MERGERS AND ACQUISITIONS AS AN ENTRY STRATEGY BY MAJOR BANKS IN KENYA TO EXPAND IN THE EAST AFRICAN MARKET

BY

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

OCTOBER, 2013

DECLARATION

I declare that this is my original work and has not been presented for an award in any other university.

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This research project has been submitted with my approval, as university supervisor**.**

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ACKNOWLEDGEMENTS

I wish to take this opportunity to acknowledge the contributions of the countless people whose thoughts, ideas, perspectives and efforts have shaped and given the exposure of this research paper. I would also like to acknowledge my supervisor, **Eliud O. Mududa** without whose valuable support, this work would not have been possible to undertake.

I wish to appreciate my parents for their dedication and encouragement to pursue this paper, my achievements are yours. Lastly I wish to thank my brother, sisters and friends for supporting me all through.

DEDICATION

This work is dedicated to my family for their support, encouragement and understanding throughout the entire study period. More so I thank the almighty Lord for giving me guidance and strength all through.

ABSTRACT

The major banks based in Kenya have embarked on an aggressive expansion to the East Africa market with the sole purpose of taping into the larger market. These banks have adopted different entry strategies in these markets depending on the suitability of the strategy in the different countries. With only a small percentage of the population banked, there is need for banks to strategise and reach out to more of the un-banked, which would constitute a big business growth in the region. Therefore, expansion strategy is vital to the adaptation of the changing business environment. This study therefore sought to investigate the extent to which the strategy of mergers and acquisitions has been adopted by these banks in expansion and the appropriateness of the entry strategy within East African market. This study adopted a census survey design. The population comprised the six major banks which were those licensed to operate by the banking Act as at April 30, 2012. The research instrument of data collection was a questionnaire consisting of structured and unstructured questions. Secondary data was also used to obtain the required information. Secondary data included reports to shareholders, public records banking surveys and economic reviews from central bank supervision annual reports. The researcher found out that the institutions adoption of the strategy was guided by the need to increase the level of share capital, expanding distribution network, increasing the market share but the most important was to benefit from best global practices. The researcher also found that among the motives of mergers and acquisition, differential efficiency, operation synergy, market share and market penetration informed the adoption of the strategy to a great extent. Others such as agency problem, tax benefit and pure diversification influenced the decision only to a little extent with the latter only having a moderate influence. The study therefore recommends that for commercial banks to successfully undertake their expansion by adoption of mergers and acquisitions they should ensure that they use the best practice and ensure that they critically analyze and understand the target institutions, be financially stable to implement the expansion, ensure that there is an attractive market before expanding and have appropriate and adequate workforce to implement the expansion.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Increasing trade within the East Africa region is beginning to drive an ever-increasing demand and opportunities for businesses in this region leading to the expansion or reorganization of Kenya based banks in the region. The banks have to evaluate and choose strategies that will enable them penetrate and gain competitive advantage in the new market. Entry strategies are crucial to the survival of new firms as they ensure that the firms are moving in the right direction from the start without deviating from their goals. A number of banks based in Kenya are pursuing regional expansion programmes, a strategy to meet the ever increasing demand for banking services in East Africa region.

The process of banking for the unbanked in Africa has seen millions of people previously considered as being un-creditworthy operate accounts with banks and not micro-finance institutions. This new market is what had brought the move to new territories by banks in the region. Branches opened continuously across the region in a bid to tap resources and avail facilities to people who could not be reached. In so doing there is emergence of new joint ventures, partnerships, mergers, acquisitions and other market entry strategies being put into play by banks as the scramble for customers continues.

Besides, there are urgent bids for the creation of customer specific products depending on the peoples' economic activities such as in the case of fishermen, tourists, florists, cash crop growers etc. Merry-go-round groups have quickly been transformed by banks to groups financing creating a wider reach. With all these, the move to embrace technology has also been put to play with the onset of mobile banking and partnering with mobile service providers to use mobile shops as banking centers. Agency banking model that have just been embraced have further expanded the distribution of banking services leading to the establishment of village banks. Financial services will then be provided from the supermarkets to canteens with much ease. With all that shaping of the banking industry in the country it is hard to know what the next move could be but what is clear is that Kenya based banks will take financial empowerment to another level. This is not only happening in Kenya but also within the wider region as a whole.

The study therefore was seeking to assess the extent to which the major banks in. Kenya applied mergers and acquisitions in their expansion, the appropriateness of adoption of the strategy within the East African market, the level of success or failure of this strategy; the causes of success and failure and recommendation of possible solutions.

1.1.1 Internationalization of business

In economics, internationalization has been viewed as a process of increasing involvement of enterprises in international markets, although there is no agreed definition of internationalization or international entrepreneurship. There are several internationalization theories which try to explain why there are international activities in trade.

Therefore for those entrepreneurs who are interested in the field of internationalization, there is need to posses the ability to think globally and have an understanding of international cultures. The understanding and appreciation of the different beliefs, values behaviors and business strategies of a variety of companies within the different countries, will enable the local businesses to internationalize successfully. Enterprises must also have an ongoing concern for innovation, maintaining a high level of quality, be committed to corporate social responsibility, and above all continue to strive to provide the best business strategies and goods or services demanded in the various countries they are expanding to.

1.1.2 Foreign market entry strategies

There are a variety of ways in which a company can enter a foreign market. No one market entry strategy works for all international markets. Direct exporting may be the most appropriate strategy in one market while in another you may need to set up a joint venture and in another you may well license your manufacturing. There will be a number of factors that will influence your choice of strategy, including, but not limited to, tariff rates, the degree of adaptation of your product required, marketing and transportation costs. While these factors may well increase your costs it is expected the increase in sales will offset these costs. Here is a brief on the market entry strategy that a firm can apply: Local office is simple form of foreign direct investment; the exporter establishes a local presence through a representative or branch office, rents office space and hires staff (could be just one person).

