firms, respectively.

Greenfield Investment is a form of foreign direct investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees. This has been accompanied by more diverse forms of collaboration between enterprises, such as informal alliances for research and development and other strategic purposes. Meanwhile, new channels for globalization such as electronic commerce are supplementing more traditional modes of trade and foreign investment. And a wider range of sectors, particularly many service sectors, and countries, increasingly non-Organization for Economic Co-operation and Development (OECD) countries, are represented in the current wave of industrial globalization.

1.1.3 The Value of the Firm

The firm value is an economic measure of the market value of a business. It can also be defined as the present value of the firm’s current and future profits (Baye, 2006). It is linked to profit maximization. Therefore a firm looking to maximize its profits would also be concerned with maximizing its value.
Firm valuation is essential for deriving market prices which is important for simulation (Key & Biggs, 1990). Firm valuation can be obtained through different measures and each measure would give different values. The most common measure of the value of the firm is its accounting net worth or book value. This value of the firm depends on various factors such as the size of a firm's free cash flows (cash flows available for distribution to all of a firm's investors after expenses and operations support for growth). It also depends on the timing of those cash flows and the risk attached to them.

1.1.4 Effects of Cross Border Mergers and Acquisitions on the Value of the Firm

In assessing the success of mergers and acquisitions, the key focus should be on the corporate and shareholder value. Shareholders are the controlling power in the organization and the residual owners of the company (Martynova and Renneboog, 2008). However, the value of the firm is an important focal point for any study since focusing on the firm value yields an efficient evaluation criterion (Tuch and O’Sullivan, 2007). The driving forces underlying the trend to cross-border M&A are thus complex and vary by sector.

Some of the key factors stimulating the growth of cross border mergers and acquisitions are the prolonged economic growth in countries such as the United States which in turn increases the capital available for industrial purchases abroad and attracts more inward investment and to a greater extent the globalization of financial markets. In some mature industrial sectors, international competition and market pressures due to excess capacity and falling demand are driving restructuring. Technological change, particularly in
information technology, facilitates the international expansion of firms, which are also seeking to capture new market opportunities in fast-changing technologies and to pool research and development costs.

Organizations keen to expand are increasingly seeking to exploit intangible assets such as technology, human resources, brand names through geographical diversification and acquisition of complementary assets in other countries. Government policies such as investment liberalization, privatization and regulatory reform are also increasing the number of and access to industrial targets for acquisition.

1.1.5 Cross Border Mergers and Acquisitions by listed firms in Kenya

The purpose of project was to develop an approach to the relationship between cross border mergers and acquisitions among listed firms in Kenya and its effect on the net worth of the firms’ wealth. It explored the sustainability of such corporate firms that have been involved in cross border mergers and acquisitions. The study also tried to reveal whether these companies flourish further under cross border merger or acquisition and also to examine what happens to firms that are created by a merger or acquisition (M&A) across different countries. The objective of this study therefore was to understand why organizations take this mode of expansion. However, the main focus of was on studying the financial performance of acquiring companies and comparing their performance before and after the merger. To conduct a uniform research and arrive at an accurate conclusion, this research was restricted to listed firms in Kenyan who have acquired companies in neighboring countries in order to increase their regional presence.
1.2 Research Problem

In a cross border merger and acquisition situation, several studies have proved that on average the target entity gain substantial effect i.e. abnormal returns. However, whether bidding firms experience a wealth effect from M&A is a matter of ongoing debate among academic researchers (Moeller et al: 2005). It is in therefore right to say that this area of M&A activity remain unclear despite a number of studies and thus a need exists for continued research on this subject. Secondly, the problem with previous empirical evidence in the field is that the vast majority of studies have focused on observations and cases from the US, Canada, and to some extent the UK leaving little emphasis on M&A activity in the rest of Europe and probably Africa and Asia (Bruner: 2004, Brealey et al: 2008, Sudarsanam; 2003).

It is because of the above reasons that I found this area of cross border mergers and acquisition to be a good topic for study and this has motivated me in order to further conduct the analysis in line with previous academic evidence in the field of cross border M&A. Therefore, this academic project focused on Kenyan cross border M&A profitability from a quantitative perspective by examining the abnormal returns in the period surrounding the announcement date. The research tested whether the firm’s wealth gains are enough to compensate it for the risk it bears in investing in the acquiring firm or the cross border target firm following the acquisition announcement. In other words, the return earned from investing in the acquirer’s stock or target’s stock is larger than what could been have earned in the alternative venture.
This study also documented in a comprehensive manner the financial experiences of companies that have undergone cross border mergers and acquisitions in Kenya. The study was meant to establish whether cross border mergers and acquisitions always result in increases of the company’s net worth.

In Kenya, Chesang (2002) carried out a study on Merger Restructuring and Financial Performance of Commercial Banking in Kenya. Although her study did not cover mergers and acquisitions in other sectors of economy and did not include cross border M&A, this study will included an insight in the field of mergers and acquisitions across the East African region as well as the impact of the firms’ returns as regards the factors that contribute to the success or failure of mergers and acquisitions of Kenyan firms.

