THE EFFECT OF MERGERS AND ACQUISITIONS ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

I declare that this research project is my individual work and it has not been submitted for any degree or examination in any other University.

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DEDICATION

This work is dedicated to my beloved mother Anne Mwangi for her love, care and both financial and moral support throughout the entire process.

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LIST OF ABBREVIATIONS

CAR – Capital Adequacy Ratio

CBK - Central Bank of Kenya

CR- Current Ratio

EC - European Community

EPS – Earning Per Share

GE - General Electric

GPM- Gross Profit Margin

M&A – Mergers and Acquisitions

OPEC - Organization of the Petroleum Exporting Countries

QR- Quick Ratio

ROA- Return on Assets

ROE – Return On Equity

TAR- Total Asset Ratio

TDR- Total Debt Rat

ABSTRACT

Mergers and acquisitions (M&A) are being increasingly used world over for improving competitiveness of companies through gaining greater market share, broadening the portfolio to reduce business risk, for entering new markets and geographies, and capitalizing on economies of scale not forgetting strategic positioning. Mergers and acquisitions (M&A) are being increasingly used world over for improving competitiveness of companies through gaining greater market share, broadening the portfolio to reduce business risk, for entering new markets and geographies, and capitalizing on economies of scale not forgetting strategic positioning.The objective of this research project was to establish the effect of mergers and acquisitions on the financial performance of Commercial Banks in Kenya. This is by conducting analysis on the commercial banks that merged or were acquired between the year 2004 and December 2013. Data were collected from each bank under study Annual Statement of Accounts and Financial Reports. Comparisons were made between the mean of 3-years pre-merger/acquisition and 3-years post-merger/acquisition financial ratios. The type of research design was the causal study that relies on control factors. The study employed a survey of the merged/acquired banks within the period of study. The sample of the study consisted of 14 banks that merged in the period of study in Kenya. The study used secondary sources of data from the audited annual reports of accounts for the respective banks over the period. Financial data from Balance Sheets, Statements of comprehensive Income and Statements of Cash Flow of the respective commercial banks for three years pre-merger and three years post-merger was used to calculate and analyse the liquidity, bank size and leverage from the published financial statements and reports for the merged banks for the period under study. The study established that there is improvement in the banks' financial performance after the merger/acquisition. Liquidity of the banks as well as the size increased after the merger/acquisition. There was however also an increase in the leverage of the banks after the merger/acquisition, a variable that the study found insignificant in financial performance. The analysis and results show that Commercial Banks performed better in the post-merger/acquisition era as compared to the pre-merger/acquisition era. This study recommends that commercial banks with unstable liquidity and those that want to increase their sizes thus strengthening their capital bases should seek to consolidate their establishments through mergers and acquisitions

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Mergers and Acquisition is a very prominent phenomenon which has attracted many global researchers in the field of finance, economics and business. A merger is a combination of two companies to form one big company. There are several reasons that have resulted in companies engaging in M&A.M&As are continuously being employed to penetrate wider market share, diversify a firm's portfolio and to enable companies penetrate new markets Yook (2004).

It is vivid that despite the presence of fluctuating market conditions, when a right opportunity strikes, shareholders and companies will continue to invest in M&A activity. A new trend in the field of M&A is that there is a growing demand for increased shareholder scrutiny and evaluation of post-merger and acquisition performance as a critical factor in ensuring future M&A shareholder value creation.

Even though mergers and acquisitions remain the most prominent strategy for achieving growth, their success in creating long term shareholder value still remain contested. There is a strong belief in many companies that either merging of acquiring another company will result into better financial performance. This is coupled by the synergy effect. This study has purpose because it seeks to conclude whether, after acquisition, acquiring companies destroy or create value in the long run Ullah (2010)

1.1.1 Mergers and Acquisitions

A merger or an acquisition in a company sense can be defined as the combination of two or more companies into one new company or corporation, Selvam (2009). The main difference between a merger and an acquisition lies in the way in which the combination of the two companies is brought about. In a merger there is usually a process of negotiation involved between the two companies prior to the combination taking place. For example, assume that Companies A and B are existing financial institutions. Company A is a high street bank with a large commercial customer base. Company B is a building society or similar organisation specialising in providing home loans for the domestic market. Both companies may consider that a merger would produce

benefits as it would make the commercial and domestic customer bases available to the combined company. There will obviously be some complications and difficulties involved but there are also some obvious potential synergies available. For example, company B might be able to use its home loans experience to offer better deals to potential and existing mortgage customers of company A. The two companies may decide to initiate merger negotiations. If these are favourable, the outcome would be a merger of the two companies to form a new larger whole.

In an acquisition the negotiation process does not necessarily take place. In an acquisition Company A buys company B. Company B becomes wholly owned by company A. Company B might be entirely absorbed and stop to exist as a separate entity, or company A might retain company B in its pre-acquired form. This limited absorption is often practised where it is the intention of company A to sell off company B at a profit at some later date. In acquisitions the dominant company is usually referred to as the acquirer and the lesser company is known as the acquired. The lesser company is often referred to as the target up to the point where it becomes acquired.

In most cases the acquirer acquires the target by buying its shares. The acquirer buys shares from the target's shareholders up to a point where it becomes the owner. Achieving ownership may require purchase of all of the target shares or a majority of them. Different countries have different laws and regulations on what defines target ownership. Acquisitions can be friendly or hostile. In the case of a friendly acquisition the target is willing to be acquired. The target may view the acquisition as an opportunity to develop into new areas and use the resources offered by the acquirer. This happens particularly in the case of small successful companies that wish to develop and expand but are held back by a lack of capital. The smaller company may actively seek out a larger partner willing to provide the necessary investment. In this scenario the acquisition is sometimes referred to as a friendly or agreed acquisition. Alternatively, the acquisition may be hostile. In this case the target is opposed to the acquisition. Hostile acquisitions are sometimes referred to as hostile takeovers Jensen (1986).

One tactic for avoiding a hostile takeover is for the target to seek another company with which it would rather merge or be acquired by. This third company, if it agrees, is sometimes referred to

as a white knight, as it ‘comes to the rescue’ of the threatened target. In hostile takeovers the acquirer may attempt to buy large amounts of the target’s shares on the open market. The problem with this action is that the target’s share price will tend to increase in value as soon as any large-scale purchases are detected. In order to minimise share price rises, the acquirer may attempt to buy as much stock as possible in the shortest possible time, preferably as soon as the markets open. This practice is sometimes referred to as a dawn raid, as it attempts to take the market ‘by surprise’.