If the company is interested in going beyond the simple export of goods and services, licensing, joint ventures (JV) and offshore operations should be explored. While direct exporting may be a profitable method of market entry for some businesses, licensing manufacturing rights to your product to a foreign company or setting up a foreign manufacturing JV may be viable alternatives. Strategic alliance partners are often identified through bankers, accountants, business consultants, industry associations and networks, and government contacts.

1.1.3 Mergers and acquisition as a foreign market entry strategy

Growth is essential for sustaining the viability, dynamism and value-enhancing capability of a firm. A growth-oriented firm is not only able to attract the most talented executives but it would also be able to retain them. Growth leads to higher profits and increase in shareholders' value. A firm can achieve its growth objective by combining its operations with other firms through mergers and acquisitions (Pandey, 1999). It follows that M&A activity is a key corporate growth strategy in finance through which managers can enhance their firms' growth.

Mergers and Acquisitions (M&A) are the most popular means of corporate restructuring or business combination, which have played an important role in the external growth of a number of leading firms in the world. Literature shows that the number of world mergers and acquisitions is high in developed countries than in developing countries. This disparity reveals that most firms have tended to keep off from pursuing M&A as reflected by the statistics of firms that have merged with or acquired other firms in Kenya during the period 1995 – 2001, hence missing out on benefits of M&A growth strategy. However over the past few years economic activities in the country have been characterized by an increasing number of local and cross-border mergers and acquisitions due to the benefits that accrue thereof. The ensuing disparity in world mergers and acquisitions and Kenya in particular necessitates this study.

1.1.4 East African market

The East African Community constitutes a major common market operating as an integrated customs union, since 01 July 2011. The East African Community provides a rare opportunity for the business community in the five countries of Rwanda, Burundi, Uganda, Kenya and Tanzania to enjoy a seamless market. This market has a population of 133.5 million and a GDP of US Dollars 74.5 billion. The GDP per capita is US Dollars 558.00. The opening up of East Africa provides rare opportunity for the business community in the region to explore and benefit from markets that have until very recently been beyond reach. Emphasis of the East African Community is on merchandize and trade. The potential is therefore vast for the business community in the region.

The overarching objective of establishing an EAC Common Market is to realize an accelerated economic growth and development; through the attainment of free movement of persons, labour, goods, capital and services, and the right of establishment and residence. It is envisioned that the Business Community will benefit from the Common Market through a more strengthened, coordinated and regulated economic and trade relations among Partner States. This, it is expected, will assist in promoting regional accelerated harmonious and balanced development.

1.1.5 Structure of banking industry in East Africa

The commercial banking industry in Kenya is the fourth largest in the region behind South Africa, Nigeria, and Mauritius. The banking sector includes 43 commercial banks, including 12 foreign banks. Cross-border linkages are an important feature; seven Kenyan banks have established subsidiaries in neighbouring countries. The banking system in Tanzania has grown significantly since 2003, but remains relatively small and dominated by a top tier of larger domestic legacy and foreign banks. There are 33 commercial banks in Tanzania, including 16 foreign banks. Government ownership is limited to four smaller fully-owned banks and minority stakes in the three largest domestic banks. The top tier mainly caters to a small group of large corporate, which often represent up to 70 percent of banks' loan portfolios.

The sector in Uganda has expanded significantly since a moratorium on licensing new banks was lifted in 2005. Eight new banks have been licensed since 2005, bringing the total to 22 commercial banks, including 14 foreign banks, operating in Uganda. In addition, the total network of bank branches has more than tripled over that time to 390. There are 12 commercial banks operating in Rwanda, including three foreign banks, while in Burundi there are seven commercial banks and two financial establishments with total assets representing 54 percent of GDP. Privately owned banks account for 73 percent of assets and 80 percent of deposits; the government remains the majority shareholder in two banks, and in two financial establishments specializing in housing and development.

1.1.6 Banking industry in Kenya

Central Bank of Kenya is the body mandated to supervise the activities of the banks in the country. It is tasked with formulating and implementation of monetary and fiscal policies. Central bank is the lender of last resort in Kenya and is the banker to all other banks. The CBK ensures the proper functioning of the Kenyan financial system, the liquidity in the county and the solvency of the Kenya shilling. The Ministry of finance is where CBK falls.

To address issues that affect the Banking industry in Kenya, banks have come together and formed a forum under the Kenya Bankers Association. Kenyan Banks have realized tremendous growth in the last five years and have expanded to the East African region. The banking industry in Kenya has also involved itself in automation, moving from the traditional banking to better meet the growing complex needs of their customer and globalization challenges. There has been increased competition from local banks as well as international banks, some of which are new players in the country. This has served the Kenyan economy well as the customers and shareholder are the ones who have benefited the most.

The number of commercial banks in the sector declined to 43 by June 30 2012 from 48 in June 2005 following mergers. Among the recent mergers are CFC/Stanbic Bank merger, EABS-Akiba Bank merger, EABS/ECOBANK merger. These mergers have been aimed at strengthening the financial base of the resulting firm hence increasing its competitiveness. Other non-bank financial institutions (NBFIs) include mortgage finance companies, building societies and SACCOs, which also provide basic banking services

(Monthly economic review; Jan 2006 issue) According to the Central Bank of Kenya, during the year the banking sector recorded improved performance in the fiscal year 2011/12. The sector's total assets increased by 15.8 percent from Ksh 1,873.8 billion in June 2011 to Ksh 2,195 billion in June 2012.