Few studies have been done in Kenya concerning cross border M&A and by conducting this study, this paper was intended to ascertain how Kenyan companies perform when they move to the wider regional market. Many companies in Kenya use Return on Capital Employed (ROCE), Return on Assets (ROA) and Profitability as their measure of performance and by which they are judged by investors and stockholders alike. This study also set to find out the effects of cross border mergers and acquisitions, if any, on the performance of the companies in Kenya post such M&As. The question for the study was therefore; what is the difference between the financial performance of a firm before and after the cross border merger?
1.3 Research Objective

The objective of this study was to establish the financial performance effect of cross border mergers and acquisitions on the value of listed firms in Kenya.

1.4 Value of the Study

This study will be of value to investors and firms in Kenya and Africa who are in a competitive industry as it will add knowledge on the understanding of the importance of cross border mergers and acquisitions in analyzing company performance.

Academics and researchers will find this study useful as it will provide more insight into the relationship between cross border mergers and acquisitions and company performance. To the practitioners of management, the study will be helpful in updating themselves and their respective industries on best management practices. Executives and managers of listed companies in this region will also find this study useful as it has gone into the details of the cross border merger processes since it covers the various challenges that have been faced in past cross border mergers and acquisitions. Finally, this study will contribute to the knowledge and research required by students taking Masters in Business Administration in East Africa who may want to study and research more in the area of cross border mergers and acquisitions in this region.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their study in the field of CBM&A. The specific areas covered here are the importance of cross border mergers and acquisitions on the value of listed firms in Kenya.

Cross-border mergers and acquisitions’ can be defined as an activity in which an enterprise from one country buys the whole asset or controlling percentage of an enterprise in another country, Zhu & Huang, (2007). This definition is further broaden by Child et al. (2001) who argues that M&As of companies with their headquarters in the same country also face cross-border issues, as they have to integrate operations in different countries.

Cross-border M&A can be either inward or outward. Inward cross-border M&A incur an inward capital movement through the sale of domestic firms to foreign investors (M&A sales), while outward cross-border M&A incur an outward capital movement through the purchase of all or parts of foreign firms (M&A purchases). However, inward and outward cross-border M&A are closely related, since M&A transactions involve both sales and purchases.

Trends in cross-border M&A differ among developed and developing countries. My approach to the literature review will be to discuss the possible theories behind M&A generally and more specifically in cross border M&A. I will present the main differences between the neoclassical theories and behavioral theories as they are both vital in the
discussion and understanding of shareholder wealth effects of M&A to target and bidding firms. Then, I will develop the hypothesis that will be tested in order to answer the questions set forward in the problem statement. I will also look at the development of cross border M&A generally.

### 2.2 Theories of Mergers and Acquisitions

Scholars like Trautwein (1990) identified seven theories propelling the merger motive: efficiency theory, monopoly theory, valuation theory, empire-building theory, process theory, raider theory and disturbance theory. Trautwein argues that the major distinction, at a general level, between the various theories is whether the merger is viewed as a rational choice based on expected favorable consequences as opposed to being an outcome of a cognitive decision process or an external economic disturbance.

The theories that model merger causes as a rational choice are then further divided into two categories, those that argue that the major benefits of merger accrue to bidder shareholders and those that see management as behaving in their own self-interest. According to Trautwein, the differences between the theories that consider bidder shareholder as the main beneficiary of mergers are caused by different views as to the source of that wealth. In this research proposal we shall look at three theories namely, Efficiency Theory, Valuation Theory and Process Theory.

#### 2.2.1 Efficiency Theories

The efficiency theory, proposes that it is mainly bidder shareholders and indirectly target shareholders and management who benefit from the wealth created by the generation of
synergies from the two firms. This theory states that more firms that are efficient will acquire less efficient firms and realize gains by improving their efficiency. This means that target is not always inefficient but only relatively inefficient. Hence, mergers are driven by differential efficiency between the target and bidder management.

The inefficient management theory suggests that the existing management is simply inefficient, and hence, another management whether best or not, would replace the existing one and increase the efficiency of the business. Efficiency theory distinguishes three types of synergy, operational, managerial and financial.

The operating synergy theory postulates that even when both the target as well as bidder is equally efficient, simply combining their resources would lead to synergistic benefits due to economies of scale and complementary benefits. Thus, mergers are driven by synergy.

The financial synergy theory emphasizes that debt capacity of two combined firm will be larger than summation of debt capacities of two individual firms. Financial synergy also arises from credit rating of both the firms, tax differential of both the firms, proportion of use of internal and external funds.

Diversification provides numerous benefits to managers, employees, owners of the firms and to the firm itself. Diversification through mergers is commonly preferred to diversification through internal growth, given that the firm may lack internal resources or capabilities requires
Strategic Realignment to Changing Environment suggests that the firms use the strategy of Mergers and acquisition as ways to rapidly adjust to changes in their external environments. When a company has an opportunity of growth available only for a limited period of time slow internal growth may not be sufficient.

Hubris hypothesis on the other hand implies that managers’ look for acquisition of firms for their own potential motives and that the economic gains are not the only motivation for the acquisitions. This theory is particularly evident in case of competitive tender offer to acquire a target.

2.2.2 Valuation Theory

This philosophy viewed acquisitions as being executed by managers who have superior information than the stock market about their exact target’s unrealized potential value. The assumption here is that the acquirer possesses valuable and unique information to enhance the value of a combined firm through purchasing an undervalued target or deriving benefits from combining the target’s business with its own.

The leveraged buyout can be categorized into this theory. One of the most common criticisms about this valuation theory is that it is impossible to acquire accurate and tangible information about the acquisition results, and further stated that “the concept of private information as a basis for mergers warrants further consideration, since it shows away the problematic assumption of capital market efficiency can be avoided.”