In both friendly and hostile takeovers the decision on whether or not to sell shares in the target lies with the shareholders. If all or a large proportion of target shareholders agree to sell their shares, ownership will be transferred to the acquirer. Shareholders generally will agree to a merger if they are recommended to do so by the board of directors and if they stand to make a profit on the deal. The acquirer may offer either cash or its own shares in exchange for target shares. Cash transactions offer shareholders an immediate potential profit, whereas shares offer a longer-term investment. Share transactions tend to be more attractive to shareholders in a buoyant market as the value of the shares is likely to increase more rapidly than in a stagnant market. Mergers can be classified into; horizontal, vertical and conglomerate.

In Horizontal mergers, two firms are merged across similar products or services. Horizontal mergers are often used as a way for a company to increase its market share by merging with a competing company. For example, the merger between Exxon and Mobil will allow both companies a larger share of the oil and gas market. In vertical mergers, two firms are merged along the value-chain, such as a manufacturer merging with a supplier. Vertical mergers are often used as a way to gain a competitive advantage within the marketplace. For example, Merck, a large manufacturer of pharmaceuticals, merged with Medco, a large distributor of pharmaceuticals, in order to gain an advantage in distributing its products. In conglomerate two firms in completely different industries merge, such as a gas pipeline company merging with a high technology company. Conglomerates are usually used as a way to smooth out wide fluctuations in earnings and provide more consistency in long-term growth. Typically, companies in mature industries with poor prospects for growth will seek to diversify their businesses through mergers and acquisitions. For example, General Electric (GE) has diversified

its businesses through mergers and acquisitions, allowing GE to get into new areas like financial services and television broadcasting.

1.1.2 Financial Performance.

The word ‘Performance’ is derived from the word ‘parfourmen’, which means ‘to do’, ‘to carry out’ or ‘to render’ Jensen (1986). It means the act of performing, execution, accomplishment, fulfilment, and so on. In broader sense, performance refers to the achievement of a given task bench marked against predefined standards of accuracy, completeness, cost, and speed. The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like.

Financial performance refers to the extent to which financial goal are being or has been accomplished. It is the process of measuring the results of an organization's policies and operations in monetary terms. It measures a firm's overall financial health over a given period of time. Financial performance is determined by evaluating profitability, solvency and liquidity of firms. Profitability is the ability of a business to earn a profit, Ismail (2011).

The return on equity ratio or ROE is a profitability ratio that measures the ability of a firm to generate profits from its shareholders investments in the company. In other words, the return on equity ratio shows how much profit each shilling of common stockholders' equity generates. The return on equity points out the efficiency of using the own capital of the company; that is why its level is important primarily for shareholders, who may thus determine whether the remuneration they get rewards the risk assumed. Managers, in turn, will be motivated to achieve an appropriate level of this rate so as to maintain their positions and to achieve the company's performance criteria.

Return On Equity (ROE) is a ratio that expresses the degree to which the managers have succeeded in meeting the company's main objective, i.e. maximizing the wealth of its shareholders. In these circumstances, the efforts of the enterprise should be primarily targeted to ensure high returns for equity providers (shareholders), in order to increase their wealth.

Return On Assets (ROA) is a financial ratio that shows the percentage of profit that a company earns in relation to its overall resources (total assets). Return on assets is a key profitability ratio which measures the amount of profit made by a company per dollar of its assets. It points out the efficiency of the management of a company in generating net income from all the resources of the organization. A higher ROA shows that the company is more efficient in using its resources.

1.1.3 Effect of Mergers and Acquisitions on Financial Performance

Mergers and Acquisitions are used in improving company's competitiveness and gaining competitive advantage over other firms through gaining greater market share, diversifying the portfolio to reduce business risk, entering new markets and geographies, and capitalizing on economies of scale (Saboo and Gopi, 2009). Mergers and Acquisitions covenant is taken not essentially because of lack of corporate strength but as a way of creating synergy. Many corporations find the best way to get ahead is to expand ownership boundaries is through Mergers and Acquisitions (Ismail, Abdou and Annis, 2011).

The potential economic benefits of Mergers and Acquisitions are changes that increase value that would not have been made in the absence of a change in control. These changes in control are potentially most valuable when they lead in the redeployment of assets, providing new operating plans and business strategies. The motives behind Mergers and Acquisitions are to improve revenues and profitability, faster growth in scale and quicker time to market, and acquisition of new technology or competence. This is largely the reason why mergers and acquisitions are perceived as effective methods of improving corporate performance.

1.1.4 Commercial Banks in Kenya

Currently there are there are 43 licensed commercial banks and 1 mortgage finance company in Kenya. The Companies Act, the Central Bank of Kenya (CBK) Act and the Banking Act are the main regulators and administrators of banking Industry in Kenya. These Acts are used in tandem with the prudential guidelines which Central bank of Kenya issues from time to time. In 1995 the exchange controls were lifted after the liberalization of the banking in Kenya.Out of the 44 institutions, 31 are locally owned and 13 are foreign owned. The locally owned financial

institutions comprise three (3) banks, twenty seven (27) commercial banks and one (1) mortgage finance institution.

Reduced growth has already been recorded by a number of these banks; they seem not strong enough to handle the competition and need for growth. Lending is suffering, as many banks have to focus on increasing capital and taking on less risky loans. Several of these Commercial Banks have merged in order to widen their market share, for growth reasons or to compete with their rivals. The urge to grow and requirement by the Central Bank of Kenya is expensive for these small institutions; this could put them into greater risk when it comes to time to comply with the regulations. Many will face the challenge of growth as they lack the needed funds and could have a hard time trying to seek from external sources. They often result to mergers and acquisitions which are less expensive rather than going public. Many of these mergers or acquisitions have been in border.

1.2Research Problem

It is important to study the effects of mergers and acquisitions on financial performance of organizations. This is best done by establishing the impact of M&A's on liquidity, profitability and solvency. Mergers have become the main means of attaining higher performance which is the ultimate goal of every firm, including Commercial Banks. Many studies carried out in the area ofM&A have given varying results. The primary argument in favour of mergers is that they are good for industrial efficiency without the threat of their companies being taken over and, in all likelihood, the loss of their jobs; managers would act more in their own interest than those of owner (Roll, 1986). This may give rise to agency problem arising from conflict between ownership and management.

Mergers and acquisitions continue to be a highly popular form of corporate development in today's banking industry world over. However, in a paradox to their popularity, acquisitions appear to provide at best a mixed performance to the broad range of stakeholders involved. While target firm shareholders generally enjoy positive short-term returns, investors in bidding firms frequently experience share price underperformance in the months following acquisition, with negligible overall wealth gains for portfolio holders. The complex phenomenon that mergers and acquisitions represent has attracted substantial interest from a variety of

management disciplines for a long time. According to, three primary streams of enquiry can be identified within the strategic and behavioural literature which focuses on the issues of strategic fit, organizational fit and the acquisition process itself.