1.1.7 Major banks in Kenya

Having in mind that the study focuses on the major banks, CBK classifies a bank as being "large" when it achieves more than five per cent market share. A bank's market share is determined by the size of its total assets, loan accounts, deposit base, and total capital. Mid-tier banks are those with a market share below five per cent but larger than one per cent, while those with less than a percentage are classified as small banks.

There are six large banks which control 53.7 per cent of the industry, 15 mid-tier lenders and 22 small sized banks whose combined market share of 9.46 per cent. These six banks include, Equity Bank, Kenya Commercial Bank, Co-operative Bank, Barclays Bank, Standard Chartered Bank, CFC stanbic Bank.

1.2 Research problem

In respect of expansion in the banking sector, Burger (1995) stress that although it offers many benefits to the firms operating in this sector, there are also many complex issues associated with global expansion. Some of these issues have been identified by Dymsza (1972) who highlights the following as most relevant; firms must deal with multiple political, economic, legal, social and more so the cultural environments as well as various rates of change within each of them. Social cultural, national differences and variations in business practices all tend to make communication between headquarters and overseas affiliates difficult.

Present and future competition may be more difficult to undertake in a number of countries because of differences in industrial structure and business practices. The degree of significant economic, marketing and other information required for planning varies a great deal among countries in availability, depth and reliability.

According to Fish and Rudolf (1986), these complexities are especially important in the banking industry where changing environmental conditions can have a large impact on banks returns. In order to overcome these complexities, these organizations from their viewpoint, usually determine marketing opportunities in a country by way of a four-step process which are general environment, market potential, sales and weighting prospective profitability versus risks. They further emphasize that analysis of the business environment takes on a much more significant dimension in plotting international expansion. Such an analysis includes studying political, economic and social aspects of the target country.

Another angle of expansion has been approached by Dunning and McQueen (1982) who use economic theories to explain the strategies adopted by some large banking organizations when expanding their business. The strategies of business expansion in the banking sector have been looked at occasionally by researchers who did not distinguish processes from strategies.

However, inorganic growth and licensing have been regarded as the main strategies for banks business expansion. This importance of monitoring the environment has been emphasized by West and Olsen (1989), who maintain that the information resulting from this process, can be used for strategic purposes. It is their view that the increased complexity, the acceleration in the rate of change and the variability in the environment and resulting trends have brought about a need for management to develop methods of monitoring the environment.

Regarding strategic planning for banking organizations, Little john (1991) argue that, apart from the obvious service nature of the industry, applications of strategy will have to take into account the variability of conditions in different locations due to the multi-site nature of hospitality operations. Therefore there is need to plan corporate-wide issues and the overall distribution of bank portfolios when deciding where new units should be opened. The question for this study therefore is: why have major banks in Kenya adopted mergers & acquisitions as an entry strategy within the East African market?

1.3 Research objectives

The objectives of this study were:

i. To determine the extent to which major banks in Kenya have adopted the strategy of mergers and acquisitions in the expansion within the East African market.
ii. To determine the appropriateness of adoption of mergers and acquisitions as an entry strategy within the East African market by the major banks Kenya.

1.4 Value of the study

To managers the study will enable managers of Commercial Banks in Kenya and the region, understand and appreciate the expansion strategies that relate to the industry. The study will also assist other small banks managers make appropriate decisions having studied the strategies that have been implemented by the Commercial Banks in Kenya to successfully expand their operations in the region. Managers will also be made aware of the challenges that have been experienced in the adoption and implementation of the strategies of mergers and acquisition and hence this will help them make appropriate adjustments to counter these challenges and achieve the best results.

To the customers the study will assist users understand the prospects of development in the banking industry and appreciate them. This is important because any cost implications, which may be passed to the customers in exchange for better service delivery, will be accepted. The users will also be able to predict the future of the Commercial Banks and prepare to conform.

To regulators and policy makers the study will provide insights on the strategies that can enhance the sector's growth, and hence guide in regulation and policy formulation. This will therefore help policy makers of the Banking sector such as Central Bank and ministry of Finance and Planning among others in the East Africa region, with the development and review of existing policies to achieve synergy with the existing circumstance.

To researchers and academicians, the study will provide materials of reference on the same topic of mergers and acquisition as an expansion strategy. In addition the study will also highlight other topics of future research like the relations between strategies adopted and the survival of the banking industry.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The aim of this chapter is to explain the process of arriving at this particular research topic. In the quest for explaining the process, we try to understand various terms used frequently in merger and acquisition research and study important works of authors associated with the field.

2.2 Conceptual Foundation

Merger and Acquisition literature is laden with usage of terms like merger, acquisition. Many authors use this terms/classify them differently. A few arduously distinguish between each, whereas others use them synonymously. For example, Weston, Chung and Hoag (1996) recognize two forms of combinations- mergers and acquisitions (tender offers). Machiraju (2003) on the other hand uses merger as a broader term and considers acquisitions and takeovers as two of its type. Other works in the area classify combinations as mergers, acquisitions (takeovers) and hostile takeovers (tender offers are considered as one of the modus operandi for hostile takeovers). In the following paragraphs, we try to study and understand these terms with help of definitions provided by various authors/ sources and theories.

2.2.1 Psychic distance theory

According to Evans Jody, Treadgold, Alan Mavondo and Felix, Psychic distance is the distance between the home market and a foreign market resulting from the perception and understanding of cultural and business differences. Psychic distance is a key factor in explaining variations in both expansion patterns and organizational performance. Despite the substantial growth in research on internationalization of retailing, most contributions have been highly descriptive and generally benefit of coherent theoretical frameworks. The psychic distance concept provides an appropriate theoretical framework to explain variation in the organizational performance of retailers operating in the international arena. It is recognized that psychic distance alone cannot explain variation between countries in retailers` performance. Other factors such as the strategic decision making process, entry strategy adopted, the nature of the business, the extent of adaptation to the business environment and organizational & managerial characteristics also influence the performance of the international business.

