RELATIONSHIP BETWEEN MERGERS AND ACQUISITION AND THE FINANCIAL PERFORMANCE OF LISTED FIRMS IN NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

Student

I hereby declare that this research project is my own work and effort and that it has not been submitted anywhere for any award. Where other sources of information have been used, they have been acknowledged

Signature …………………………………… Date ……………………………..

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

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DEDICATION

This project is dedicated to my parents for their unwavering support and love all through the project period.

ABSTRACT

Mergers and acquisition plays an important role in external corporate expansion, acting as a strategy for corporate structuring and control. It is a different activity from internal expansion decisions, such as those determined by investment appraisal techniques. M&A can facilitate fast growth for firms and is also a mechanism for capital market discipline, which improves management efficiency and maximizes private profits and public welfare. The main objective of the study was to establish the relationship between mergers and acquisition and the financial performance of listed firms in Nairobi Securities exchange, period of study was between 2000 to 2013.The study used data from firms annual financial reports data, the annual financial reports were obtained from capital markets authority and from the listed firms under study. The various studies on the relationship of mergers and acquisitions on financial performance gave different results; some studies indicate that listed firms experience improved/better financial performance after merger/acquisitions while other studies found no change in the financial performance. Other studies also did indicate listed firms in M&A deals experienced decreased financial performance during early years after M&A and later improved financial performance. The research design for the study was descriptive study; data analysis was divided into pre-merger/acquisition period and post-merger/acquisition period. A Mann Whitney test at confidence level of 95% was performed on data sets to get pre-merger/acquisition period and post-merger/acquisition averages. This helped in comparison of financial performance before and after merger/acquisition. Ratio analysis on financial data collected was undertaken in order to compare and ascertain the financial performance over the two periods. The study concluded that mergers and acquisitions do have a positive relationship with financial performance for firms listed in Nairobi Securities Exchange.

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ABBREVIATIONS

AEX - Amsterdam Exchange

ANOVA - Analysis of Variance

CFROI - Cash Flow Return on Investment

CVA - Cash Flow Value Added

ECOWAS - Economic Community of West African States

EPS - Earnings per Share

EVA - Economic Value Added

M&A - Mergers and Acquisitions

NSE - Nairobi Securities Exchange

ROA - Return on Assets

ROE - Return on Equity)

SG-SSB - Société Générale - Social Security Bank

SPSS - Statistical Package for the Social Sciences

SVA - Shareholder Value Added

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Mergers and acquisition plays an important role in external corporate expansion, acting as a strategy for corporate structuring and control. It is a different activity from internal expansion decisions, such as those determined by investment appraisal techniques. M&A can facilitate fast growth for firms and is also a mechanism for capital market discipline, which improves management efficiency and maximizes private profits and public welfare. Along with globalization, merger and acquisition has become not only a method of external corporate growth, but also a strategic choice of the firm enabling further strengthening of core competence. The mega-mergers in the last decades have also brought about structural changes in some industries, and attracted international attention as explained by (Piesse et al, 2006).

Abdou et al. (2011) noted mergers and acquisitions decisions as critical to the success of corporations and their managers. And many corporations find that the best way to get ahead is to expand ownership boundaries through mergers and acquisitions because M&A create synergies in terms of gain in economies of scale, expansion of operations and costs cutting. Investors may also expect mergers to deliver enhanced market power. Mergers and Acquisitions are the vital growth strategies of corporates in the scenario of globalization and liberalization to face competition and move ahead. M&A have grown

not only in volume but also in value, it is often stated that the companies go for inorganic growth strategies like M&A to improve performance (Leepsa and mishra, 2013).

M&A is built upon hard analysis, research and continuous dialogue among corporate officers, board members and external advisors. Companies unite to forge strengths without necessarily losing individuality while creating a new and better organization. A successful merger is not the result of contracts and documents binding organizations together. Rather it is a function of implicit agreement governing conduct of all individuals involved and the effects the new organization will have on these individuals (Bruner, 2004).

1.1.1 Mergers and Acquisition

Mergers and acquisitions is defined by Walker (2013) as term referring to buying and selling, acquiring and disposing of both private and public companies with cases of acquisitions of publicly traded companies being referred to as takeovers, she indicated that concept synergies is where benefits are realized when two entities are joined together as one of the essence of mergers and acquisitions, so that “two plus two equals five”. The value of the joined firm becomes greater than when the firms are separate.

Mergers occur when two organizations willingly agree to collaborate with each other by joining their available assets, liabilities, and cultural values on a relatively equal basis across different businesses and industries. In contrast, acquisitions occur **when one** organization buys and takes over the operations of another organization (Vazirani, 2012).

Deloitte (2014) defines M&A as a transaction or other event in which an acquirer obtains control of one or more businesses. Resulting transactions are either merger or acquisitions.

Merger is a combination of two or more companies in which the assets and liabilities of selling firms are absorbed by the buying firm. Although the buying firm may be a considerably different organization after the merger it retains its original identity. An acquisition on the other hand is the purchase of an asset such as a plant, a division or even an entire company (Sherman, 2011). Acquisitions of companies can be either full or partial; in full acquisitions the acquirer buys all the stock capital of the purchased company. In particular acquisitions the acquirer obtains a controlling interest, normally over 50% of the equity stocks but less than 100%. Partial acquisitions could occur by agreement when stockholders in target company want to retain a stake in the company post acquisition or because some stockholders in the target company could refuse to sell their stocks. In takeovers negotiations rival bidder can structure deals in significantly different ways. One bidder might want to buy entire target company another majority stake (Dearborn, 2000).

Various types of mergers and acquisitions exist; horizontal M&A is a combination of two firms that produce the same type of goods or service, vertical M&A is a combination between a firm and one of its suppliers or customers, congeneric M&A is a combination between firms in the same general industry but for which no customer or supplier

relationship exist and conglomerate M&A which is a combination between firms in totally different industries (Brigham and Houston, 2009).

1.1.2 Financial Performance

Financial performance refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives is being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Shilpa, 2010).

Financial performance has long been measured using accounting based ratios; this has been termed as inadequate as firms have been focusing on shareholder value as the primary long term objective of the organization. Value based metrics include the economic value added (EVA), the cash flow return on investment (CFROI), the shareholder value added (SVA), the economic margin and the cash flow value added (CVA). Accounting principles is seen to provide companies with room for manipulating the accounting figures. Earnings figures may be computed using alternative and equally acceptable accounting methods, a change in accounting method for financial reporting purposes can materially impact earnings but does not alter company cash flows and therefore it does not affect its economic value (Venanzi, 2012).