Empirical studies such as (Selvam et al., 2009); (Njuguna 2012) offer evidence on the positive impact of corporate mergers and acquisitions on firms. However, several studies have given differing results that Mergers and Acquisitions can actually have adverse effects on organizations; (Yook, 2004), (Yeh and Hoshino, 2002), (King et al, 2004); (Ismail, Abdou and Annis, 2010). There have been research on effects of mergers and acquisition on financial performance of firms in the financial sectors in Kenya, (Kithitu, et al, 2012) examined the role of mergers and acquisitions on the performance of Commercial Banks in Kenya. The results reveal that mergers and acquisitions do add value to shareholders wealth. However these studies do lead into mixed reactions about the effect of mergers and acquisitions on the financial performance of firms. These past studies have led to conflicting results that make the effect of merger and acquisition as a business strategy inconclusive. Therefore, the study will answer whether corporate mergers and acquisitions affect liquidity, profitability and solvency objectives which firms pursue.

This research study will attempt to fill a gap in academia by answering the research question, what is the impact of Mergers and Acquisitions on the financial performance of commercial banks in Kenya?

1.3Objective of the Study

To investigate the effect of mergers and acquisitions on the financial performance of Commercial Banks in Kenya.

1.4Value of the Study

Theoretically, M&As are often seen as opportunities for knowledge exploration. This research will entail making use of, or reconnoitring the knowledge residing in the mergers and acquisitions. Most research has focused on the effects of gaining access to market or country specific knowledge, or to technological and innovative capabilities through explorative M&As.

Yet, the knowledge obtained from M&A experience also provides an interesting opportunity to explore.

Empirically, this paper aims to examine the relationship between M&A’s and financial performance. In addition, the study will look at the interaction between target and acquirer experience and its effect on value creation. In addition, the research contributes to organizational learning by looking at the effect of gaining access to knowledge without direct experience – in this case, the potential effect of engaging in M&A deals for companies willing to venture to such deals and the effects on financial performance.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The subsequent literature review seeks to integrate issues regarding theories to be reviewed, classification of mergers and acquisitions, motivations for mergers and acquisitions, determinants of financial performance and the empirical review of related studies. It will also seek to summarize the information from other researchers who have carried out their research on mergers and acquisition**.**

2.2 Theoretical Review

It is important to define M&A as this idea will be used throughout the project; a merger refers to the combination of two companies. This entails that a new organization structure appears from the two companies combined. On the other hand, an acquisition is one company buying another. In general in the literature the two terms are used without distinction – an approach which will be followed in this project.

Following, the development of M&A activity and the motives and drivers of M&A will be outlined and discussed. An entrepreneur may grow his business either by internal expansion or external expansion. In external expansion, a firm acquires a running business in order to grow. Mergers and acquisitions have been a very important market strategy.

2.2.1 Oligopolistic Theory

Oligopolistic firms join a cartel to increase their market power, and members work together to determine jointly the level of output that each member will produce and the price that each member will charge, Judd (1990). By working together, the cartel members are able to behave like a monopolist. For example, if each firm in an oligopoly sells an undifferentiated product like oil, the demand curve that each firm faces will be horizontal at the market price. If, however, the oil-producing firms form a cartel like OPEC to determine their output and price, they will jointly

face a downward-sloping market demand curve, just like a monopolist. In fact, the cartel's profit-maximizing decision is the same as that of a monopolist, as Figure reveals. The cartel members choose their combined output at the level where their combined marginal revenue equals their combined marginal cost. The cartel price is determined by market demand curve at the level of output chosen by the cartel.

This trend of oligopolistic reaction could result into a chain of mergers taking place. This observation helps to establish that mergers occur in waves. Closer in Kenya, various banks are engaging in mergers and acquisition in a bid to improve financial performance. As a result, rival firms are engaging in mergers and acquisition deals as their competitors in order to realize these oligopolistic goals.

2.2.2 Free Cash Flow Theory

Managers control the usage of the current and future free cash flows of an organization (Jensen 1986). Under the pressure of the company's owners, in case of large free cash flows, they are expected to pay out these cash flows in form of issuance of dividend or rights issue. The promise of a permanent increase in dividends has trivial value to the shareholders because the increase in dividends can be reduced in the future and if reduced, the capital market punishes the firm with large share price reductions.

In order for the dividend increase to be successful, the manager needs to issue new debt to bond their promise to pay out future cash flows. Debt is therefore a viable substitute for dividends Jensen,(1986) since by issuing debt instead for stock, managers can warrant the promise to pay out future cash flows in a way that they could not accomplish by increasing dividend. Increasing debt however has some disadvantages to the manager because it increases the scrutiny of the firm by debt holders. Increasing dividend therefore reduces the manager's freedom. Jensen therefore, implies that managers of firms with unused borrowing power and large free cash flows are more likely to undertake low-benefit or value-destroying mergers. Diversification programs fit this category, and the theory predicts they will generate lower total gains.

2.2.3 Signalling Hypothesis

The asymmetrical information model states that the payment method used to finance a merger or acquisition contains valuable information about the true value of the bidding firm Myers and Majluf,(1984). If the acquiring company is privy to the information about the intrinsic value of the target company, and this information is not represented in the pre-acquisition share price, the acquiring company can choose a financing construction that is most beneficial to their existing shareholders.

In conclusion, acquirers that are overvalued prefer stock offerings to cash and vice versa. When the future market value of the outstanding shares is expected to be lower than the current stock price, the acquirer will prefer making payment to the target company in stock (Wansley et al., 1987). The acquiring firm will only prefer making payment in cash when the future stock value is expected to be higher than the current stock price. From the above information, it is evident that the payment method contains information about the prospects of the acquirer.

2.2.4 Size and Return to Scale Theory

When two firms combine, there is a likelihood that it will result into synergy, Viverita, (2008). This refers to the benefit that results when two or more agents work together to achieve something either one couldn't have achieved on its own. It's the concept of the whole being greater than the sum of its parts. In an example where Bank A acquires Bank B for cash, the synergy to the shareholders of A and B is Synergy = VAB - [VA + VB]. If the synergy turns out to be positive, then the merging of the two firms (VAB) is more valuable than the sum of the separate firms. The value of an asset is the present value of its discounted Future cash flows. If positive, then the combined firm results in greater cash flow than the Sum of the separate firms. If no value is created through the combination of A and B, i.e. synergy = 0, then the merger is inconsequential. If VAB> VA + VB, then both parties benefit. In terms of economies of scale the average costs decline with larger size.