2.2.2 A view of bank concentration theories

Concentration refers to the degree of control of economic activity by large firms Sathye, (2002). Increase in concentration levels could be due to considerable size enlargement of the dominant firm(s) and / or considerable size reduction of the non-dominant firm(s). Conversely, reduction in concentration levels could be due to considerable size reduction of the dominant firm(s) and / or considerable size enlargement of the non-dominant firm(s) Athanasoglou et al., (2000). The degree to which bank market structure matters for competition and performance has been a “hotly debated topic”. The outcomes of numerous researches have resulted in the existence of numerous bank concentration theories in literature. In the main, these theories could be classified into pro-concentration theories and anti-concentration theories. The theoretical analysis of the concentration implications of the Kenyan banks consolidation exercise shall be based on these theories.

2.2.3 Pro-concentration theories

Proponents of banking sector concentration argue that economies of scale drive bank mergers and acquisitions (increasing concentration), so that increased concentration goes hand-in-hand with efficiency improvements Demirguc-Kunt and Levine, (2000).

To buttress this point, Boyd and Runkle (1993) examined 122 U.S. bank holding companies and found an inverse relationship between size and the volatility of asset returns. However, these findings are based on situations in which the consolidations were voluntary, unlike the case with the concluded banks consolidation exercise in Kenya. Some theoretical arguments and country comparisons suggest that a less concentrated banking sector with many small banks is more prone to financial crises than a concentrated banking sector with a few large banks. This is partly because reduced concentration in a banking market results in increased competition among banks and vice-versa. Proponents of this ‘concentration-stability’ view argue that larger banks can diversify better so that banking systems characterized by a few large banks will be tend to be less fragile than banking systems with many small banks.

According to Allen and Gale (2003), concentrated banking systems may also enhance profits and therefore lower bank fragility. High profits provide a buffer against adverse shocks and increase the franchise value of the bank, reducing incentives for bankers to take excessive risk.

Furthermore, a few large banks are easier to monitor than many small banks, so that corporate control of banks will be more effective and the risks of contagion less pronounced in a concentrated banking system Beck, Demirguc-Kunt and Levine (2003).

2.3 Mergers and acquisitions

Investopedia.com4 defines merger as, ‘a merger involves the mutual decision of two companies to combine and become one entity; it can be seen as a decision made by two “equals". The combined business, through structural and operational advantages secured by the merger, can cut costs and increase profits, boosting shareholder values for both groups of shareholders. A typical merger, in other words, involves two relatively equal companies, which combine to become one legal entity with the goal of producing a company that is worth more than the sum of its parts. In a merger of two corporations, the shareholders usually have their shares in the old company exchanged for an equal number of shares in the merged entity.’ Weston, Chung and Hoag (1996:4) define merger as, ‘any transaction that forms one economic unit from two or more previous ones’. Mc Carthy (1963: 16) defines merger as, ‘the combination of two or more business entities into a single economic enterprise.

According to De Pamphilis (2001:5), ‘mergers can be described from a structural or industrial-operational perspective. From a structural standpoint a merger is a combination of two firms in which only one firm’s identity survives. A statutory merger is one in which the acquiring company assumes the assets and liabilities of the target company in accordance with the statutes of the state in which it is incorporated. A subsidiary merger of two companies occurs when the target becomes a subsidiary of the parent.

Investopedia.com6 defines acquisition as, ‘a takeover, is characterized by the purchase of a smaller company by a much larger one. This combination of "unequals" can produce the same benefits as a merger, but it does not necessarily have to be a mutual decision. A larger company can initiate a hostile takeover of a smaller firm, which essentially amounts to buying the company in the face of resistance from the smaller company's management.

Unlike in a merger, in an acquisition, the acquiring firm usually offers a cash price per share to the target firm’s shareholders or the acquiring firm's shares to the shareholders of the target firm according to a specified conversion ratio. Either way, the purchasing company essentially finances the purchase of the target company, buying it outright for its shareholders’. According to Machiraju (2003:2), ‘the traditional acquisition is the negotiated acquisition in which a willing buyer and willing seller negotiate the terms under which an acquisition or merger occurs.

Mc Carthy (1963: 16) defines acquisition as, ‘a number of so-called mergers involving exchanges of capital stocks legally are acquisitions, particularly where there are large number of shareholders involved. In such non-merger cases, one company “acquires” the voting stock of another solely in exchange of its voting stock. Acquisitions, in a legal sense, may also be effected for cash or cash equivalent, such as debt securities’. According to De Pamphilis (2001:5), ‘an acquisition occurs when one company takes a controlling stake in another firm, a legal subsidiary of another firm, or selected assets of another firm such as a manufacturing facility'.

2.4 Types of mergers and acquisition

Mergers and acquisitions are categorized into four major types on the basis of product and market in which the acquirer and acquired company operate before the merger. Horizontal merger involves two firms operating and competing in the same kind of business activity and geographical market. Vertical Merger integrates the operations of a supplier and a customer. In a backward vertical merger, the customer acquires the supplier, whereas in a forward merger the supplier acquires the customer.

In concentric merger a market/technology extension merger takes place between two companies in a similar field whose sales do not overlap but may expand the acquiring firm's geographical or product market owing to related market/technology while on the other hand conglomerate merger occurs between firms engaged in unrelated types of business activities. Basic purpose of amalgamation is utilization of financial resources, risk diversification and also a synergy of managerial functions.

Finally we have cross-border merger and acquisition which according to Mangold and Lippok (2008) are less frequent, particularly those involving firms in different industry segments.

2.5 Motives of mergers and acquisitions

There are various motives for acquisitions and mergers. These extend from economies of scale to managerial motives. Here an attempt is made to evaluate some of these reasons.