This theory proposes to the reader that capital markets do not possess perfect information about objects they put a value on through share prices. What this approach suggests is
that it is impossible for a market to pinpoint an exact value on a company, as this value is individual to different potential buyers.

This difference in valuation by the respective companies is based upon their own knowledge of, or belief in, potential synergy effects that a merger between their own specific organization and that of the targets would create. This is thus a case of information asymmetry squared.

Using this viewpoint when setting a value on a company, there would be almost as many valuations as there are potential buyers. Needless to say, this is at odds with the established belief in the effective capital market.

What is interesting about this theory is that it really is the only that truly deals with the difficulties of valuation. This is because it not only recognizes the difficulties of the market, but also those of the buyers themselves. By doing this, the theory wrestles with the ambiguity that information invariably presents to the analyst. Shackle stated that a bidder is uncertain concerning the accuracy of his bid, and that he needs the market to confirm its correctness.

The market on the other hand, is unable to assess the bid from his point of view, as they do not possess all the private information that he holds. Seen in this context it becomes obvious that the correct valuation of companies is a highly contestable issue. Trautwein concurs that this theory is interesting, as the concept of private information, which forms the base of the theory, offers a bridge between the belief in the efficient capital market and its obvious inability to offer clear valuation in many cases.
2.2.3 Process Theory

This approach hinges on rationalization and it indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory, the central role of organization routines, or political power in the decision process rather than completely rational choices. Duhaime & Schwenk (1985) identified the limitations of information processing capacities in acquisition decisions. He found that the managers’ behavior was over-optimistic in the acquisition decision process. They proposed a systematic acquisition process perspective. He found that political and structural matters affect the acquisition process and outcome, whereas argued that cultural distances between two companies have enormous impacts on acquisition and the post-acquisition integration process.

While decision-makers lack all the information they need in order to make a correct assessment of a situation, and while they lack the capacity to compute all data even if they had all the information, the so-called Process Theory has cropped up as a possible explanation. Theorists like Allison and Cyert and March maintain that organizations are made up of groups of people with limited cognitive abilities (no matter how intelligent or analytical they are).

As their cognitive abilities have their boundaries, they are destined to act with only limited rationality. In these situations where ambiguity is great, people tend to employ a form of cognitive shortcuts, which save some time and effort from actually re-thinking the problem from scratch.
Tradition and routine are good examples of such cognitive shortcuts. By reverting to the use of traditions or routines, organizations copy behavior of the past and apply it to the present situation, which saves much effort in analyzing. In many cases this type of behavior yields at least adequate result, and the tradition is reinforced. When the tradition ceases to offer a satisfactory solution, a new way of solving the problem must be worked out

### 2.3 Empirical Evidence

According to Shimizu et al, 2004, traditionally cross border M&A research has been extracted from transaction cost economics and ownership location internalization frameworks and has recently been extended to a resource based view and organizational learning perspectives, (Barkema & Vermeulen, 1998). The resource based view highlights the importance of value and heterogeneity in firms’ resources (Shimizu et al, 2004).

Not many studies have been done on cross border mergers and acquisitions in Kenya. However there are several studies on the effect of mergers and acquisitions generally on the value of the firm.

Korir (2006) studied the effects of M&A on financial performance of listed companies in the Nairobi Stock Exchange. He used turnover, volume, market capitalization and profit as measures of performance. His study concluded that mergers improved companies listed at the Nairobi Stock Exchange.

Chesang (2006) studied the performance of banks in a M&A using the key financial measures like capital adequacy, solvency, profitability and earnings ratio. The result of
her study concluded that other than capital adequacy and solvency ratios, merged firms have not improved their profitability as majority declined in profitability after the merger.

Ali Fatemi (1984) addressed the question of whether multinational corporations are more profitable than domestic corporations from the perspective of efficient markets. He specifically looked at the risk-adjusted rates of return realized by shareholders of multinational corporations (MNCs) versus purely domestic firms (DMCs). Based on the idea that the profit maximization strategy for investing internationally will result in higher dividends to shareholders and/or a higher price of the common stock, Fatemi (1984) looked at the realized rates of return for his analysis. His research is distinct in that it sought to minimize measurement error, excluded firms with any international involvement from the DMC group, used multi-period comparative tests, and implemented new tests. Fatemi’s results indicated that MNCs and DMCs provide shareholders the same rate of return and thus, contrary to many earlier studies, MNCs are not more profitable than DMCs. Also, the return on the multinational portfolio fluctuated less than the return on the domestic only portfolio signifying that global diversification does reduce risk, in that the beta of multinational firms was lower and the returns were more stable. Finally, he found that the debt capacity of MNCs is higher.

Doukas and Travlos (1988) studied the effects of foreign corporate acquisitions by U.S. firms on the acquiring firms’ stock returns. They split their sample into three: those U.S. firms that were already operating in the (foreign) target firm's country, those not operating in the target country and, finally, those bidders going abroad for the first time. They found a significant positive abnormal return of 0.37% only when U.S.
multinationals enter a foreign country for the first time and zero or insignificant returns in the other two subsamples. They found no gains to shareholders of U.S. firms expanding abroad through acquisitions. They thus established that gains are significant only when firms acquire overseas for the first time.