1.1.3 Mergers and Acquisitions on Financial Performance

Business combinations are always related to external business expansions, the reasons for business expansions include; acquiring sources of new productive facilities, productions know how, marketing organizations, obtaining competent management, achievement of economies of scale and tax advantage. It is based on use of resources of an existing business to achieve growth in business activity by increasing sales, entering new markets and achieving economies of scale (Zaneta and Lina, 2003).

Basis for mergers is the assumption that such consolidations lead to improvements in efficiency and profits amassed through increased market power, economies of scale, reduced earnings volatility, diversification, and other financial and operational synergies. However with significant increase in mergers collapse of certain firms has been witnessed (Sharma, 2009). Merger and acquisitions acts as an important tool for the growth and expansion of the economy. The main motive behind the merger and acquisitions is to create synergy, that is one plus one is more than two. Merger and acquisitions help the companies in getting the benefits of greater market share and cost efficiency (Khan, 2011).

1.1.4 Listed Firms in Nairobi Securities Exchange

Mergers and acquisition activities in Nairobi Securities exchange have been on the rise over the years, Access Kenya was acquired by dimension data holdings a premium provider of it solutions and services for kes 3 billion in May 2013. Another acquisition is that of motor dealer cmc motors limited by Al Futtaim which was closed during year

2014, Total Kenya acquired Chevron Kenya in 2009, Transcentury acquired Riftvalley railways during the year 2006 and Unga millers is also in talks to acquire ennsvalley bakery just to mention a few of acquisitions deals (Standard Digital, 2013).

Increased activity among listed financial institutions is also evident, in 2002 I&M holdings merged with Biashara Bank Ltd to form Investment and Mortgage Bank Ltd, Co-operative Merchant Bank Ltd merged with Co-operative Bank Ltd in 2002 to form Co-operative Bank Ltd, First American Bank Ltd merged with Commercial Bank of Africa Ltd in 2005 to form Commercial Bank of Africa Ltd, in 2008 Cfc Bank Ltd merged with Stanbic Bank Ltd to form Cfc Stanbic Ltd Kenya, Commercial Bank Limited merged with Savings and Loan (K) Limited to form Kenya Commercial Bank Limited in 2010 (Central Bank Of Kenya, 2014).

1.2 Research Problem

Mergers and acquisitions continue to be a highly popular form of corporate development, firms engaged in Merger and Acquisitions are more likely to achieve operating and financial synergies and economies of scale therefore leading to stronger post-acquisition operating performance, merger and acquisition failures are few but not uncommon (Gathecha, 2013). Some of the firms listed in Nairobi Securities Exchange have been involved in M&A deals as a way of expansion and strategic development. This is the reason why this study will be of help to investors and other various stakeholders in knowing why some listed firms are engaging in mergers and acquisitions and how does this relate to the bottom line growth in financial performance.

As noted by Zaneta and Lina (2003) business combinations are always related to external business expansions, the reasons for business expansions include; acquiring sources of new productive facilities, productions know how, marketing organizations, obtaining competent management, achievement of economies of scale and tax advantage. Basis for mergers and acquisitions is the assumption that such consolidations lead to improvements in efficiency and profits are amassed through increased market power, economies of scale, reduced earnings volatility, diversification, and other financial and operational synergies (Sharma, 2009).

A study by Xin (2003) using the event study method and accounting indicators, investigated 1216 cases covering all major M&A events related to listed companies in China from 1993 to 2002. The study was aimed on whether M&A created value in China. The results showed that stock prices and financial performances of targeted companies improved significantly after M&A deals; the reverse impact was seen on purchasing companies; and the net impact on purchasing and targeted companies as a whole was not statically significant.Ward and Smit (2007) did a research to determine whether large acquisitions, concluded in 2001, 2002 or 2003 add value to acquiring companies listed on the Johannesburg Stock Exchange Limited. The researchers examined the share price performance of the acquiring company around the acquisition announcement date and the impact on operating financial performance in the two years subsequent to the acquisition. The study concluded that large acquisitions on average give a zero net present value investments for acquiring companies and their shareholders.

Odhiambo (2013) did a study on why organizations undertook the inorganic mode of expansion that is cross border mergers and acquisitions. The focus was on 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. The study revealed that listed firms engaging in cross border mergers and acquisitions exhibited financial gains from these transactions.

Based on studies by different people, few studies have been done on Nairobi Securities Exchange. This gives me a reason to do a study in the Kenyan context. The study will seek to give answer on the relationship of mergers and acquisitions to the financial performance of firms listed in Nairobi Securities. Do listed firms experience growth in their financial performance after a merger or acquisition?

1.3 Research Objectives

The objective of this study is to establish the relationship between mergers and acquisitions and the financial performance of listed firms in The Nairobi Securities Exchange.

1.4 Value of the Study

The study will help shareholders, scholars, government, customers and other interested stakeholders in understanding how listed firms involved in mergers and acquisitions relate with their financial performance. To the Shareholders and employees, the findings

will help shareholders in making decisions related to M&A i.e. various synergies that are as a result and how it relates to financial performance. The employees will be in a position to evaluate on how M&A activities affect financial performance and going concern of related firms. This will help employees make a decision on their job security and air their views using the right channels on issues relating M&A.

The study will assist scholars' access empirical literature and give more avenues for the scholars to do more on the research based on research gaps. The study will also add to finance body of knowledge on what is known about relationship of mergers and acquisitions and financial performance of listed firms. The study will help government in a assessing the relationship of M&A and financial performance; this will help in formulation of laws governing M&A to the benefit of the country and economy.

The study will assist customers be in a position to understand on the possible effects of M&A and how it affects them. Synergies can be created that will lead to reduction of prices of items or otherwise in case the M&A deal does not succeed. M&A also has the possibility of creating monopolistic firms that act to the detriment of customers in terms of prices. Based on the positive and negative effects of M&A customers through relevant systems can air their views.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter is on previous studies done on the topic, the studies are summarized and discussed. Focus is on theoretical reviews i.e. the theories relating to the study, empirical studies i.e. the findings of previous studies on the area of study and the determinants of financial performance.

2.2 Theoretical Review

Theoretical review examines the various theories relating to subject of study, the study will review on theory of financial synergy that explains on benefits gained by firms in term of financial performance as a result of mergers or acquisitions.

2.2.1 Q Theory of Mergers

Jovanovic and Rousseau (2002) developed Q-theory of mergers that proposed that the same forces driving firms' direct investments also drive their decisions about merging with other firms, and views mergersin a macroeconomic sense as devices for solving an economy wide problem of reallocating capital. Reallocation is needed as new technologies emerge with the potential to transform fundamentally the ways that firms do business. Readying the existing capital stock (both physical and human) for use in a new technological climate is less costly, if new firms as they gain experience with new technologies are able to acquire older firms while keeping their organization capital

intact. When this happens, the management skills and technological adaptability of the acquirer are passed to the target's assets, facilitating their transition back to the technological frontier.