Differential efficiency; this theory stresses on differential efficiencies of different management in different companies. Manne (1965) highlights the existence of a positive correlation between corporate managerial efficiency and the market price of shares of that company. If a company is poorly managed the market price of the shares of that company falls as compared to the market price of the shares of other companies in the same industry. This difference in share price of companies indicates the potential capital gain that can accrue if the management of the company passed into the hands of a more efficient management. The company in question becomes an attractive takeover target for those who believe that they can manage the company more efficiently. Firms operating in similar business are more likely to be acquirers since they would better possess the ability to detect under-performance and will have the knowhow to turnaround the company.

Inefficient management; this theory is related to the differential efficiency theory. Takeover is seen as an effort by the shareholders of the acquired company to discipline the management of the company. Managers often have problem in abandoning their old strategies, even when these strategies do not contribute to the growth of the company. When the need to restructure is overlooked by the management, the capital markets through the market for corporate control come to rescue. The shareholders of the target company through the takeover market pass on the control to the more efficient management. The price paid to the shareholders has to be at a premium over current market price (Jensen and Ruback, 1983) to solicit them to sell their shares.

Operating synergy can be achieved through horizontal, vertical and conglomerate mergers. This theory assumes that economies of scale exist in the industry and prior to a merger, the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale. There are four kinds of synergies: cost, revenue and market power and intangibles. Cost synergies are again broken down into fixed cost and variable cost synergies. Fixed cost synergies like sharing central services such as accounting and finance, the office, executive and higher management, legal, sales promotion and advertisement, can substantially reduce overhead costs. Variable cost reduction is associated with increased purchasing power and productivity.

Revenues synergies are associated with cross-selling products or services through complementary sales organizations or distribution channels that sell different geographic regions, customer groups or technologies. Intangibles include brand name extensions and sharing of know how. This kind of synergy is realized by transferring of these intangible capabilities from one firm to another.

Pure diversification; unlike the stakeholders of a company who reduce their diversifiable risk by holding a portfolio of well-diversified scrip, manager's income from employment constitutes a major portion of their total income. Hence risk attached with a manager's income is to a large extent a function of firm's performance. Managers invest heavily in organization capital during their tenure with the firm. A major part of this capital may be firm specific, increasing the employment risk of the managers. Managers can thus be expected to diversify their risk by engaging in conglomerate mergers (Amihud and Lev, 1981). Similarly a firm engaged in manufacturing/marketing of a single product, which is in the maturity or decline phase of its life cycle, might like to invest the cash flows into growing businesses.

The learning by employees has been developed over time. This learning may also be firm specific. It makes sense to employ this organization capital in growth businesses instead of letting them get destroyed with the withered business. Market synergies are discussed in the section on market power.

Agency problems; on one hand literature on mergers and acquisitions points out that corporate takeovers are used as disciplining mechanism by the shareholders of the acquired firm, on the other hand authors also consider takeovers as manifestation of the agency problem. Ignoring the welfare of its shareholders, the management of acquiring company makes value-eroding acquisitions to increase the size of their company and thereby increasing their compensation. The relationship between size and compensation has been signaled by Murphy (1985). Roll (1986) points out that the payment of excess bid premium, in a takeover by the management may be the result of hubris.

Bids are made when valuation of the target firm by the acquiring firm exceeds the market price of the firm. The bids are abandoned when the valuation is lower than that of the market price of the firm. If however there are no gains in the acquisition, then the theory of hubris says that managers do not abandon these bids because of positive errors in valuation i.e. the overbearing presumption of the acquiring managers is that their valuation is right. Jensen (1986) uses the free cash flow hypothesis to explain takeover activity in certain cases.

When a firm generates cash flows and does not have enough projects with a positive net present value, it is prudent to pay the additional cash to the shareholders. This payout of cash is detrimental to the interests of managers, because it reduces the resources under the manager's control and thereby diminishes their power. The management will also have to go through monitoring of the capital requirements when for future need of funds they have to go back to capital markets to raise new resources. Managers have incentives to grow their firm beyond an optimal size (as pointed above). The reward to middle managers through promotions also generates a bias towards growth to supply the new positions that such promotion based rewards system may require.

Acquisitions are one way for the manager to spend excess cash instead of paying it to the shareholders. Therefore managers of firms with free cash are more likely to undertake low benefit or value destroying acquisitions.

Market Power; Acquisitions, especially horizontal mergers may also be undertaken to destroy competition and establish a critical mass. This might increase the bargaining power of the company with its suppliers and customers. Economies of scale may also be generated in the process. Example of this could be VIP's takeover of Universal Luggage and its thereafter putting an end to Universal's massive price discounting, which was eating their profits. The HP and Compaq merger also created the largest personal computers company in India. Internationally, as well this move was supposed to put IBM under immense pressure.

Market expansion (organic route of growth takes time); organizations need place, people, regulatory approval and other resources to expand into newer product categories or geographical territories. Acquisition of another organization with complementary products or geographic spread provides all these resources in a much shorter time, enabling faster growth.

Tax benefits; if a healthy company acquires a sick one, it can avail of income tax benefits under section 72-A of Income Tax Act. This stipulates that subject to the merger fulfilling certain conditions, the healthy company's profit can be set off against the accumulated losses of the sick unit. The money saved must be used for the revival of the sick unit. The healthy company, besides saving on tax, acquires additional manufacturing capacities and strength. Tax advantage was one of the reasons that prompted the takeover of Allwyn by Voltas. Reasons for mergers as enumerated above are all economic in nature and the most commonly quoted ones across various industries. Mergers and acquisitions are a very old phenomenon and have occurred due to these different reasons for over a century now. Renewed interest in mergers and acquisitions in the present context is due to two reasons: first because of increase in number of cross- national mergers and second due to increase in financial stakes involved and the corresponding realization that majority of mergers and acquisitions fail to create value or meet their objectives.