Morck and Yeung (1992) examined acquiring firms' stock price reaction to news of foreign acquisitions. They tested for the internalization theory by focusing on relation between stock price reaction and indicators for presence of acquirer intangible assets relating to technology, marketing, and the convergence of managers and shareholders’ interests. Their data consisted of 322 foreign acquisitions by US corporations between 1978 and 1988. They used market model to calculate abnormal returns. The empirical results showed a significant mean abnormal return of 0.29 percent indicating that market views international acquisitions as good news.

Markides and Ittner (1994) examined the impact of international acquisitions made in the period from 1975 to 1988 on the market value of the U.S. bidding firms. They reported a 2-day abnormal return of 0.32%, which was significant only at the 10% level. They argued that, “The stock market, therefore, is not overly enthusiastic about international acquisitions. It does not view them, however, as good news.” They further observed that acquisitions in related industries created more value than those in unrelated industries.

Eun et al (1996) established that firms buying into the United States of America gained, but the returns vary across the country of acquirer and the intangible assets of target firms have a significant impact on acquirers’ value gains, lending support for reverse internalization theory. However, United Kingdom evidence by Danbolt (1995) reveals
positive but insignificant returns to overseas acquirers in the month of announcement with some evidence also of differences across the country of acquirer. Corhay & Rad (2000) presented weak evidence of gains to Dutch firms acquiring overseas with returns found to be greater when firms had less overseas exposure and when they diversified outside their core business.


Cakici et al (1996) found out that United States firms lose when acquiring overseas in contrast to the gains for foreign firms acquiring in the United States over the same period, 1983-1996. Moeller & Schlingemann (2005) and Conn et al (2005) compared domestic to foreign takeover announcement effects for United States and United Kingdom acquirers over a similar time span respectively, finding domestic announcements to be more wealth creating in contrast to foreign ones. Campa & Hernando (2004) evidence for Continental European acquirers reached a similar conclusion. Eckbo & Thoburn’s (2000) study of domestic and international acquiring firm returns in the Canadian market also found superior announcement returns for domestic firms compared to foreign firms. In their ex-post study of United Kingdom firms Aw & Chatterjee (2000) also established
support for greater wealth effects for those acquiring domestically compared to those acquiring overseas.

However, Lowinski et al (2004) reported no differences in the returns to firms engaged in domestic and overseas acquisitions over the period 1990-2001, citing the extent of integration in the Swiss market for this. In contrast, however Kang (1993) establishes greater gains for Japanese foreign acquirers into the United States compared to domestic acquirers there while more recently Goergen & Renneboog (2004) found cross border acquisitions to be more wealth enhancing for Continental European acquiring firms than domestic transactions.

2.4 Summary of Literature Review

The study of the wealth effect of cross border M&A on the acquiring firm’s value is inconclusive. The issue of why acquiring firm loses in a foreign takeover activity remains an unresolved issue. This study is aimed at shedding some light on the wealthy effect of CBM&A on the overall value of acquiring companies as well as the target companies.

Cross Border Mergers and Acquisitions in Kenya are set to increase due to the opening up of the regional trading blocs and a strong performance by the Kenyan economy driven by the Vision 2030. The pre and post performance in CBM&A by these firms is therefore important in order to establish whether such ventures would have increased financial benefits both to the shareholders and also to the company.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section discusses the research design and methodology used in the study. The key areas include the population, data collection methods and data analysis technique. An event study methodology was conducted on the companies that have participated in cross border Mergers and Acquisitions in Kenya and contrast the strategic benefits that have come out as a result of such mergers.

The event study methodology was used to examine the financial results of the firms before and after the announcement of the cross border merger and acquisition using key financial indicators. The abnormal return depicts the part of the return that is not predicted by the market index and is, therefore, an estimate of the difference in firm’s value due to the event. The predicted return is the return that is expected if no merger announcement event took place.

Event study is an important tool in finance. When a significant event happened on a company (such as CBM&A in this research), it is difficult to measure the valuation change of a company.

3.2 Research Design

Subsequent to establishing a paradigm, the development of an appropriate research design is pursued. According to Burns & Bush (2002) a research design, which is a function of the research objectives, is defined as a set of advance decisions that makes up
the master plan specifying the methods and procedures for collecting and analyzing the
needed information. An appropriate research design is essential as it determines the type
of data, data collection technique, the sampling methodology, the schedule and the
budget (Hair et al. 2003). Primarily, it helps to align the planned methodology to the
research problems (Churchill & Iacobucci 2004).

This project adopted a causal study that relies on control factors. Causal studies are
concerned with learning why, that is, how one variable produces changes in another
(Cooper & Schindler, 2006). The study also endeavored to establish the relationships
among variables of how the profitability of companies involved in CBM&A changes
before or after the process.

In order to obtain more insight information into this topic, this paper adopted an
exploratory survey design, considered appropriate because the study was correlated and
analytical in approach. This project used quantitative measures. A survey seeks to obtain
information that describes existing phenomena by asking individuals about their
perceptions, attitude, behavior or values, Mugenda and Mugenda (2003).

3.3 Population

The population of this study was the seven listed companies in Kenya who have so far
acquired other companies in the East African region in nine different transactions. No
mergers have been recorded so the study concentrated on the acquisitions mentioned
above.
The companies that were selected for this study are considered to be the leading players in the acquisitions and mergers having participated in the exercise on many occasions.