A key implication is that firms with high values of Tobin's Q (defined as the ratio of a firm's market value to the replacement cost of its assets), and therefore greater ability to raise the value of target assets, will use acquisitions more intensely than purchases of more costly new capital. The Q-theory of mergers holds that a firm's M&A activity depends on the difference between its Q and the Q's of its potential targets.

Using exchange listed United States firms from Standard and poor's compustat database for 1970 to 2000, Jovanovic and Rousseau (2002) found that M&A investments are more sensitive by a factor of 2.6 to Tobin's Q than are direct investments. Since transactions costs (i.e., brokerage, legal, etc.) associated with M&A are considerable, however, firms must weigh these costs against the advantages of M&A over direct capital investment.

2.2.1 Theory of Financial Synergy

Fluck and Lynch (1999) developed the theory of financial synergy, the theory explains that the motivation of mergers and acquisitions stems from inability to finance marginally profitable projects as standalones due to agency problems. Example is conglomerate merger which is a technology that allows these projects to survive a period of distress by improving profitability. The theory sees mergers as a way of increasing the combined values of acquirers and targets by financing positive net present value (NPV) projects that

cannot be financed as standalones. This theory view mergers as a way to increase the combined value of the acquirer and target.

The theory has two important caveats concerning its applicability; first, one of the merging firms must be experiencing financial distress. The theory is most directly applicable to marginally profitable start-up companies and existing companies that are financially distressed. Second, theory only applies when severe agency problems exist between the manager and the claim holders of the distressed firm. The theory for this reason is more applicable to mergers where one of the merging firms is small (Fluck and Lynch, 1999).

2.2.2 Hubris Theory

Roll (1986) developed Hubris theory, the theory takes a hypothetical view that mergers and acquisitions affect the value of merging firms. When a merger or acquisition announcement is made, the shareholders of the bidding firm incur a loss in terms of the share price while those of the target firm generally enjoy a rise in the share price. The current reasoning behind this is that when a firm announces a merger offer to the target, the share price of the target firm increases because shareholders in the target firm are ready to transfer shares in response to the high premium that will be offered by the acquiring firm.

Roll contends that some managers overestimate their own managerial capabilities and pursue takeovers with the belief that they can better manage their takeover target than the

targets current management team, acquiring managers then overbid for the target and fail to realize the gains expected from the merger in the post merger period thereby diminishing shareholders wealth (Megginson and Smart, 2009).The theory further support explanations such as taxes, synergy as reasons for mergers.

2.3 Determinants of Financial Performance of Listed Firms

Valentin (2012) classifies the financial performance of a company into classic and modern indicators of financial performance. Classic indicators include return on assets, return on equity, return on investment, gross profit margin, net profit margin, debt ratio, current ratio, acid test ratio with modern indicators being related to the concept of creating value. Financial performance exists at different levels of the organization, financial performance measures are split into; profitability, liquidity/working capital, gearing, investor ratios (Kaplan Financial Knowledge, 2014). Determinants of financial performance range from strategy, management and organization effectiveness the measures are explained individually below.

2.3.1 Management

Daft (2009) viewed managers as people who scout for problems, make decisions for solving them and monitor consequences to see whether additional decisions are required. Good decision making is vital part of good management because decisions determine how the organization solves its problems, allocates resources and accomplishes its goals. Apple Company is an example of management good decisions. The company seemed all but dead in mid-1990 but became the world's most admired company in 2008 in terms of

financial performance and other factors. This was based on decisions made by chief executive Steve Jobs and other top managers.

2.3.2 Business Strategy

Kourdi (2009) terms strategy as plans, choices and decisions used to guide a company to greater profitability and success.A clearly considered strategy provides the impetus for commercial success whereas a weak or misunderstood strategy may lead to a company going out of business. Strategy enables managers to understand their customers and competitors. This understanding is dynamic and enables companies develop competitive products. Strategy helps to highlight how profits can be increased through the development of new products and development of their staff skills.

2.3.3 Organizational Effectiveness

Dressler (2004) observed that there is a general assumption that companies with relatively low overheads costs will be more productive and yield better financial performance. The lower the relative overheads costs the better the companies perform in terms of return on sales and return on assets. Business practioners generally agree that effective organizations will positively influence the company's financial performance and value creation.

2.4 Empirical Studies

Olusola and Ojenike (2012) did a study on mergers and performance of conglomerates companies in Nigeria. The study analyzed the effect of mergers and acquisition on performance of firms in Nigeria. Panel data for the study was collected on four sample companies for the period of fifteen years. Conglomerates companies were purposively selected for the study because they were the only sector on the Nigeria stock exchange list that had carried out merger and acquisition, the period of study covered 1990-2005.

Variables used in the study included profitability performance measure by sales/turnovers, net profit, earnings per share, returns on capital employed, and market adjusted returns of securities An analysis of the performance of the selected companies before and after the merger and acquisition transactions revealed that the post-merger and acquisition transactions really improved the performance of sampled companies. This implies that the realization of merger and acquisition objectives such as optimization of resources was achievable.

Research by Halfar (2011) with the aim of evaluating whether, in the long-run acquiring companies create or destroy value with target acquisitions, by comparing and evaluating pre and post-acquisition performance within defined event windows.Three metrics were used namely; abnormal share price return, abnormal operating cash-flow return and abnormal intrinsic value creation. The study population was defined as all mergers and acquisitions that had occurred between 2000 and 2009 in Johannesburg Stock Exchange. The research used a non-representative, judgmental sample of 29. A two tailed paired

sample T-test at the 5% level of significance was used to test for statistically significant difference of means between the pre and post-acquisition event windows. Statistical analysis was completed using IBM's SPSS software package. The research concluded that, on average, mergers and acquisitions destroy value within two years post-acquisition, although some evidence was found in support of acquiring firm value creation in the third year after the acquisition.

Moctar and Xiaofang (2014) did a study on the impact of mergers and acquisitions on the performance of West African banks. The study was conducted across the economic community of West African States (ECOWAS) which is the most popular regional economic community in Africa. To achieve the objective of the study, investigations were conducted to determine banks that have experienced M&A in ECOWAS region. data was collected from banks annual reviews. Three groups of variables were used in this study: liquidity ratio, performance ratios (return on assets and return on equity) and investment valuation variables (earnings per share). Two groups of banks were used as case study: the first group consists of Access bank plc Nigeria and SG-SSB Ghana the two banks that had experienced M&A and the second group consisted of Zenith bank plc Nigeria and Bank of Africa Niger that have not experienced M&A. The study first compared the situation of the first group before and after the mergers and also analyzed the two groups in terms of liquidity, performance and investment valuation using financial ratios. The study revealed that in terms of liquidity, M&A improved the situation of the banks in short and long term. It also revealed that performance and investment variables decrease in the period of M&A and increase two or three years later.