2.6 Non- realization of gains in mergers and acquisitions

Many researchers have tried to explore reasons for failure of mergers/acquisitions. According to Allred, Boal, and Holstein (2005) roughly half of all mergers and acquisitions fail. Homburg and Bucerius (2006) citing work by other authors claim that between sixty to eighty percent mergers fail. The reasons for failure are many. Earlier researchers, for a considerable period of time blamed, mainly economic rationale or reasons like non realization of anticipated synergies and cost savings, incompatible facilities and technologies for dismal success rate of mergers and acquisitions.

In the recent past, however researchers identified integration related issues as major value destroyers. Elucidating reasons for merger failures, Allred, Boal, and Holstein (2005:24) say, ‘but a simpler explanation is perhaps closer to the real issue the merged entities did not fit together or the integration could not be made to work effectively’. Jemison and Sitkin (1986) in their seminal work have tried to answer this question. According to them, success of integration is determined by the importance paid to both organization fit and strategic fit in the pre-acquisition phase.

However, it is observed that strategic fit is given more importance at the expense of organizational fit in the pre-combination phase of merger, thus resulting in unsatisfactory integration and merger performance. Strategic fit is defined as the degree to which the target firm augments or complements the acquirer’s strategy and thus makes identifiable contributions to the financial and non -financial goals of the acquirer. Organizational fit is defined as the match between administrative practices, cultural practices and personnel practices of the acquiring and target firm. Since acquisitions, especially related, require the integration of a variety of organizational activities, issues of organizational fit must also be considered. If during the process of acquisition, organizational fit factors are ignored, the acquisition outcomes are less likely to be desirable. Integration has been highlighted as a crucial factor in ensuring success of merger.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section identified the population and the techniques that were used in conducting the study. It has presented the research design that was used, the data collection method and instruments and eventually how data was analyzed and presented.

3.2 Research design

The research was carried out through a census survey on major banks in Kenya. The researcher intends to collect data from a broad number of members of the population, which would facilitate on understanding the reason for adoption of mergers and acquisition strategies by the major banks Kenya in their expansion within the East African market.

The researcher selected the design because it would best describe the relationships that existed between the variables without bias (Kothari, 2003). The primary purpose of the census survey was to identify the extent to which the strategy of mergers and acquisition had been applied by these banks and its appropriateness.

3.3 Population of the study

The population comprised the six major banks which were, those licensed to operate by the Banking Act as at April 30, 2012. These banks include, Equity Bank, Kenya Commercial Bank, Co-operative Bank, Barclays Bank, Standard Chartered Bank, CFC stanbic Bank.

The census survey focused on acquiring banks, not target banks, due to the unavailability of financial information. The population of interest was subdivided into senior managers in each organization namely; the Heads of Strategy and Planning, Finance Directors and Marketing Directors.

3.4 Data collection

The research instrument for collection of data was a questionnaire consisting of structured and unstructured questions. Secondary data was also used to obtain the required information. Secondary data included reports to shareholders, public records Banking Surveys and Economic Reviews from Central Bank Supervision annual reports.

The respondents were persons who made strategic decisions within the organization. Three senior managers in each organization namely the Heads of Strategy and Planning, Finance Directors and Marketing Directors were asked to fill the form. Some of which were hand delivered and they were picked later and others E-mailed to the respondents. Follow up were done via personal visits, telephone calls and e-mail to facilitate responses and also to enhance the response rate.

3.5 Data analysis

The data collected was recorded, coded, presented and analysis done. Descriptive statistics such as percentages, frequencies, measures of central tendency such as means, and median were used to analyze the data.

Comparison and analysis of ratios were also used to compare the effect of mergers on growth in assets, profitability and shareholders' value during the pre-merger period and post-merger period. The output was presented in the form of tables, bar chart, pie charts, frequencies, percentages and graphs.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents and discusses the analysis of the data collected from the various respondents. The data was also analyzed using the procedures indicated in chapter three above. The data analyzed in this chapter is based on the questionnaires which were presented to the respondents by the researcher. This chapter was discussed under the topics; respondents' rate, qualitative and quantitave data, and discussions of the study as shown below.

4.2 Data analysis and results

From a study population of 18 respondents, 15 respondents from the 6 banks, filled and returned the questionnaires comprising of 83.3% response rate.

4.2.1 Company demographics

Table 1: Number of employees in the bank

Employees	Frequency	Percentage%
Less than 500	**0**	**0 %**
5,00- 1,000	**1**	**16.7 %**
1,001 -2,000	**2**	**33.3 %**
2,001 -5,000	**2**	**33.3 %**

5,001 – 10,000	**1**	**16.7 %**
Above 10,001	**0**	**0 %**
Total	**6**	**100 %**

The study sought to establish the number of employees in the banks. From the study, most of the banks had over 1,000 employees as shown by 33.3%, followed by 16.7% of the banks that had 5,00- 1,000 employees. 16.7% of the banks had more than 5,000 but less than 10,000 employees.

4.2.2 Number of branches in Kenya and East Africa

The researcher found that 66.7% of the bank had more than 100 branches in Kenya with the remaining 33.3% having less than 50.

The study also sought to find out how many branches the banks had in the region. The findings were that half the population had at least a branch in the region with two of them having more than 50 branches each.

4.2.3 Banking services offered to customers

The study found that the banking services offered by banks to customers were such as retail banking services i.e. deposits, withdrawals, giving loan to customers, foreign exchange services, trade finance, investment banking, corporate banking, credit and debit cards, mobile banking, asset financing, Diaspora banking and e-banking

4.3 Expansion within East Africa

Table 2 : Banks that have expanded within East Africa

Expansion	Frequency	Percentage
Those that have expanded	**3**	**50%**
Those that have not expanded	**3**	**50%**

The study found out that 50% of the banks in the study have expanded to East Africa region with the remaining 50% having not expanded to the region as entities based in Kenya.