3.4 Sample Design

The sample was be made up of five cross border mergers and acquisitions that have taken place in the last ten years and involve the acquisitions of Uganda Microfinance Limited by Equity Bank Limited, Savings and Finance Commercial Bank Limited of Tanzania by NIC Bank Limited, Precision Air of Tanzania by Kenya Airways Limited, Monitor Publications Limited in Uganda by Nation Media Group Limited and Serengeti Breweries Limited of Tanzania by East African Breweries Limited.

The acquisition of TPS Uganda Limited by TPS East Africa Limited was not considered in this study since it happened in the year 2012 and the financial results of the merger are still not available.

3.5 Data Collection

The study used secondary data. Secondary data is data which is already present and was collected by some other person for some different purpose (Kumar, 2005). The data used in this study was collected from the audited financial statements of the respective acquiring companies. The financial information over a period of time was thus studied and analyzed and this involved collecting the financials before the merger period and after the merger.

The information generated was then used to compute key financial statistical indicators before the merger and after the merger such as Return on assets (ROA), return on sales
(ROS), and the operating margin. The aim of this test was to study the key statistical trends over this period.

Financial information was also be collected from secondary sources such as annual reports, press releases, and Nairobi Security Exchange Market reports, analysis reports of research companies, search engines and relevant websites. The study used observation data collection techniques and examined relevant documents (e.g. annual reports, project reports, etc). Multiple sources of data were also used to address the ethical need to increase the reliability and validity of the research processes (Yin, 1994).

3.6 Data Analysis

In this paper, the use of accounting ratios was employed to analyze the financial performance of the selected companies that have been involved in the cross border M&A. For the pre-merger/acquisition period, ratios of the acquiring companies were examined so as to get an indication of the relative performance. Pre-merger average data was then be compared with the post-merger average data in order to determining the changes that have occurred in performance following the cross border merger or acquisition. The analysis of operating performance prior to and post merger and acquisition was conducted in line with the method specified in Barber and Lyon (1996).

Profitability performance indicators such as Return on assets (ROA) based on both EBIT and EBITDA (Earnings before Interest, Taxes and Depreciation), return on sales (ROS) based on both EBIT (Earnings before Interest and Taxes) and EBITDA (Earnings before Interest, Taxes and Depreciation), and cash flow return on assets
The unit of analysis was the firms that have undertaken the cross border merger or acquisition. The data collected was analyzed quantitatively as well as qualitatively using descriptive statistics. The researcher collected all secondary information regarding cross border mergers and acquisitions and edited the data. Only financial information that would lead to the objectives of this research was picked. The researcher then input the result of this research in a spreadsheet.

For the purpose of this study, the researcher will used the following indicators to compare pre and post acquisition performance of the firm. These indicators are Operating Margin or Return on Sales, and Return on Assets or Cash Flow Return on Assets

Return on sales (ROS) ratio was used to evaluate the firm’s operational efficiency. ROS is also known as a firm's "operating profit margin". The Operating Margin employed in this study is calculated as follows:

\[
OM_t = \frac{EBITD_t}{Sales_t}
\]

Return on sales (operating margin) can be used both as a tool to analyze a single company's performance against its past performance, and to compare similar companies' performances against one another. The ratio varies widely by industry but is useful for comparing different companies in the same business. This ratio is based on the real cash earnings of a firm (Earnings before Interest, Taxes and Depreciation-EBITDA) and is neutral to differential accounting practices across firms, degree of leverage and tax
treatments of assets. It is also widely used in sectors that require large investments in infrastructure with long gestation period.

The second indicator, return on assets, is also based on the EBITD due to its neutrality to depreciation methods, leverage and tax treatment and measures pre and post acquisition efficiency of assets. If the expected synergies from acquisition are realized, asset efficiency of the company should improve. Return on Asset ratio employed in this study is calculated as follows:

\[
ROA_t = \frac{EBITD_t}{Total\ Assets_t}
\]

After computing the pre and post acquisition performance variables, the study used the Mann-Whitney test (also known as Wilcoxon Rank Sum Test) of two medians as the principal method of testing for significant changes in the variables. The Wilcoxon Rank Sum test is used to test for a difference between two samples. It is the nonparametric counterpart to the two-sample Z or t test. Instead of comparing two population means, we compare two population medians.

More specifically the researcher also tested whether post acquisition cross-sectional sample medians are larger than the pre-acquisition cross-sectional sample medians.
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Data Analysis and Findings

This chapter presents data analysis, interpretation and discussion of the research findings. The data obtained from the financial statements of the five listed companies who have made cross border acquisitions in the last ten years was used to compute the ratios mentioned in chapter three above. The companies included Equity Bank Limited, NIC Bank Ltd, Kenya Airways Ltd, Nation Media Group Ltd and East African Breweries Ltd. These listed companies were chosen due to the reliability of their financial statements since they are subject to audit by reputable firms and also due to the various regulatory frameworks that listed companies undergo.

The presentation of the event study procedure in relation to operating figures is organized as follows. First focus will be on the operating figures selected for the study. Then the event day and the estimation period are defined and finally the statistical tests are specified. In trying to detect the effects of an event upon the performance of the company the research extracted the operating figures to be included in the event study. In this case five performance measures were selected. These are return on assets (ROA) based on EBIT, return on assets (ROA) based on EBITDA, return on sales (ROS) based on EBIT, return on sales (ROS) based on EBITDA and cash flow return on assets (CF ROA).