This meant that in West Africa, M&A had significant short and long term positive effects on the liquidity of banks, while a negative effect in short term and a positive effect in long term on the performance and investment valuation variables.

Agorastos et al. (2012) study examined the effects of mergers and acquisitions (M&As) of acquiring firms in Greece among different industries using accounting data. The main objective of the study was to evaluate the post-merger performance of Greek listed firms in the Athens Stock Exchange that participated in merger or acquisition in the five year period from 1998 to 2002, among seven different industry categories. A set of twenty six ratios was employed, in order to measure thirty firms' post-merger performance per industry, as well as the whole sample, and selected accounting data from 1994 to 2006 were compared for the post-merger performance of the sample firms at four years after the M&A events. The results revealed the post-merger performance of the acquiring firms was affected by their industry type. The results also showed M&A did not provide a better post-merger performance for the acquiring firms on the whole examined sample.

Prasad and Mahesh (2012) did a study which focused on the performance of Indian Airline companies after the consolidation of airline sector in year 2007-08. The main objective of the paper was to analyze whether the Indian airline companies achieved financial performance efficiency during the post-merger & acquisition period specifically in the areas of profitability, leverage, liquidity, and capital market standards. Pre and post-merger performance ratios were computed for the entire set of sample companies, which had gone through M&A during the selected period. The pre and post M&A

performance ratios were compared to see if there is any statistically significant change in performance of acquirer firm after M&A, using "paired sample t-test" at confidence level of 0.01 or 99%. Also Pearson Correlation coefficient test was been employed to assess the relationship of variables. The findings of the study showed no improvement in surviving Company's return on equity, net profit margin, interest coverage, earning per share and dividend per share post-merger & acquisition. The study showed a negative relationship between mergers and acquisitions on financial performance.

Sharma (2013) examined the impact of merger on the financial performance of merging companies by examining some pre-merger and post-merger financial ratios. The sample consisted of 9 Bombay Stock Exchange listed companies of metal industry involved in mergers during the year 2009 to 2010. Paired sample t test was carried out to assess the difference in performance between post-merger and pre-merger periods. The findings showed a marginal but not significant improvement in case of liquidity and leverage but the profitability results showed significant decline in return on net worth and return on asset. The results of the study suggested that in case of M&A, synergy can be generated in long run with the careful usage of the resources. The success of M&A deals depended on post integration process, timely action and checking on the costs of integration process. The study showed mixed results on the relationship between mergers and acquisitions on financial performance with time being of essence.

Muia (2011) explored the determinants of growth of firms through mergers and acquisitions in Kenya by focusing on completed merger and acquisition transactions of

firms listed at the Nairobi Stock Exchange. The period covered was the occurrence of M&A between 1999 – 2009.The study examined bidder characteristics, industry variables and market variables. The study population consisted of 32 firms in the financial and industrial sectors listed at the Nairobi Stock Exchange. Stratified and purposive sampling techniques were used to obtain a sample size of 6 firms. The data were analyzed and presented using descriptive statistics implemented through appropriate statistical computer package. Pearson's correlation was used to study variables relationship. Profitability, industry concentration, sales growth and stock market index were the used variables in determining growth of firms through mergers and acquisitions. The study concluded that firms be encouraged to embrace M&A growth strategy in corporate finance especially when pursuing the profitability and wealth objectives.

Gathecha (2013) did a study on information content of mergers and acquisition announcement at the NSE for listed companies. The period covered occurrence of M &A between 1999 to 2011.The study used Descriptive research design, the population of this research consisted of all the companies that had undergone mergers and acquisition. Both stratified and purposive sampling techniques were used to design and select a representative sample size of five firms in financial and industrial. The data was analyzed using descriptive statistics to describe the variables under investigations. Descriptive statistics used were arithmetic mean, median, maximum, minimum, standard deviations, percentages and rankings. Statistical Package for the Social Sciences (SPSS) software was used for data analysis. From the findings, information content of mergers and acquisition positively affected shareholders' wealth, results indicated that generally, there

was an increase in the volumes of shares traded when mergers and acquisitions were announced and also increase in volumes of shares traded after the mergers and acquisitions as compared to those before the mergers and acquisitions.

Harjeet and Jiayin (2013) did a study on empirical investigation of mergers and acquisitions by Chinese listed companies. They examined 136 M&A deals from 1997 to 2007 initiated by Chinese companies listed on the Shanghai and Shenzhen Stock Exchanges where the acquirer gains complete control of the target. The data showed that the Chinese M&A market is dominated by domestic deals with unlisted targets that are either stand alone private firms or wholly owned subsidiaries. Acquirers experienced significant positive abnormal stock returns around the announcement date and over the three years after the acquisition. The results were largely driven by state-owned firms, cash acquirers and firms that acquire related targets. The results did not find change in operating performance from the pre to the post-acquisition period for the acquirers.

Rosy (2013) did a study on mergers and acquisitions with focus on empirical study for the Post-Merger Performance of Selected Corporate Firms in India. A sample of 47 firms listed in Indian stock exchanges which had undergone M&A during April 1, 2008 to March 31, 2009 was chosen. The study captured the impact of M&A on liquidity, profitability, operating performance and leverage of sample merged/acquirer companies using ratio analysis and t-test. The financial ratios used in the study were current ratio, quick ratio, gross profit ratio, net profit ratio, return on assets, return on capital employed, debtors turnover ratio, fixed assets turnover ratio, total assets turnover ratio, debt equity

ratio and interest coverage ratio. The study proved that there is a significant improvement in the liquidity, profitability, operating performance and financial leverage for a few merged/acquirer firms.

Knapen (2012) analyzed the shareholder wealth effects of mergers and acquisitions based on the stock prices of the merging firms in the nine-year period from 2003 up to 2011. The study only included takeovers in which one of the involved firms is Dutch and listed on the Amsterdam Stock Exchange. The hypothesis was tested using an event study, in order to determine abnormal returns in a specific window set around the date of announcement. The study gave insight on effects around the announcement dates of 71 takeovers. For the four investigated event windows, it showed all significant positive cumulative abnormal returns on average. The paper concluded that mergers and acquisitions in the sample did create positive shareholder wealth effects.