4.3.1 Motivators of expansion

The researcher also found that the major motivator of expansion was profitability. The banks sort to give the investor a better return on their investment. The others were; increased SME in the region, entrepreneurial leadership in these banks, profitability, improvement of quality of services, increased market share, reaching all the customers, improving economy of scale and scope, and customer relationship management.

4.3.2 Challenges faced during the expansion

The researcher sort to investigate whether the banks had challenges during their expansion. The study shows that all the banks had challenges at given stages during the expansion these challenges include; cultural diversity, in availability of ready work force, political risk, legal & regulatory frame questioning the ability to settle the disputes arising, increased competition, and the high cost of operations .

4.4 Adoption of mergers and acquisition by the banks in their expansion within East Africa.

Table 3 : Banks that had Adopted Mergers and Acquisition in Expansion within East Africa.

Expansion	Frequency	Percentage
Those that have Adopted Merger & Acquisition	**1**	**16.7%**
Those that have not Adopted Merger & Acquisition	**5**	**83.3%**

The study found out that 16.7% of the banks of the banks in the study had adopted the strategy of mergers & acquisition to expand within East Africa region with the remaining 83.3% having not adopted the strategy to expand to the region as entities based in Kenya.

4.5 Discussion

This section discusses the merger options applied by the banks, the motives of expansion within East Africa, the factors influencing the adoption of the strategy and finally the financing and coverage of the expansion.

4.5.1 The merger and acquisition options applied by the banks

The researcher found out that among the banks that had expanded within East Africa, one of the banks had adopted the vertical option of mergers & acquisition to a great extent by taking over a smaller institution completely.

4.5.2 Mergers and Acquisition motives that informed the banks decision

The researcher also found that among the motives of mergers and acquisition, differential efficiency, operation synergy, market share and market penetration informed the adoption of the strategy to a great extent. Others such as agency problem, tax benefit and pure diversification influenced the decision only to a little extent with the latter only having a moderate influence.

4.5.3 Factors influencing mergers and acquisition

By seeking to investigate about the factors that influenced mergers and acquisition, the researcher found out that the institution`s adoption of the strategy was guided by the need to increase the level of share capital, expanding distribution network, increasing the market share but the most important was to benefit from best global practices.

From the study the researcher also found out that government regulations and policies had moderate extent influence on the choice of the strategy, on the other hand financial position, availability of ready workforce and the branch network distribution had a greater influence in deciding to settle on this strategy. Finally market penetration and cultural diversity had the greatest influence in adoption of the strategy of mergers and acquisition.

4.5.4 Financing and coverage of the expansion by the institutions

The findings of the study in relation to the financing of the expansion to East Africa were that the institutions had raised funds from the public through the stock exchange, profit plough backs by the particular institution, the resources from customer deposits, interest from loans advanced from customers, borrowing mainly from central banks and also by collaborating with banks or government agencies. The researcher also found out that the institutions that had expanded to the region had not been able to ensure equal branch distribution in some of the countries of East Africa during the time that the study was conducted. However majority of the institution had brought on board Agency banking, Mobile banking, locating the banks where they were accessible by most customers, E-banking, automated teller machines (ATMs) and POS devices to bridge the gap in financial service provision in these areas.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the discussion of the findings, gives conclusions and provides the recommendations of the study and suggestions for further research. The study was based on the objectives of the study which were to determine the extent to which major banks based in Kenya have adopted the strategy of mergers and acquisitions in the expansion within the East African market and to determine the appropriateness of adoption of mergers and acquisitions as an entry strategy within the East African market by the banks.

5.2 Summary

From the findings, the study found that all the major Kenya based banks that had undertaken expansion were focusing on the need to increase the level of share capital, expanding distribution network, increasing the market share but the most important was to benefit from best global practices. The expansion strategy of mergers and acquisitions was meant to enhance market penetration which was successful to a great extent for some of them.

From the study, the factors that influenced the expansion strategy by the major Kenya based banks were found to be financial position, availability of ready workforce, the branch network distribution, market penetration and cultural diversity.

The study also established that the distribution channels used by the banks to reach all the

Customers were such as, locating the banks where they were accessible by most customers, mobile banking, agency banking, Internet banking, automated teller machines (ATMs), and POS devices.

The study also found that some of the challenges that affected the expansion, and these included; cultural diversity, in availability of ready work force, political risk, legal & regulatory frame questioning the ability to settle the disputes arising, increased competition, and the high cost of operation.

The study also established that in order to fund expansion, the banks obtained the resources from customer deposits, interest from loans advanced to customers, public listing, borrowing mainly from central banks and also by collaborating with government agencies. In order to obtain the appropriate workforce for expansion, the steps taken by the banks were taking contracts with the developers, developing and training the existing employees with the skills to undertake the assignment, negotiations on pay and conditions of employment, shaping of the workforce to meet the needs, recruiting more employees and other non personal services like outsourcing.

5.3 Conclusion

From the study, the researcher concludes that all the commercial banks in Kenya had undertaken major expansion since they were started. The expansion strategies adopted by these banks were physical branch distribution network, infrastructure software, electronic distribution systems and the option of merger and acquisitions was also adopted by the institutions to a little extent but one of the institutions had adopted the entry strategy in one of the country by taking over a small micro finance fully.

The distribution channels used to reach all the consumers in expansion were contracting distributors, locating the banks where they were accessible by most customers, mobile banking, agency banking, Internet banking, automated teller machines (ATMs), POS devices.