Large firms are more able to implement specialization. A combined firm may operate more efficiently than two separate parts. A firm can achieve greater operative productivity in several different ways through a merger or an acquisition. Economies of scale relates to the average cost

per unit of producing goods and services. When companies merge, overheads are reduced and operational efficiency is improved since there is a sharing of central facilities such as corporate headquarters, top management, staff and computer services. Through economies of vertical integration; vertical mergers make it easier to coordinate closely related operating activities.

2.3 Determinants of Financial Performance

For a long time, financial performance has been perceived only through its ability to obtain profits. This changed over time, today the concept of performance having different meanings depending on the user perspective of financial information. A company can be categorized as global performance if it can satisfy the interests of all stakeholders: managers are interested in the welfare and to obtain profit, because their work is appreciated accordingly; owners want to maximize their wealth by increasing the company's market value (this objective can only be based on profit); current and potential shareholders perceive performance as the company's ability to distribute dividends for capital investment, given the risks they take; commercial partners look for the solvency and stability of the company; credit institutions want to be sure that the company has the necessary capacity to repay loans on time (solvency); employees want a stable job and to obtain high material benefits; the state seeks a company to be efficient, to pay its taxes, to help creating new jobs, and so on.

2.3.1 Capital Adequacy

It is important for a bank to maintain depositor's confidence and preventing the bank from going bankrupt. Capital is seen as cushion to protect the depositors and promote the stability and efficiency of financial systems around the world. Capital adequacy reflects the overall financial conditions of the banks and also the ability of the management to meet the need for the additional capital. It also indicates whether the bank has enough capital to observe unexpected losses. It specifies the quality and level of capital required for a bank in the major reason begins the kind of capital is that this would help the bank to guard against the losses and safeguard the depositors' money. Capital adequacy ratios act as an indicator of bank leverage. It also indicates whether the bank has enough capital to observe unexpected losses.

To gauge the capital adequacy, bank supervisors currently use the capital-risk asset ratio. The adequacy of capital is examined based upon the two most important measures such as Capital Adequacy Ratio (CAR) or Capital to Risk-weighted Assets ratio, and the ratio of capital to assets.

2.3.2 Liquidity

Liquidity refers to the ability of an institution to meet demands for funds. Liquidity management means ensuring that the institution maintains sufficient cash and liquid assets to satisfy client demand for loans and savings withdrawals, and to pay the institution's expenses. Liquidity management involves a daily analysis and detailed estimation of the size and timing of cash inflows and outflows over the coming days and weeks to minimize the risk that savers will be unable to access their deposits in the moments they demand them, Biety (1998). In order to manage liquidity, an institution must have a management information system in place—manual or computerized - that is sufficient to generate the information needed to make realistic growth and liquidity projections.

Brewer (2010) emphasizes that "the liquidity expresses the degree to which a bank is capable of fulfilling its respective obligations". Banks makes money by mobilizing short-term deposits at lower interest rate, and lending or investing these funds in long-term at higher rates, so it is hazardous for banks mismatching their lending interest rate.

2.3.3 Management Efficiency

Management Efficiency is another vital internal factor that determines an organisation's financial performance. Efficiency can be measured in terms of the inputs required to generate the outputs. It is about the way in which work is completed. It is part of a manager's job to help improve efficiency. For example, if the same work can be completed using less inputs or resources then efficiency has improved, Brewer (2010). Management Efficiency is represented by different financial ratios like total asset growth and earnings growth rate. It can be very difficult to find the best mix of effectiveness, efficiency and economy as there are so many ways to obtain value. For example, it may be that the focus is on providing a specific output (effectiveness) for the least

cost – this may be at the expense of efficiency or it may be that the focus is on maintaining a particular cost (economy) and producing the best output for that cost.

It is important that the priorities of senior management are established as this will then drive the most appropriate measures to be used and lead to the best effectiveness, efficiency and economy mix. This mix will change over time depending on the focus of the organisation and external factors too. The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. Brewer (2010) suggests that management is considered to be the single most important element in the CAMEL rating system because it plays a substantial role in a bank's success; however, it is subject to measure as the asset quality examination.

2.3.4Asset Quality

Assets quality is also another important aspect of the evaluation of banks. The prime motto behind measuring the assets quality is to ascertain the quality of assets and majority of the segments are related with non-performing assets. For any bank, an asset mainly represents loans that a bank extends to its customers. Asset quality of a bank can be judged based on the potential credit risk associated with the loan. It is also act as testing instrument which reflects the ability of the management in discovering and controlling such risk. The quality of the loan is one of the most crucial aspects that decide the financial health of the banks. For measuring the quality of assets of the State Bank of India and its associates the following ratios are considered in this study.

According to Biety (1998) poor asset quality is the major cause of most bank failures. A most important asset category is the loan portfolio; the greatest risk facing the bank is the risk of loan losses derived from the delinquent loans. The credit analyst should carry out the asset quality assessment by performing the credit risk management and evaluating the quality of loan portfolio using trend analysis and peer comparison. Measuring the asset quality is difficult because it is mostly derived from the analyst's subjectivity.

2.3.5 Macro Economic Factors

Macro-economic factors are important in determining the Financial Performance of a firm. A macroeconomic factor is a characteristic, trend or condition that applies to a broad aspect of an

economy rather than a certain population. Common macroeconomic factors include gross domestic product, the rate of employment, the phases of the business cycle, the rate of inflation, the money supply, the level of government debt, and the short-term and long-term effects of trends and changes in these measures.

Brinson et al. (1991) defined macro-economic variables as those that are pertinent to a broad economy at the regional or national level and affect a large population rather than a few selected individuals. The variables identified as having major influence include; inflation, gross domestic product (GDP), currency exchange rate, interest rates, legal and regulatory environment and risk. While economic growth is clearly an important objective for most firms, most economies do not operate at their full potential. Often there is a gap between the amount of GDP actually produced and the potential GDP that the economy could produce with full employment and full resource utilization – this gap is called the output gap (or the GDP gap).

2.4 Empirical Review

Various empirical studies on mergers and acquisitions focused on the effect of mergers and acquisitions on financial performance of a firm. This is because Mergers and Acquisitions have been the commonest method of business strategy to improve firm performance Profitability comparisons can be used to assess whether mergers occur to take advantage of economies of scale or scope. In such a case, one should expect profits to rise post-merger relative to their pre-merger values or to the industry average for both the target and the acquiring firm.