2.5 Summary of Literature Review

In summary several theories have been put forward to explain on mergers and acquisitions, Q-theory of mergers as formulated by Jovanovic and Rousseau proposes that the same forces driving firms' direct investments also drive their decisions about merging with other firms, and views mergers in a macroeconomic sense as devices for solving an economy wide problem of reallocating capital, theory of Financial Synergy as proposed by Zsuzsana Fluck and Anthony Lynch explains that the motivation for mergers stems from the inability to finance marginally profitable, possibly short-horizon projects as stand-alone entities due to agency problems between managers and potential

claimholders. The final theory reviewed under study is hubris proposed by Richard Roll contends that some managers overestimate their own managerial capabilities and pursue takeovers with the belief that they can better manage their takeover target than the targets current management team.

The various studies on the relationship of mergers and acquisitions on financial performance gave different results; some studies indicate that listed firms experience improved/better financial performance after merger/acquisitions while other studies found no change in the financial performance. Other studies also did indicate listed firms in M&A deals experienced decreased financial performance during early years after M&A and later improved financial performance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter guides on the methods of how the objective of the study will be achieved, it covers the research design, population, sample design, data collection and analysis.

3.2 Research Design

This is the process that guides researchers on how to collect, analyze and interpret observations. It is a logical model that guides the investigator in the various stages of the research (Degu and Yigzaw, 2006). The research design for the study was descriptive study. Descriptive studies are also conducted to demonstrate associations or relationships between things in the world around. Descriptive studies can involve a one-time interaction with groups of people that is referred as cross-sectional study or a study might follow individuals over time, referred as longitudinal study, descriptive statistics use arithmetic mean, median, mode, maximum, minimum, standard deviations or variance as descriptor of a variable (Basic Research Concepts, 2014). The study focused on why some of the listed firms are engaging in M&A and how does this relate to their financial performance.

3.3 Population and Sample Size

The target population is the group or the individuals to whom the survey applies. It is those groups or individuals who are in a position to answer the questions and to whom

the results of the survey apply (Kitchenham and Pfleeger, 2002). The population for study will be 10 listed firms in Nairobi securities exchange and have participated in mergers or acquisitions during the period 2000 to 2013.

A sample of five companies was picked using judgmental sampling i.e based on the size of the firm and availability of data during pre-M&A and post-M&A period. The sampled companies are, Nation Media Ltd, Total Kenya Ltd, Kenya Co-operative Bank Ltd, Kenya Commercial Bank Ltd and Kenya Airways Ltd.

3.4 Data Collection

The study used secondary sources of data i.e. From the audited annual financial reports of the listed firms over the period of study. Financial annual reports were obtained from capital markets authority and from the listed firms under study. Financial data was from; statement of financial position, statement of comprehensive income, cash flow statements, statement of changes in equity.

3.5 Data Analysis

Data analysis was divided into pre-merger/acquisition period and post-merger/acquisition period. This helped in comparison of financial performance before and after merger/acquisition. Comparison was on 3 years before M&A and 3 years after M&A. Ratio analysis on financial data collected was undertaken in order to compare and ascertain the financial performance over the two periods in line with the method specified by (Agorastos et al, 2012). Profitability as a measure of financial performance was

analyzed; profitability ratios to be done included return on assets (ROA), return on equity (ROE) and earnings per share (EPS), ratio analysis was also used by (Odhiambo, 2013).

The first indicator return on asset (ROA) as a ratio was measured as below, synergies from mergers and acquisition were realized when ROA improves.

ROA = Income after Interest and Tax/Total Assets

The second indicator return on equity was measured as below, synergies from mergers and acquisition was realized when ROE improves.

ROE = Income after Interest and Tax/ Shareholders' Equity

The third indicator earnings per share was measured as below, synergies from mergers and acquisition were realized when EPS improves.

EPS = Income after Interest and Tax - Preferred Stock Dividends/ Average outstanding shares

After computation of the pre and post-performance ratios variables, average ratio performance for each firm was computed both for pre and post-merger/acquisition period. The study then used spss to perform mann whitney test which will helped in getting means for comparing pre and post M&A results. Test was done to determine whether post-acquisition cross-sectional sample means were larger than the pre-acquisition cross-sectional sample means.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

The chapter presents data analysis, interpretation and discussion of the research findings. The results are presented in tables to highlight the major findings; data was obtained from the financial statements of the five listed companies engaged in mergers and acquisitions. The companies are Nation Media Ltd, Total Kenya Ltd, Kenya Co-operative Bank Ltd, Kenya Commercial Bank Ltd and Kenya Airways Ltd.

4.2 Descriptive Statistics

Descriptive data is presented in tabular form in quantitative terms, division is made between pre-M&A and post-M&A. The objective is to find how firms perform financially after a M&A.

4.2.1 Return on Assets

Return on asset (ROA) measures how assets are utilized to generate income for the firm, synergies from mergers and acquisition is realized when ROA improves. Ratio is measured as below,

ROA = Income after Interest and Tax/Total Assets

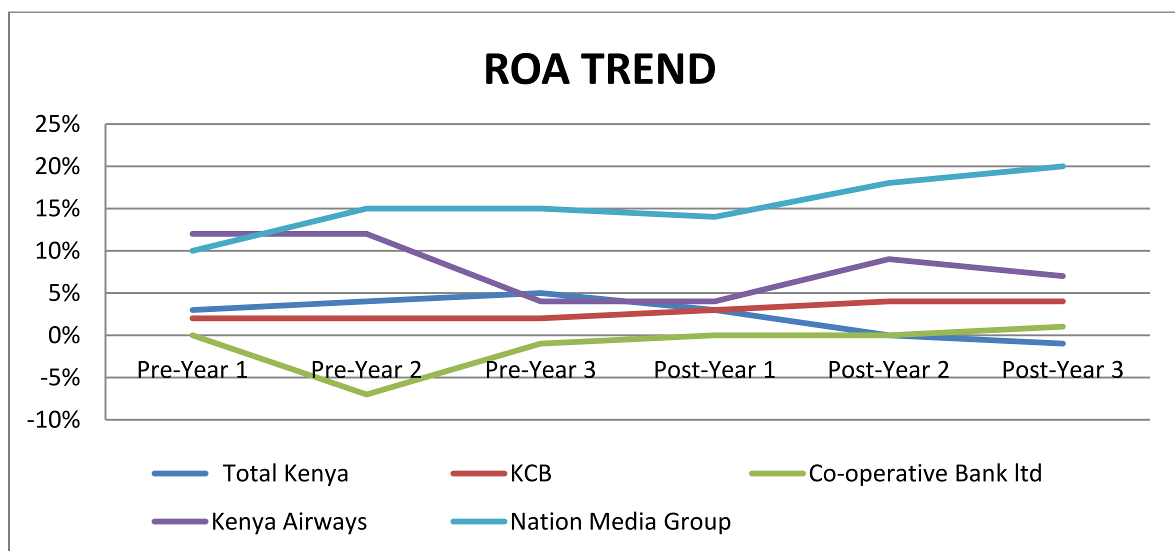
Average ROA for each firm was done i.e. average for both pre-M&A and post-M&A, the results for each firm are as below,