The study also concludes that there were factors influencing expansion of commercial banks in Kenya. These factors included availability of managerial workforce resources, industry and/or market attractiveness, access to distribution channels, financial health and government regulatory policies and the challenges that affected the choice of expansion strategy were government policy and regulations, legal policies, business culture, technology and learning and innovations and franchising.

5.4 Recommendations

The study therefore recommends that for commercial banks to successfully undertake their expansion by adoption of mergers and acquisitions they should ensure that they use the best practice and ensure that they critically analyze and understand the target institutions, be financially stable to implement the expansion, ensure that there is an attractive market before expanding and have appropriate and adequate workforce to implement the expansion. Otherwise, they should know how best to obtain them for example through outsourcing experts from the labour market and developing and training their employees with the skills to undertake the assignment.

The banks should also ensure that they have adequate distribution channels to reach all the consumers. They should also consider the government policy that can affect the choice and implementation of the expansion strategy.

5.5 Limitations of the study

The study, therefore, suggests that further research should be undertaken to investigate how other expansion strategies as adopted by the major Kenya based banks and the impact on profitability and market share of the particular institutions.

Further, research should be undertaken in other types of industry to establish the expansion strategies adopted.

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APPENDICES

Appendix I: Respondents Letter

Wallace Muthama,

P O Box 79415-00100,

NAIROBI.

Date: 2nd Aug 2013

Dear Respondent,

<u>RE: MBA RESEARCH PROJECT</u>

I am a postgraduate student at the University of Nairobi in the school of business pursuing a Master Degree in Business Administration (MBA – International Business). As a partial requirement to complete my degree programme, I am undertaking a Management Research on **"Mergers and Acquisitions as an Entry Strategy by the Major Banks in Kenya to Expand in the East African Market".**

Your organization is one of the banks selected and therefore forms part of the population of study. I kindly request for your valuable time in assisting me to complete the attached questionnaire. The information in this questionnaire will be treated with utmost confidentiality and will not be used for any other purpose apart from its intended academic use. A copy of the research report will be availed to you.

Thank you.

Yours Faithfully

Wallace Muthama

Appendix II: Questionnaire

TOPIC: MERGERS AND ACQUISITIONS AS AN ENTRY STRATEGY BY THE MAJOR BANKS IN KENYA TO EXPAND IN THE EAST AFRICAN MARKET

Instructions

(i). kindly give brief responses in the space provided.

(ii). Please tick in the space provided appropriately.

SECTION A: COMPANY DEMOGRAPHICS.

1. Name of the Bank

....

2. Which year was the bank established?

....

3. What is the total number of employees in the Bank?

Less than 500 ( ) 500-1000 ( )

1001-2000 ( ) 2001-5000 ( )

5001-10000 ( ) Above 10001 ( )

4. How many branches does the bank have in Kenya?

....

5. What is the number of branches outside Kenya but within the East African market?

....

6. What banking services does the bank offer to its customers? Kindly list them.

a)..

b)..

c)..

d)...

e)...

<u>SECTION B: EXPANSION TO THE EAST AFRICA MARKET.</u>

1.Has the bank expanded to the East African market?

Yes ( )

No ( )

2. If yes; what is the main motivator of the expansion?

....

3. If no; is the bank planning to initiate an expansion in the near future?

....

4. Are there any challenges in the way of the Bank`s expansion strategy?

Yes ( )

No ( )

5. If yes; kindly state the five (5) major challenges.

i)...

ii)..

iii)...

iv)...

v)..

SECTION C: MERGERS & ACQUISITIONS.

1.Has the institution adopted the strategy of mergers & acquisition in expansion to the East African region?

Yes ( )

No ( )

2. If yes; in how many countries of East African market has the bank applied the expansion strategy?

....

3. To what extent has the bank applied the strategy of merger & acquisition in the East African market.

Little extent ( )

Moderate extent ( )

Great extent ( )

Very great extent ( )

4. To what extent has the expansion strategy been a success?

Little extent ( )

Moderate extent ( )

Great extent ( )

Very great extent ( )

5. To what extent has the Bank applied these options of mergers & acquisition

Merger Options.	Not at all 1	little extent 2	Moderate extent 3	Great extent 4	Very great extent 5
Horizontal M & A					
Vertical M & A					
Concentric M & A					
Conglomerate M & A					
cross border M & A					

If there are others, please specify...

....

....

....

....

....

6. To what extent did the following motives of mergers & acquisition inform the decision by your firm to expand to the East Africa market using the strategy?

	Not at all 1	little extent 2	Moderate extent 3	Great extent 4	Very great extent 5
Differential efficiency					
Inefficient management					
Operating synergy					
Pure diversification					
Agency problem					
Market power					
Market expansion					
Tax benefits					

If there are others, please specify..

....

....

....

....

....

....

SECTION D : FACTORS INFLUENCING THE ADOPTION OF MERGERS & ACQUISITIONS.

1. What has influenced your institution to adopt mergers & acquisitions in expansion to the East Africa market?

i)...

ii)..

iii)...

iv)...

2. To what extent have the following factors influenced the bank to adopt mergers & acquisitions in its expansion strategy?

	Not at all 1	little extent 2	Moderate extent 3	Great extent 4	Very great extent 5
Government regulations & policies					
Financial position					
Availability of workforce					
Market penetration					
Cultural diversity					
The branch network Distribution					

If there are others, please specify...

....

....

....

....

3. How did the bank get the funds to finance its expansion through mergers and acquisitions?

....

....

4. Has the bank been able to ensure that it has equal branch- network distribution within the entire East African market?

Yes ( )

No ( )

5. If No; how has the bank ensured that is reaches out to both the actual and potential customers in this market?

....

....

....

....

THANK YOU

---END..