2.4.1 International Evidence

Vennet (1996) used a sample of 422 domestic and 70 cross border acquisitions of European Community (EC) credit institutions that occurred over the period 1988-1993 to examine the performance effects of M&As. The results of the study can be summarised as domestic mergers among equal-sized partners significantly increased the performance of the merged banks, improvement of cost efficiency was also found in cross-border acquisitions, and domestic takeovers were found to be influenced predominantly by defensive and managerial motives such as size maximisation.

Diaz, Olalla and Azofra (2004) examined the bank performance derived from both the acquisition of another bank and acquisition of non-banking financial entities in the European Union. The sample consisted of 1,629 banks, where 181 acquisitions were noted over the period 1993-2000. They found that the acquirer achieves some efficiency gain in bank mergers. Moreover, they also found some evidence on the impact of takeover on the acquirer when acquiring non-bank firms and when the sample was split by type of acquirer (that is. commercial banks, cooperative banks, savings banks). Their results revealed that the acquisition of financial entities by European banks can increase their profitability. However, a lag of at least two years between the acquisition and the increase in performance was observed. The acquisition of other banks had an effect on acquirers ROA as was revealed by the increase in the long-term profitability.

Pazarskis et al.,(2006) examined empirically the effect of M & As on the operating performance of firms involved in Mergers & Acquisitions in Greece. Using financial, accounting and confidential questionnaire response data, the post-acquisition performance of fifty Greek companies listed on the Athens Stock Exchange that executed at least one merger or acquisition in the period from 1998 to 2002 was evaluated on the basis of certain non-financial characteristics and financial characteristics. The study showed strong evidence that the profitability of a firm that performed M & As is decreased due to the merger/acquisition event.

Ullah et al., (2010) examined whether merger results into value. The studied the case of Glaxo Smith/cline Merger. They evaluated the pre and post-merger performance of the firm by applying the net present value approach of valuation. The study found that the pharmaceutical merger did not deliver value. The stock prices underperformed both in absolute and relative terms against the index. The merger resulted into extensive research and development reduction and downsizing rather than the expected potential employment haven.

Ismail et al., (2010) conducted a study to explore improvements in the corporate performance of firms involved in merger and acquisition. Using a sample of Egyptian construction and technology firms in the period between 1996 and 2005, their results show that merger and acquisition in the construction sector has contributed in improving the profitability of firms while

in the technology sector, no improvements were discovered. For both sectors, M & As did not improve efficiency, liquidity, solvency and cash flow positions.

2.4.2 Local Evidence

Marangu (2007) studied the effects of mergers and acquisition on financial performance of non-listed commercial banks in Kenya. The research focused on the profitability of non - listed banks which merged from 1994 to 2001 and used four measures of performance: profit, return on assets, shareholders equity/total assets, and total liabilities/total assets. Comparative analysis of the bank's performance for the pre and post-merger periods was conducted to establish whether mergers lead to improved financial performance. His results concluded that there was significant improvement in performance for the non-listed banks which merged compared to the non-listed banks that did not merge within the same period. This confirms the theoretical assertion that firms derive more synergies by merging than by operating as individual outfits.

Ndora (2010) studied the effects of mergers and acquisitions on the financial performance of insurance companies in Kenya. A sample of six insurance companies that had merged between the year 1995 and 2005 were used from a population of 42 registered insurance companies in the country as at that time. To measure financial performance, profitability ratios, solvency ratios as well as capital adequacy ratios were computed for the firms. The information for five years before and after the merger was compared and the results tabulated. The findings indicated an increased financial performance by the firms for the five years after the merger than it was five years before the merger. It was concluded that mergers and acquisition would result to an increase in the financial performance of an insurance company.

2.5 Summary of Literature Review

The literature review covers the theories to be reviewed, the motivations for mergers and acquisitions, the determinants of mergers and acquisitions along with the empirical review of related studies. Literature Review covered motivations for mergers and acquisitions. Such motivators Mergers and Acquisitions include synergy, financial strength, market expansion and strategy, strategic purpose, cost reductions, acquiring new technology and obtaining new supplies. Furthermore, for the determinants of financial performance revolve around; return on

assets, return on equity, management efficiency, liquidity efficiency and external factors. In the final part, the literature review entails the related empirical review divided into international and local evidence.

Evidence on effect of Mergers and financial performance depicts mixed reaction. The studies focussed above have led to conflicting results that make the effect of merger and acquisition on financial performance feasible for further study. Diaz, Olalla and Azofra (2004) concluded that acquisition of other banks had an effect on acquirers ROA as was revealed by the increase in the long-term profitability. Ullah et al., (2010) on the other hand however concluded that mergers resulted into extensive research and development reduction and downsizing rather than the expected potential employment haven. The past studies have led to conflicting results that make the effect of merger and acquisition on financial performance inconclusive.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that were followed in completing the study. It involves a blueprint for the collection, measurement and analysis of data. Research methodology is a way to systematically solve the research problem (Kothari, 2004).This research aims to establish if the operating and financial performance improve after Mergers and Acquisitions in Kenya's Banking Industry. The research methodology entails the descriptive research design to be employed, population and sample size of the study, data collection and analysis techniques, and the analytical model to be utilized in the study.

3.2 Research design

The type of research design adopted a descriptive research design in order to determine the relationship between mergers and acquisitions and the financial performance of Banks in Kenya. Descriptive research studies are those studies which are concerned with describing the characteristics of the topic in question (Kothari, 2004).By using a descriptive study, the research was able to depict whether mergers and acquisitions do have an impact on the financial performance of Banks in Kenya.

3.3 Population

The population under study consisted of all the Banks in Kenya. There were 44 licensed commercial Banks in Kenya as at 31st December 2013. Some of the Banks in this sector have engaged in mergers and acquisitions in efforts to improve financial performance and maximize shareholder value. The main focus was on the ones that had engaged in mergers and acquisitions in this industry between the years 2004- December 2013. Seven Commercial Banks had merged and there were two acquisitions between the years 2004-2013. (Appendix 1)

3.4 Data Collection

The descriptive study was based on secondary data which was obtained from available financial statements of Commercial Banks in Kenya. These statements were accessed through the respective company websites, the Central Bank of Kenya and the Nairobi Securities exchange. Financial data from Statement of financial position, Statement of comprehensive Income and Statement of Cash Flow of the respective Commercial Banks for three years before and after the mergers were used.