4.1 Table: Firms Average ROA

	pre-acquisition period			Average pre - M&A	post-acquisition period			Average post - M&A
Company	**Year 1**	**Year 2**	**Year 3**		**Year 1**	**Year 2**	**Year 3**	
Total Kenya	3%	4%	5%	4%	3%	0%	-1%	1%
KCB	2%	2%	2%	2%	3%	4%	4%	4%
Co-operative Bank ltd	0%	-7%	-1%	-3%	0%	0%	1%	1%
Kenya Airways	12%	12%	4%	9%	4%	9%	7%	7%
Nation Media Group	10%	15%	15%	13%	14%	18%	20%	17%

Source: Author

Figure 4.1.1 ROA Trend



The ROA trend indicate most companies experienced a better return on assets after a post-merger or acquisition. Total Kenya Ltd and Kenya Airways Ltd post-merger or acquisition performance trend compared to pre-merger or acquisition is lower indicating a poor performance. KCB, Nation Media Group Ltd, Co-operative Bank Ltd post-merger or acquisition ROA trend is on the increase indicating a positive performance.

4.2.2 Return on Equity

Return on equity measures how much profit a company generates with the money shareholders have invested. Synergies from mergers and acquisition is realized when ROE improves. Ratio is measured as below,

ROE = Income after Interest and Tax/ Shareholders' Equity

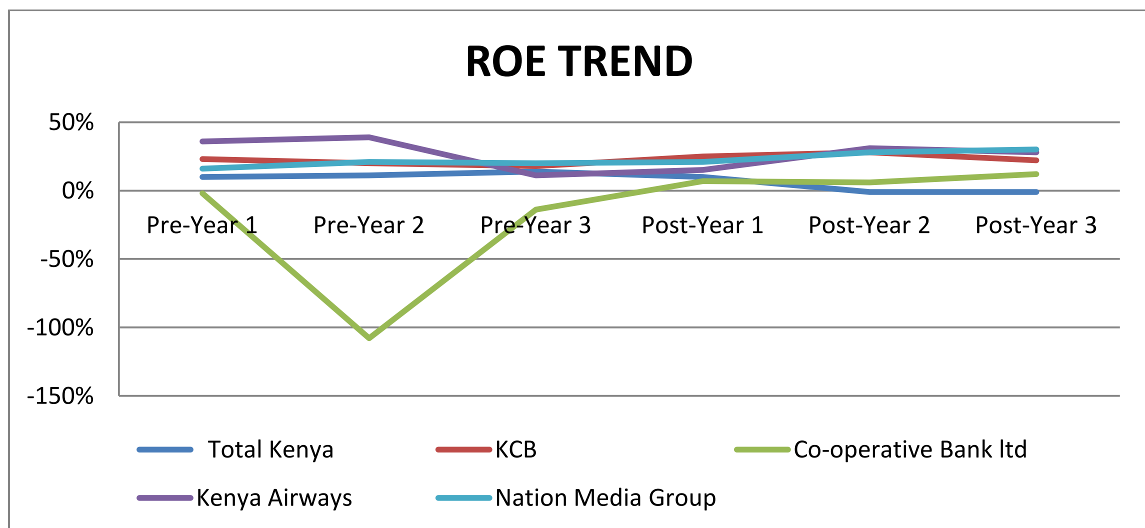
4.2 Table: Firms Average ROE

Companies	**pre-acquisition period**			**Average pre - M&A**	**post-acquisition period**			**Average post - M&A**
	Year 1	**Year 2**	**Year 3**		**Year 1**	**Year 2**	**Year 3**	
Total Kenya	10%	11%	14%	12%	10%	-1%	-1%	2%

KCB	23%	20%	18%	20%	25%	28%	22%	25%
Co-operative Bank of Kenya Ltd	-2%	-108%	-14%	-42%	7%	6%	12%	9%
Kenya Airways	36%	39%	11%	29%	15%	31%	28%	25%
Nation Media Group	16%	21%	20%	19%	21%	28%	30%	26%

Source: Author

Figure 4.2.1 ROE Trend



The ROE trend indicates most companies experienced a better return on assets after a post-merger or acquisition. Total Kenya Ltd was the only company that experienced a down trend in ROE during post-merger or acquisition period. The other companies,

Kenya Airways Ltd, KCB, Nation Media Group Ltd, and Co-operative Bank Ltd reported an improved trend during post-merger or acquisition period.

4.2.3 Earnings per Share

Earnings per share measures portion of a company's profit allocated to each outstanding share of common stock. Synergies from mergers and acquisition is realized when EPS improves. Ratio is measured as below,

EPS = Income after Interest and Tax - Preferred Stock Dividends/ Average outstanding shares.

4.3 Table: Firms Average EPS

Company	**pre-acquisition period**			**Average pre - M&A**	**post-acquisition period**			**Average post - M&A**
	Year 1	**Year 2**	**Year 3**		**Year 1**	**Year 2**	**Year 3**	
Total Kenya	2.78	2.99	4.02	3.26	3.07	(0.24)	(0.32)	0.84
KCB	1.47	1.97	1.84	1.76	3.72	4.11	4.82	4.22
Co-operative Bank ltd	-5.71	-131.65	-23.69	(53.68)	12.79	8.97	31.39	17.72
Kenya Airways	6.05	3.75	1.81	3.87	2.82	8.4	10.45	7.22
Nation Media Group	7.5	11.3	9	9.27	11.00	7.60	9.00	9.20