The reason for including more than one operating figure is an attempt to provide more proof to the conclusions of the event study and at the same time most performance measures have some drawbacks and including more than one will help overcome these
potential drawbacks.

4.2 Descriptive Statistics

Before going into the analysis to be performed in this study, a short description of the data is presented. As already mentioned the event study was done to try and detect any abnormal returns after the cross border merger or acquisition in a sample of the 5 transactions that have happened in Kenya among the listed companies in the last ten years. This data is presented in quantitative terms by analyzing the earnings before tax (EBIT), before and after the acquisition and similarly analyzing the earnings before interest, tax, depreciation and amortization (EBITDA) over the same period.

Table 4.2: Descriptive Statistics

<table>
<thead>
<tr>
<th>Company</th>
<th>Performance Indicator</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>% Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>EBIT</td>
<td>6,350</td>
<td>2,858</td>
<td>122%</td>
</tr>
<tr>
<td></td>
<td>EBITDA</td>
<td>7,099</td>
<td>3,281</td>
<td>116%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>EBIT</td>
<td>1,059</td>
<td>1,038</td>
<td>2%</td>
</tr>
<tr>
<td></td>
<td>EBITDA</td>
<td>1,205</td>
<td>1,160</td>
<td>4%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>EBIT</td>
<td>2,634</td>
<td>966</td>
<td>173%</td>
</tr>
<tr>
<td></td>
<td>EBITDA</td>
<td>3,552</td>
<td>4,575</td>
<td>-22%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>EBIT</td>
<td>1,021</td>
<td>898</td>
<td>14%</td>
</tr>
<tr>
<td></td>
<td>EBITDA</td>
<td>1,311</td>
<td>1,190</td>
<td>10%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>EBIT</td>
<td>12,578</td>
<td>11,569</td>
<td>9%</td>
</tr>
<tr>
<td></td>
<td>EBITDA</td>
<td>14,520</td>
<td>13,398</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: Author
From the analysis above, there is an increase on EBIT and EBITDA in the 5 sampled companies except Kenya Airways Limited which posted a decrease in the EBITDA in the year following the acquisition.

The study also analyzed the 5 performance measures mentioned above and tested the change in any of these before and after the acquisition. A positive variance indicates that there is a performance improvement as a result of the acquisition. This is summarized in the table below.

**Table 4.2: Performance Variance Analysis**

<table>
<thead>
<tr>
<th>Company</th>
<th>Return on assets based on EBIT</th>
<th>Return on assets based on EBITDA</th>
<th>Return on sales based on EBIT</th>
<th>Return on sales based on EBITDA</th>
<th>Cash Flow return on assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>3%</td>
<td>3%</td>
<td>1%</td>
<td>0%</td>
<td>-10%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>0%</td>
<td>0%</td>
<td>-8%</td>
<td>-8%</td>
<td>-8%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
<td>5%</td>
<td>0%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>-1%</td>
<td>2%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>-4%</td>
<td>-5%</td>
<td>0%</td>
<td>-1%</td>
<td>1%</td>
</tr>
<tr>
<td>Overall</td>
<td>4%</td>
<td>3%</td>
<td>11%</td>
<td>10%</td>
<td>-1%</td>
</tr>
</tbody>
</table>

Source: Author
4.3 Summary of Findings and Interpretations

The five performance measures are applied to determine abnormal operating performance before and after the CBM&A. To ensure the robustness of the tests, the operating performance is evaluated based on five different operating measures. For each of the five operating measures the results of the test are presented followed by a discussion of the robustness and reliability of the results.

4.3.1 Return on assets based on EBIT

Since the return on assets is the prevailing operating measure for detecting abnormal operating performance it is the starting point in this presentation and discussion of results. The table below shows the results of the return on assets (ROA) based on EBIT. Three of the tests return a positive performance while one test shows no improvement. Only one company, East Africa Breweries Limited shows a negative performance after the cross border acquisition with Serengeti Breweries in the year 2010. The total sample of 5 deals shows a significant positive performance, which means that in all the acquiring deals, the acquiring company gains from the cross border merger and acquisition.
### Table 4.1: Return on assets based on EBIT

<table>
<thead>
<tr>
<th>Return on assets based on EBIT</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>8%</td>
<td>5%</td>
<td>3%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>2%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>11%</td>
<td>1%</td>
<td>10%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>23%</td>
<td>22%</td>
<td>1%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>33%</td>
<td>37%</td>
<td>-4%</td>
</tr>
<tr>
<td>Overall</td>
<td>12%</td>
<td>8%</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: Author

### 4.3.2 Return on assets based on EBITDA

This second operating measure based on EBITDA instead of EBIT was intended to ensure an operating measure uninfluenced by both financing and accounting methods. Despite some adjustments in this operating measure compared to the one using EBIT it is expected that the empirical results based on ROA (EBITDA) will be in accordance with the results presented above for ROA (EBIT).

The empirical results of the test are presented in table below. In this case only one test returns a negative performance. The overall impression from this table is an overweight in favor of positive operating performance. This is in line with the conclusions drawn above in relation to ROA (EBIT). Positive performance in this case indicates that the
acquiring companies are more efficient after the merger. This overall impression or trend is present over each of the time horizons for which the analyses are conducted.