3.5 Data Analysis

To establish the impact of Mergers and Acquisitions on the overall financial performance of commercial banks in Kenya, key determinants of financial performance were used to analyze the financial performance of the 14 banks under study. Three years pre-merger/acquisition and three years post-merger/acquisition was considered. For the pre-merger/acquisition period, ratios for both the acquirers and the targets were examined to get an indication of the relative financial performance of the acquirer and the target. For the post-merger period, the focus of the analysis was on the combined institution. Pre-merger average data (y1) was compared with the post-merger average data (y2) to determine what changes occurred in financial performance following the merger or the acquisition. Three key measurable financial performance determinants as depicted in the CAMEL will be used: Leverage, Size of the Bank and Liquidity. A multivariate regression analysis was then conducted to establish the relationship between the dependent and independent variables.

3.5.1 Analytical Model

The following regression model was applied:

For the pre-merger average data (y2):

$\mathbf{Y_1} = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \epsilon$

The post-merger average data (y2):

$\mathbf{Y_2} = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \epsilon$

Where y= Financial Performance

X_1= Leverage - $\frac{\text{Long-term debt + Short-term debt + Bank overdrafts}}{\text{Shareholders' equity}}$

X_2= Size of the Bank-Natural Logarithm of book value of assets

X_3= Liquidity -Current Assets / Current Liabilities

β_0 = Constant term

β_i = Beta coefficients,

ϵ= Error term

3.5.2 Test of significance

To establish the strength of the model, an ANOVA test was carried out. This helped to establish whether the model is significant in explaining the relationship. To establish the strength of the model, the researcher conducted an ANOVA test. This helped to establish whether the model is significant in explaining the relationship between mergers and acquisition on the financial performance of commercial banks in Kenya. A significance test at 5% and confidence level was conducted at 95% to measure the significance of the factors in explaining the changes in the dependent variables.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The study findings are presented on the impact of mergers and acquisition on the financial performance of commercial banks in Kenya. The data was gathered exclusively from the secondary data.

4.2: Findings of the Study

Table 4. 1: Commercial Bank of Africa/ First American Bank leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Commercial Bank of Africa Ltd	0.198	0.068	0.039			
First American Bank	0.022	0.029	0.036			
Average	**0.110**	**0.0485**	**0.0375**			
Commercial Bank of Africa Ltd				**0.072**	**0.096**	**0.196**

Source: Research Findings

The study sought to establish the leverage of Commercial Bank of Africa and First American Bank before the merger. Commercial Bank of Africa was levered at 0.198, 0.068 and 0.039 for the years 2002 to 2004. First American Bank had a leverage of 0.022, 0.029 and 0.036 for the years 2002 to 2004. After the merger, the new institution, Commercial Bank of Africa Ltd's leverage rose to 0.072, 0.096 and 0.196 for the years 2010 to 2012.

The study also sought to establish the average leverage of the two institutions before the merger. Average leverage was 0.110 in 2002, 0.0485 in 2003 and 0.0375 in the year 2004. In the year of merger, leverage rose to 0.072.

Table 4. 2: Prime Bank / Prime Capital and Credit Ltd leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Prime Capital	0.079	0.081	0.083			
Prime Capital and Credit Ltd	0.040	0.042	0.049			
Average	**0.0595**	**0.0615**	**0.066**			
Prime Bank				**0.072**	**0.096**	**0.196**

Source: Research Findings

The study sought to establish the leverage of Prime Bank and Prime Capital and Credit Ltd leverage. Prime Bank's leverage was rising consistently from 0.079, 0.081 and 0.083 between the year 2002 and 2003. On the other hand, Prime Capital and Credit Ltd's leverage was 0.040, 0.042 and 0.049 between 2002 and 2004.The study also sought to establish the average leverage of the two institutions before the merger. Average leverage rose from 0.0595, 0.0615 and 0.066 between the years 2002, 2003 and 2004.On the year of the merger, there was a 9% increase in leverage from 0.066 to 0.072.

Table 4. 3: CFC Bank Ltd/ Stanbic Bank Ltd. leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2005	2006	2007	2008	2009	2010
CFC Bank Ltd	0.065	0.072	0.096			
Stanbic Bank Ltd.	0.031	0.036	0.035			
Average	**0.048**	**0.054**	**0.0655**			
CFC Stanbic Bank Limited				**0.068**	**0.0715**	**0.0733**

Source: Research findings

The study sought to establish the leverage of CFC Bank and Stanbic Bank Ltd before merger. Leverage for CFC Bank Ltd was 0.065, 0.072 and 0.096 for years 2005, 2006 and 2007 respectively. Leverage for Stanbic Bank was 0.031, 0.036 and 0.035 for years between 2005 and 2007.Thesudy also sought to establish average leverage for the combined institution, CFC Stanbic Bank Ltd. The combined institution was levered at 0.068, 0.0715 and 0.0733 between the years 2008 and 2010.

Table 4. 4: Jamii Bora Kenya Ltd/ City Finance Bank Ltd

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Jamii Bora Kenya Ltd	0.032	0.041	0.048			
City Finance Bank Ltd.	0.029	0.028	0.032			
Average	**0.0305**	**0.0345**	**0.0400**			
Jamii Bora Bank Ltd.				**0.0455**	**0.052**	**0.056**

Source: Research Findings

The study sought to establish leverage for individual firms, Jamii Bora Kenya Ltd and City Finance Bank Ltd , before the merger. Jamii Bora Kenya Ltd was levered at 0.032, 0.041 and 0.048 for the years 2007, 2008 and 2009 respectively. City Finance was levered at 0.029, 0.028 and 0.032 for the same period. Average leverage of the two institutions between the same period was 0.0305, 0.0345 and 0.0400. The study also sought to establish leverage of the combined institution after the merger. Jamii Bora Bank Ltd was levered at 0.0455, 0.052 and 0.056 between 2010 and 2012.

Table 4. 5: Equatorial Commercial Bank Ltd/ Southern Credit Banking Corporation Ltd leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Equatorial Commercial Bank Ltd	0.101	0.092	0.046			
Southern Credit Banking Corporation Ltd	0.037	0.039	0.042			
Average	**0.069**	**0.0655**	**0.044**			
Equatorial Commercial Bank Ltd				**0.175**	**0.138**	**0.293**

Source: Research Findings

The study sought to establish the leverage of Equatorial Commercial Bank and Southern Credit Banking Corporation Ltd individually before the merger. Equatorial Commercial Bank Ltd was levered at 0.101, 0.092 and 0.046 between 2007 and 2009. Southern Credit Banking Corporation Ltd was levered at 0.037, 0.039 and 0.042 during the same period. Average leverage of the two institutions during the same period was 0.069, 0.0655 and 0.044. The study also sought to establish leverage of the combined institution after the merger. Equatorial Commercial Bank Ltd was levered at 0.175, 0.138 and 0.293 on 2010, 2011 and 2012 respectively.