Source: Author

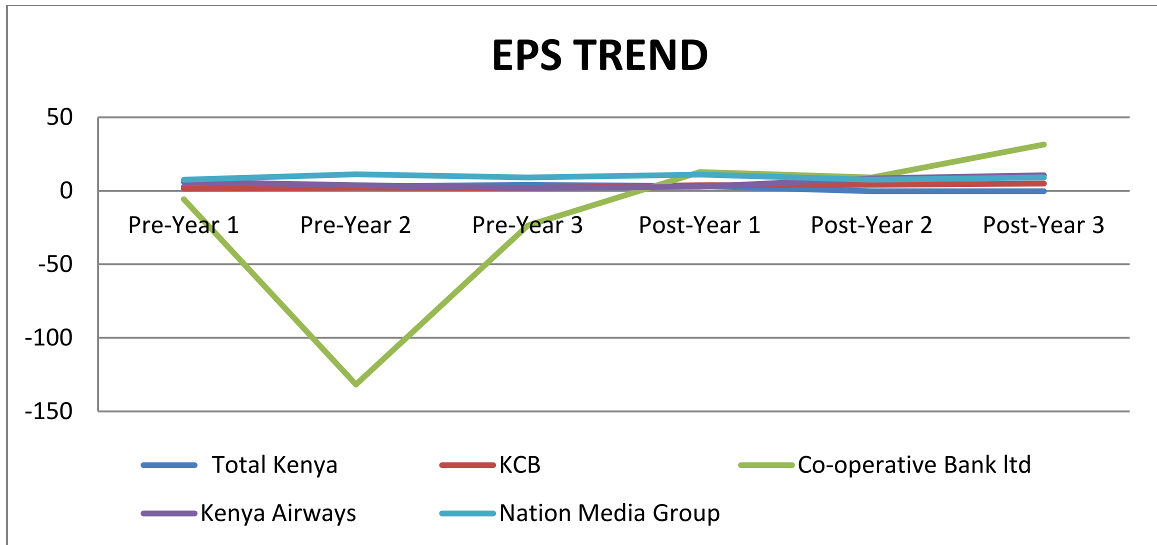


Figure 4.3.1 EPS Trend

EPS trend indicate Total Kenya Ltd and Nation Media Group Ltd reported a decreased post-merger or acquisition performance. The other companies, Kenya Airways Ltd, KCB, Co-operative Bank Ltd had an improved post-merger or acquisition trend. This indicates most shareholders earned much better during the post-merger or acquisition period. Notably is co-operative bank Ltd whose post-merger or acquisition EPS increased by a big margin.

4.3 Findings and Interpretation

To enable comparison of financial performance before and after Mergers and Acquisitions, mann whitney test at 95% confidence level was used to help in getting means out of average performances for the companies.

4.3.1 Return on Asset Measure

Return on asset analysis results give mixed results on post M&A performance, Total Kenya, Kenya Airways reports a negative post M&A financial performance indicating synergies from M&A were not achieved in the firms. However KCB, Co-operative Bank, Nation Media Group reported a positive post M&A financial performance indicating the mentioned firms benefited from M&A activities. Overall performance over the sampled firms show firms benefit from M&A activities.

4.4 Table: ROA analysis

Company	Average pre -M&A	Average post -M&A	Variance
Total Kenya	4%	1%	- 3%
KCB	2%	4%	2%
Co-operative Bank ltd	-3%	1%	4%
Kenya Airways	9%	7%	-2%
Nation Media Group	13%	17%	4%
Means (overall)	5.67%	6.5%	0.83%

Source: Author

4.3.1 Return on Equity Measure

Return on equity analysis also gave mixed results on post M&A performance, Total Kenya, Kenya Airways reports gave a negative post M&A financial performance indicating synergies from M&A were not achieved in the firms. KCB, Co-operative Bank, Nation Media Group reported a positive post M&A financial performance

indicating the mentioned firms benefited from M&A activities. Equally overall performance over the sampled firms show firms benefit from M&A activities.

4.5 Table: ROE analysis

Companies	Average pre - M&A	Average post -M&A	Variance
Total Kenya	12%	2%	-10%
KCB	20%	25%	5%
Co-operative Bank ltd	-42%	9%	51%
Kenya Airways	29%	25%	-4%
Nation Media Group	19%	26%	5%
Means (overall)	4.67%	7.5%	3.33%

Source: Author

4.3.2 EPS Measure

Earnings per share analysis results on post M&A performance indicate varying results among the firms sampled, Total Kenya, Nation Media Group reports gave a negative post M&A financial performance indicating synergies from M&A were not achieved in the firms. KCB, Co-operative Bank and Kenya Airways reported a positive post M&A financial performance indicating the mentioned firms benefited from M&A activities. Overall financial performance over the sampled firms show firms benefit from M&A activities.

4.6 Table: EPS analysis

Company	Average pre - M&A	Average post - M&A	Variance
Total Kenya	3.26	0.84	-2.42
KCB	1.76	4.22	2.46
Co-operative Bank ltd	-53.68	17.72	71.4
Kenya Airways	3.87	7.22	3.35
Nation Media Group	9.27	9.2	-0.07
Means (overall)	-6.33	5.5	11.83

Source: Author

4.4 Discussion of Research Findings

Post Mergers and Acquisitions return on asset findings for Total Kenya and Kenya Airways gave negative results on financial performance indicating synergies from M&A were not achieved in the firms. The other companies studied KCB, Co-operative Bank, Nation Media Group reported a positive post M&A financial performance indicating the mentioned firms benefited from M&A activities. The benefits could as a result of better management, introduction of new strategies or even new inventions as a result of M&A activities. The research findings therefore show the sampled firms benefited from M&A activities.

Return on equity findings which measured on how firms utilized resources received from shareholders funds, indicated overall performance over the sampled firms benefited from M&A. Post M&A financial performance for Total Kenya and Kenya Airways reported a

negative post M&A financial performance.KCB, Co-operative Bank, Nation Media Group reported a positive post M&A financial performance indicating the mentioned firms benefited from synergies resulting from M&A activities.

Financial performance measure in terms of EPS research findings indicate the sampled firms benefited from M&A activities. Post M&A financial performance measured in earnings per share indicate that Total Kenya, Nation Media Group did not benefit from Mergers and Acquisitions. The firms post M&A financial performance on EPS was adverse.KCB, Co-operative Bank and Kenya Airways reported a positive post M&A financial performance on EPS, the firms benefited from various synergies resulting from mergers and acquisition activities.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter gives summary, conclusions and recommendations based on data findings in chapter four. The chapter discussion is based on the objectives of the study i.e. relationship between mergers and acquisition and the financial performance of listed firms in Nairobi Securities exchange.

5.2 Summary of Findings

This study is made up of five chapters, chapter one discussed on background of the study, statement of the problem, objective and the importance of the study. The second chapter was on literature review that discussed both the theoretical review and empirical review on topic of the study. The third chapter focused on methodology of study the contents included the research design, study population, the sample of the study, data collection and data analysis procedure. The fourth chapter covered data analysis, results and discussion of study findings. The fifth chapter focuses on the summary, conclusions and recommendations of the study.