**Table 4.2: Return on assets based on EBITDA**

<table>
<thead>
<tr>
<th>Return on assets based on EBITDA</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>9%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>3%</td>
<td>3%</td>
<td>0%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>15%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>30%</td>
<td>29%</td>
<td>0%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>38%</td>
<td>42%</td>
<td>-5%</td>
</tr>
<tr>
<td>Overall</td>
<td>14%</td>
<td>11%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Author

**4.3.3 Return on sales based on EBIT**

Return on sales (ROS), the third performance measure was included to overcome the normal drawback normally experienced in the computation of ROA. ROS is created purely by income statement items and are thus not affected by potential problems of historic costs.

Again all test statistics are significant and show positive operating performance, thus in relation to ROS (EBIT) the acquiring companies become more efficient in generating earnings based on per unit sales. The fact that the companies get better at generating earnings indicates a positive effect of CBM&A. Across all the five samples, only one
return a negative performance and the overall result in a positive ROS. This corresponds to the conclusions drawn from the empirical results ROA (EBIT) and ROA (EBITDA).

**Table 4.3: Return on sales based on EBIT**

<table>
<thead>
<tr>
<th>Return on sales based on EBIT</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>50%</td>
<td>49%</td>
<td>1%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>44%</td>
<td>51%</td>
<td>-8%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>10%</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>18%</td>
<td>18%</td>
<td>0%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>33%</td>
<td>34%</td>
<td>0%</td>
</tr>
<tr>
<td>Overall</td>
<td>27%</td>
<td>16%</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: Author

**4.3.4 Return on sales based on EBITDA**

In order for a company to maintain the same return on sales (ROS) the company’s earnings need to increase equally compared to sales to maintain the same margin as before the merger or the acquisition. If a decrease in ROS (EBITDA) is detected the aspiration of a constant or increase in ROS (EBITDA) is not fulfilled and thereby value is destroyed. The results in four samples show zero or negative returns while only one returns a positive result performance.
Table 4.4: Return on sales based on EBITDA

<table>
<thead>
<tr>
<th>Return on sales based on EBITDA</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>56%</td>
<td>56%</td>
<td>0%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>50%</td>
<td>58%</td>
<td>-8%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>13%</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>23%</td>
<td>24%</td>
<td>-1%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>38%</td>
<td>39%</td>
<td>-1%</td>
</tr>
<tr>
<td>Overall</td>
<td>32%</td>
<td>22%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Author

4.3.5 Cash Flow Return on Assets

Cash flow return on assets (CF ROA) was included in the analysis primarily to overcome potential earnings manipulation that might be present in ROA. CF ROA indicates a company’s ability to generate cash from the investments in assets. The empirical results of the tests are presented in Table 4.4. Overall, the tests show a negative performance showing that in the short run CBM&A do not improve the cash flow return on assets of the acquiring company. Only two results show marginal improvement in the cash flow return on assets.
<table>
<thead>
<tr>
<th>Cash Flow return on assets</th>
<th>Post CBM&amp;A</th>
<th>Pre- CBM&amp;A</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Ltd</td>
<td>2%</td>
<td>12%</td>
<td>-10%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>-2%</td>
<td>6%</td>
<td>-8%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>15%</td>
<td>15%</td>
<td>0%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>17%</td>
<td>15%</td>
<td>2%</td>
</tr>
<tr>
<td>East African Breweries Ltd</td>
<td>32%</td>
<td>30%</td>
<td>1%</td>
</tr>
<tr>
<td>Overall</td>
<td>9%</td>
<td>10%</td>
<td>-1%</td>
</tr>
</tbody>
</table>

Source: Author
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the discussion drawn from the data findings presented in chapter four. This study sought to establish the effects of cross border mergers and acquisitions on the value of listed firms in Kenya. The study conducted tests of key financial statistics such as return on Assets, Return of Sales and cash Flow Return on Assets.

5.2 Summary of the Research Findings

This study commenced with an introduction chapter that described the study concept and gave the background against which this study was being carried out. The first chapter was composed of background of the study, statement of the problem, objective and the importance of the study. The second chapter reviewed related literature on the concept of cross border mergers and acquisitions and mergers and acquisitions generally. The third chapter laid out how the study was to be carried out. It composed of the research design to be used, description of the study population, the sample chosen, data collection and data analysis procedure. The fourth chapter covered data analysis, results and discussion of study findings. Finally, the fifth chapter presents the summary, conclusions and recommendations of the study.

The overall objective of this study was to perform an analysis of the performance regarding the acquiring companies in relation to cross border merger or an acquisition by listed Kenyan companies in the East African region in the last ten years. The analysis of
post performance was conducted by means of five operating measures. In order to answer the overall research question of whether or not an abnormal performance on the value of the firm can be detected in relation to a cross border merger or an acquisition the analysis was offset by the strategic rationale behind a particular deal.

The test for return on assets (ROA) using both EBIT and EBITDA indicates that acquiring companies gain in cross border mergers and acquisitions with only one sample producing a negative result. Using the return on sales (ROS-EBIT) as a basis of measuring the financial performance, only one result returns negative results. However, when testing return on sales using EBITDA gives a different outcome. Only one outcome is positive. The final performance measure using the cash flow return on assets (CF ROA) also produced mixed results but the overall results showed that CBM&A do not increase the financial performance of acquiring firms.

5.3 Conclusion and Recommendations

The overall conclusion from the empirical work in this study in relation to the creation of firm value based on cross border mergers or acquisition is in the best case an improved performance with only few cases showing negative performance. We can thus say that CBM&A improves the financial performance of the acquiring companies.