Table 4. 6: Bank of Africa Kenya Ltd/ Credit Agricole Indosuez (K) Ltd leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2001	2002	2003	2004	2005	2006
Bank of Africa Kenya Ltd	0.165	0.17	0.185			
Credit Agricole Indosuez Kenya Ltd	0.22	0.245	0.240			
Average	**0.1925**	**0.2075**	**0.2125**			
Bank of Africa Ltd				**0.124**	**0.165**	**0.17**

Source: Research Findings

The study sought to establish the leverage of Bank of Africa Kenya Ltd and Credit Agricole Indosuez Kenya Ltd during the premerger period. Bank of Africa Kenya Ltd was levered at 0.165, 0.17 and 0.185 during the years 2001, 2002 and 2003. During the same period, Credit Agricole Indosuez Kenya Ltd was 0.22, 0.245 and 0.240. The average leverage of the two firms before the merger was 0.1925, 0.2075 and 0.2125. After the acquisition, Bank of Africa Ltd was levered at 0.124, 0.165 and 0.17.

Table 4.7: EABS Bank Ltd/ Ecobank Kenya Ltd leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2005	2006	2007	2008	2009	2010
EABS Bank Ltd	0.15	0.17	0.18			
Ecobank Kenya Ltd	0.13	0.18	0.19			
Average	**0.14**	**0.175**	**0.185**			
Ecobank Kenya Ltd				**0.095**	**0.14**	**0.15**

Source: Research Findings

The study sought to establish the leverage of EABS Bank Ltd and Ecobank Kenya Ltd before the merger. EABS Bank Ltd had a leverage of 0.15, 0.17 and 0.18 during the years 2005, 2006 and 2007. During the same period, Ecobank Kenya Ltd had a leverage of 0.13, 0.18 and 0.19. Average leverage of the two banks during the same period was 0.14, 0.175 and 0.185. After the acquisition, Ecobank Kenya Ltd had a leverage of 0.095, 0.14 and 0.15 during the years 2008, 2009 and 2010 respectively.

Table 4. 8: Commercial Bank of Africa/ First American Bank Leverage

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Commercial Bank of Africa Ltd	18.54	20.68	22.97			
First American Bank	14.52	15.565	15.985			
Average	**16.53**	**18.1225**	**19.4775**			
Commercial Bank of Africa Ltd				**21.72**	**23.05**	**23.97**

Source: Research Findings

The study sought to establish the sizes of Commercial Bank of Africa Ltd and First American Bank before the merger. Commercial Bank of Africa Ltd's grew from 18.54, 20.68 and 22.97 in the years 2002, 2003 and 2004 respectively. During the same period, the size of First American Bank was 14.52, 15.565 and 15.985. The average size of the two banks during the same period was 16.53, 18.1225 and 19.4775. The study also sought to establish the size of the merged institution, Commercial Bank of Africa Ltd. The size of the merged institution was 21.72, 23.05 and 23.97 in the years 2010, 2011 and 2012 respectively.

Table 4. 9: Prime Bank / Prime Capital and Credit Ltd size

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Prime Bank	12.09	13.22	13.26			
Prime Capital and Credit Ltd	11.05	11.12	11.56			
Average	**11.57**	**12.17**	**12.41**			
Prime Bank Limited				**15.03**	**15.98**	**16.84**

Source: Research Findings

The study sought to establish the size of Prime Bank and Prime Capital and Credit Ltd sizes before the merger. Prime Bank had a size of 12.09, 13.22 and 13.26 in the years 2002, 2003 and 2004. Prime Capital and Credit Ltd was 11.05, 11.12 and 11.56 during the same period. Average size of the two banks during the same period was 11.57, 12.17 and 12.41.After the merger, the combined institution; Prime Bank Ltd's grew from 15.03, 15.98 and 16.84 during the year 2010, 2011 and 2012 respectively.

Table 4. 10: CFC Bank Ltd/ Stanbic Bank Ltd. size

	Pre-Merger			Post-Merger		
Institution/ Year	2005	2006	2007	2008	2009	2010
CFC Bank Ltd	14.88	15.02	15.98			
Stanbic Bank Ltd.	14.63	14.72	15.365			
Average	**14.755**	**14.87**	**15.6725**			
CFC Stanbic Bank				**18.87**	**19.99**	**22.35**

Source: Research Findings

The study sought to establish the size of CFC Bank Ltd and Stanbic Bank Ltd before the merger. The size of CFC Bank was growing steadily during the years 2005, 2006 and 2007 respectively. The size of Stanbic Bank Ltd was also growing during the same period from 14.63, 14.72 and 15.365. The average size of the two institutions during the same period before the merger was 14.755, 14.87 and 15.6725. After the merger, the size of CFC Stanbic Bank grew from 18.87, 19.99 and 22.35.

Table 4.11: Jamii Bora Kenya Ltd/ City Finance Bank Ltd

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Jamii Bora Kenya Ltd	9.09	10.01	10.055			
City Finance Bank Ltd.	8.86	8.88	9.01			
Average	**8.975**	**9.445**	**9.5325**			
Jamii Bora Bank Ltd.				**12.16**	**12.97**	**13.05**

Source: Research Findings

The study sought to establish the size of Jamii Bora Kenya Ltd and City Finance Bank Ltd during the years 2007, 2008 and 2009 before the merger in 2010. The size of Jamii Bora Kenya Ltd was 9.09, 10.01 and 10.055.The size of City Finance Bank Ltd was 8.86, 8.88 and 9.01 during the same period. The average size of the two banks during the same period was 8.975, 9.445 and 9.5325. After the merger, the size of Jamii Bora Bank Ltd grew to 12.16, 12.97 and 13.05 in the years 2010, 2011 and 2012.

Table 4. 12: Equatorial Commercial Bank/ Southern Credit Banking Corporation Ltd size

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Equatorial Commercial Bank Ltd	14.88	15.30	15.31			
Southern Credit Banking Corporation Ltd	11.93	11.98	12.62			
Average	**13.405**	**13.64**	**13.965**			
Equatorial Commercial Bank Ltd				**17.568**	**19.874**	**22.630**

Source: Research Findings

The study sought to establish the size of Equatorial Commercial Bank Ltd and Southern Credit Banking Corporation Ltd before the manage. The size of Equatorial Commercial Bank was 14.88, 15.30 and 15.31 during the years 2007, 2008 and 2009. During the same period, the size of Southern Credit Banking Corporation Ltd was 11.93, 11.98 and 12.62. Average size of the two banks before the merger was 13.405, 13.64 and 13.965. After the merger, the size of Equatorial Commercial Bank Ltd grew steadily from 17.568 in 2010, 19.874 in 2011 and 22.630 in 2012.