The main objective of the study was to evaluate the relationship between mergers and acquisition and the financial performance of listed firms in Nairobi Securities exchange. The data was collected from the audited annual financial reports of the listed firms over the period of study. Financial annual reports were obtained from capital markets authority

and from the listed firms under study. The data were interpreted using financial ratios namely return on assets, return on equity and earnings per share. Data analysis was divided into pre-merger/acquisition period and post-merger/acquisition period. This was used in comparison of financial performance before and after merger/acquisition. Comparison was on 3 years before M&A and 3 years after M&A.

Findings for return on assets (ROA) indicated that listed firms engaged in mergers and acquisitions benefit in their post financial performance two firms i.e. Total Kenya and Kenya Airways did not achieve the synergies resulting from mergers and acquisitions. Return on equity equally gave mixed results two firms namely Total Kenya and Kenya Airways gave a negative results after post-merger/acquisition, the other firms gave positive results indicating that mergers and acquisitions relationship with financial performance is positive. Earnings per share analysis results on post M&A performance indicate varying results among the firms sampled, Total Kenya, Nation Media Group reports gave a negative poss. Other firms reported a positive post M&A financial performance. Overall financial performance over the sampled firms show positive results indicating that mergers and acquisitions relationship with financial performance is positive.

5.3 Conclusion

Based on the results of empirical study where comparison between pre and post-merger performance in terms of return on assets, return on equity, earning per share the overall results indicated mergers and acquisitions by listed firms result in improved financial

performance. The study was undertaken to test whether mergers and acquisitions do have a positive relationship with financial performance for firms listed in Nairobi Securities Exchange.

The results from the analysis of pre- and post-merger financial performance ratios of sampled firms gave mixed results; there was positive and negative variance on different firms. The study found that there was a general increase in financial performance after mergers and acquisitions based on the objective of the study, which was to determine on the relationship between mergers and acquisitions and financial performance of listed firms. Mergers and acquisitions are therefore helpful to listed firms and can be used as a strategy to improve profitability of firms.

We can therefore conclude that mergers and acquisitions do have a positive relationship with financial performance for firms listed in Nairobi Securities Exchange. Resulting synergies from Mergers and acquisition activities which are normally attributed to various reasons like economies of scale in costs, better management, products differentiation, innovations, new strategies on different areas of operation and overall firm strategy, improved on the financial performance.

5.4 Recommendations

The study compared 3 years pre-mergers and acquisitions and 3 years post-mergers and acquisitions in order to determine the differential financial performance. The comparison period may not depict the true view of post-merger and acquisitions, recommendation is

on the need for research to be done for longer periods up to post period analysis 5-10. The study focused on listed firms it is important also for studies to be done for those firms not listed in Nairobi Securities Exchange. This will enable in comparison of how mergers and acquisitions relate to financial performance of those firms not listed in Nairobi Securities Exchange.

Study further recommends firms to consider mergers and acquisitions as a way of expansion and improvement of financial performance. Firms involved in mergers and acquisitions benefit as a result of creation of economies of scale in costs, improved business strategies, innovations, better management, business expansions among other synergies. These synergies translate to improved financial performance and overall better performance of firms.

The study recommends studies to be done on why some of the firms engaged in mergers and acquisitions do not benefit from the activity. Not all firms engaged in mergers and acquisitions have benefited, some firms have reported decreased financial performance. The study will help in knowing what went wrong during the merger or acquisition activity and how it can be avoided to the benefit of other firms planning to use M&A activity.

5.5 Limitation of the Study

The study had several limitations the data for analysis was not readily available in a database; this made data collection to be a time and effort consuming exercise. The data

had to be collected from different sources i.e. capital markets authority and listed firm's electronic sources. The data availability for firms was not also readily available making a sample of 5 firms to be taken.

The study also ignored the impact of possible differences in the accounting methods adopted by different companies in the sample. Another limitation was on the period covered by study, ideally firms engaging in mergers and acquisitions do so because of long term objectives, the period under study focused on 6 years. The period could not have provided a clear result on the relationship of M&A and financial performance.

The study used three measures of financial performance i.e ROA, ROE, EPS yet there are various other measures that could have been used such as profit margins, return on capital employed and other measures this could have generated different results on post merger/acquisitions financial performance. The study was also limited to mergers and acquisitions on financial performance of listed firms in Nairobi Securities Exchange, studies on firms not listed was limited.

5.6 Suggestion for Further Research

Suggestions for further research help in ensuring greater understanding of the findings presented and how the findings can be improved. The study focused on listed firms however several non-listed firms have engaged in M&A activity and study need to be done on them based on the objective of this study. Research also needs to be done on other motives of mergers and acquisitions other than on financial performance.

More listed firms need to be studied, the period of study should be carried over a long period of time in order for more reliable findings to be found. Mergers and acquisitions activities are normally long term and the benefits are in most cases realized in long term. Further comparative studies also need to be done on listed firms in same industry i.e. banking sector, those firms engaging mergers and acquisitions and those not engaging. This will give good comparative results for firms participating in mergers and acquisitions and those not engaging.

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APPENDICES

APPENDIX 1

LISTED FIRMS INVOLVED IN MERGERS AND ACQUISITIONS

Mergers					
	Merging company 1	**Merging company 2**	**New Company**	**Year of Deal**	**Percentage of acquisition**
1	CFC Bank Ltd	Stanbic Bank Ltd.	CFC Stanbic of Kenya Holdings Ltd	June.2008	N/A
2	Savings and Loan (K) Limited	Kenya Commercial Bank Limited	Kenya Commercial Bank Ltd	Feb.2010	N/A
3	Co-operative Merchant Bank ltd	Co-operative Bank ltd	The Co-operative Bank of Kenya Ltd	May.2002	N/A
Acquisitions	**Acquiring Firm**	**Acquired Firm**	**New Company**		
1	Kenya Airways Ltd	Precision air	N/A	2003	49%
2	Total Kenya Ltd	Chevron Kenya	N/A	June.2009	100%
3	Centum Investment Co Ltd	Platcorp Holdings	N/A	January.2013	45%
4	Trans-Century Ltd	Rift Valley Railways	N/A	December.2006	20%
5	Unga Group Ltd	Unga Millers (Uganda) Ltd	N/A	Sep.2013	40%
6	Nation Media Group Ltd	Monitor Publications Ltd	N/A	June.2005	76.50%
7	Pan Africa Insurance Holdings Ltd	APA Insurance Limited	N/A	2001	39.97%

Source: Author

APPENDIX 2

Mann Whitney Tests Average Results

	N	Mean Rank	Sum of Ranks
Average pre-M&A ROA	5	5.67	9
Average post -M&A ROA	5	6.5	7
Average pre-M&A ROE	5	4.67	6
Average post -M&A ROE	5	7.5	7
Average pre-M&A EPS	5	-6.33	6
Average post -M&A EPS	5	5.5	7

Source: Author