However, this test is based purely on the test of the financial year preceding the CBM&A. Despite this general trend from the empirical work it seems that the overall CBM&A activity may increase even further in the future. It is likely that the overall goal
of value creation is in fact not the only aspect in explaining the CBM&A activity. Other indirect benefits are also likely to be derived from this activity.

Therefore, the main focus in this study may not be actual value creation, but more a focus in relation to survival within the industry and ensuring regional presence. This motivation guided by competitive needs in order to secure survival might be considered value in itself, even though; it cannot be measured in the stock price or the accounting figures.

This motivation for CBM&A activity drawn by the competitive environment presents a somewhat different criterion for success. A criterion in which a successful cross border merger or acquisition is one in which value needs not be created as long as the company do not loose compared to the market, and so it is in this case satisfactory to follow the market and not necessarily to beat the market.

In taking this perspective on the effect and success of a cross border merger or an acquisition a zero abnormal performance compared to the preceding period is satisfactory as long as the company after the merger or the acquisition do not perform worse than the market.

5.4 Limitations of the Study

The results of this study should be considered with a degree of knowledge of its limitations. Those limitations have resulted from a problem with non availability of a recognized database which maintains the details of cross border mergers and acquisitions in Kenya. This meant that all the data had to be manually gathered due to the unavailability of the suitable electronic databases.
The manual collection of the data proved to be a time and effort consuming exercise. The size of the sample used to conduct the various studies in the study might have been larger if an electronic database was available. Another limitation was the unavailability of the data needed to analyze the impacts of some firm characteristics on the differences between the reactions of the market to the announcements of cross-border M&As by Kenyan acquirers, as well as the impacts of the characteristics on the difference between the effects cross-border M&As on the operating performance of Kenyan acquirers. There was also the limitation in the difference between the impacts cross-border M&As on the operating performance of Kenyan acquirers in periods longer than one years after the M&As as there could be other factors and no company in Kenya would have information that specifically detail the benefit of the acquisition in isolation. This could be an important limitation if firms undertake cross-border M&As as long term strategic activities which they expect to generate higher profits in future years.

5.5 Suggestion for Further Research

This area of cross border merger and acquisition needs further research in order to determine several outcomes. Most of the study done only compares the results of the year before the acquisition and the year after the acquisition. This may be misleading as the correct benefits to such a transaction are long term and the returns will definitely be realized after several years. Some firms may undertake M&As as long-term strategic activities which they expect to generate high profits for them over a very long time period. Therefore, future research should examine time periods longer than one year after
the M&As in order to check whether or not the impacts on the operating performance of firms change over longer time periods.

Based on the findings from this study as well as the other previous literature, recommendations and suggestions for further investigation are provided in order to obtain greater understanding of the findings presented in this thesis and to improve them.

For example, different approaches can be used in future studies in order to add to the understanding of the background and consequences of CBM&A transactions. One approach is to examine the issue of M&As more closely and in greater detail by using a case study analysis since this approach may provide better insights into the actual qualifications, motives and consequences of the M&A transactions. The findings of those case studies might explain any variations in the results of this current thesis and complement the findings in it.

There is also need to do a study on the private companies who also actively participate in CBM&A and whose performance may not easily be available since these are not publicly published. Finally, movement in the prices of shares of the acquiring companies in the stock market would be an interesting study as this is the determination of the actual return to the current stock holders.
REFERENCES


# APPENDIX 1: KENYA LISTED FIRMS INVOLVED IN CROSS BORDER ACQUISITIONS

<table>
<thead>
<tr>
<th>ACQUIRING FIRM</th>
<th>ACQUIRED FIRM</th>
<th>Country of Acquisition</th>
<th>Date of Acquisition</th>
<th>% Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank Limited</td>
<td>Uganda Microfinance Limited</td>
<td>Uganda</td>
<td>17.04.08</td>
<td>100.0%</td>
</tr>
<tr>
<td>NIC Bank Ltd</td>
<td>Savings &amp; Finance Commercial Bank Limited</td>
<td>Tanzania</td>
<td>01.05.09</td>
<td>51.0%</td>
</tr>
<tr>
<td>Kenya Airways Ltd</td>
<td>Precision Air</td>
<td>Tanzania</td>
<td>2003</td>
<td>49.0%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>Mwananchi Communications Ltd</td>
<td>Tanzania</td>
<td>December 2002</td>
<td>60.0%</td>
</tr>
<tr>
<td>Nation Media Group Ltd</td>
<td>Monitor Publications Limited</td>
<td>Uganda</td>
<td>June 2005</td>
<td>76.5%</td>
</tr>
<tr>
<td>TPS East Africa Limited</td>
<td>TPS Uganda Limited</td>
<td>Uganda</td>
<td>12.10.12</td>
<td>79.2%</td>
</tr>
<tr>
<td>East African Breweries Ltd (EABL)</td>
<td>Serengeti Breweries limited</td>
<td>Tanzania</td>
<td>October 2010</td>
<td>51.0%</td>
</tr>
<tr>
<td>East African Breweries Ltd (EABL)</td>
<td>Uganda Breweries Limited</td>
<td>Uganda</td>
<td>June 2002</td>
<td>98.2%</td>
</tr>
<tr>
<td>East African Cables Ltd</td>
<td>Daesung Cable Ltd</td>
<td>Tanzania</td>
<td>November 2005</td>
<td>51.0%</td>
</tr>
</tbody>
</table>

Source: Author