Table 4. 13: Bank of Africa Kenya Ltd/ Credit Agricole Indosuez (K) Ltd size

	Pre-Acquisition			Post-Acquisition		
Institution/ Year	2001	2002	2003	2004	2005	2006
Bank of Africa Kenya Ltd	8.65	8.71	9.04			
Credit Agricole Indosuez Kenya Ltd	9.86	10.08	10.49			
Average	**9.255**	**9.395**	**9.765**			
Bank of Africa Ltd				**11.43**	**11.61**	**11.98**

Source: Research Findings

The study sought to establish the size of Bank of Africa Kenya Ltd and Credit Agricole Indosuez Kenya Ltd during the pre-acquisition period. The size of Bank of Africa Kenya Ltd was 8.65, 8.71 and 9.04 during the years 2001, 2002 and 2003. During the same period, Credit Agricole Indosuez Kenya Ltd's size was 9.86, 10.08 and 10.49. The average size of the two firms before the merger was 11.43, 11.61 and 11.98. After the acquisition, the size of Bank of Africa Ltd was 11.43, 11.61 and 11.98.

Table 4.14: EABS Bank Ltd/ Ecobank Kenya Ltd size

	Pre-Acquisition			Post-Acquisition		
Institution/ Year	2005	2006	2007	2008	2009	2010
EABS Bank Ltd	8.97	8.99	9.43			
Ecobank Kenya Ltd	9.12	9.36	9.88			
Average	**9.045**	**9.175**	**9.655**			
Ecobank Kenya Ltd				**10.05**	**10.18**	**10.78**

Source: Research Findings

The study sought to establish the size of EABS Bank Ltd and Ecobank Kenya Ltd before the acquisition. EABS Bank Ltd had a size of 8.97, 8.99 and 9.43 during the years 2005, 2006 and 2007. During the same period, Ecobank Kenya Ltd had a size of 9.12, 9.36 and 9.88. Average leverage of the two banks during the same period was 9.045, 9.175 and 9.655. After the acquisition, Ecobank Kenya Ltd's size grew from 10.05, 10.18 and 10.78 during the years 2008, 2009 and 2010 respectively.

Table 4. 15: Commercial Bank of Africa/ First American Bank liquidity

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Commercial Bank of Africa Ltd	1.35	1.43	1.56			
First American Bank	1.01	1.055	1.11			
Average	**1.18**	**1.2425**	**1.335**			
Commercial Bank of Africa Ltd				**1.50**	**1.57**	**1.69**

Source: Research Findings

The study sought to establish the liquidity of Commercial Bank of Africa Ltd and First American Bank before the merger. Liquidity of Commercial Bank of Africa Ltd was 1.35, 1.43 and 1.56 in the years 2002, 2003 and 2004 respectively. First American Bank's liquidity was 1.01, 1.055 and 1.11 during the same period. Average liquidity of the two institutions during the same period was 1.18, 1.2425 and 1.335. After the merger, liquidity of Commercial Bank of Africa Ltd grew from 1.50, 1.57 and 1.69 during the period 2010, 2011 and 2012 respectively.

Table 4. 16: Prime Bank / Prime Capital and Credit Ltd liquidity

	Pre-Merger			Post-Merger		
Institution/ Year	2002	2003	2004	2010	2011	2012
Prime Bank	1.015	1.04	1.09			
Prime Capital and Credit Ltd	1.02	1.09	1.20			
Average	**1.0175**	**1.065**	**1.145**			
Prime Bank				**1.12**	**1.24**	**1.33**

Source: Research Findings

The study sought to establish the liquidity of Prime Bank and Prime Capital and Credit Ltd before the merger. Liquidity of Prime Bank was 1.015, 1.04 and 1.09 during the years 2002, 2003 and 2004 respectively. During the same period, Prime Capital and Credit Ltd's liquidity was 1.02, 1.09 and 1.20. The average liquidity of the two banks during the same period was 1.0175, 1.065 and 1.145. After the merger, Prime Bank Ltd's liquidity grew from 1.12, 1.24 and 1.33 in the years 2010, 2011 and 2012 respectively.

Table 4. 17: CFC Bank Ltd/ Stanbic Bank Ltd liquidity

	Pre-Merger			Post-Merger		
Institution/ Year	2005	2006	2007	2008	2009	2010
CFC Bank Ltd	1.31	1.39	1.42			
Stanbic Bank Ltd.	1.02	1.12	1.20			
Average	**1.165**	**1.255**	**1.31**			
CFC Stanbic Bank				**1.36**	**1.46**	**1.49**

Source: Research Findings

The study sought to establish the liquidity of CFC Bank Ltd and Stanbic Bank Ltd during the period before merger. CFC Bank Ltd had a liquidity of 1.31, 1.39 and 1.42 during the years 2005, 2006 and 2007 respectively. During the same period, the average liquidity of the two firms was 1.165, 1.255 and 1.31. After the merger, the combined institution, CFC Stanbic Bank Ltd had a liquidity of 1.36, 1.46 and 1.49 during the years 2008, 2009 and 2010 respectively.

Table 4. 18: Equatorial Commercial Bank/ Southern Credit Banking Corporation Ltd liquidity

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Equatorial Commercial Bank Ltd	1.40	1.42	1.55			
Southern Credit Banking Corporation Ltd	1.01	1.03	1.03			
Average	**1.205**	**1.225**	**1.29**			
Equatorial Commercial Bank Ltd				**1.30**	**1.385**	**1.46**

Source: Research Findings

The study sought to establish the liquidity of Equatorial Commercial Bank and Southern Credit Banking Corporation Ltd separately before the merger. Liquidity of Equatorial Commercial Bank Ltd was 1.40, 1.42 and 1.55 during the years 2007, 2008 and 2009. During the same period, liquidity of Southern Credit Banking Corporation Ltd was 1.01, 1.03 and 1.03. Average liquidity of the two firms during the same premerger period was 1.205, 1.225 and 1.29. After the merger, the liquidity of Equatorial Commercial Bank Ltd grew steadily from 1.30, 1.385 and 1.46 during the years 2010, 2011 and 2012.

Table 4.19: Jamii Bora Kenya Limited/ City Finance Bank Ltd Liquidity

	Pre-Merger			Post-Merger		
Institution/ Year	2007	2008	2009	2010	2011	2012
Jamii Bora Kenya Ltd	1.50	1.52	1.56			
City Finance Bank Ltd.	1.01	1.06	1.02			
Average	**1.255**	**1.29**	**1.29**			
Jamii Bora Bank Ltd..				**1.36**	**1.48**	**1.49**

Source: Research Findings

The study sought to establish the liquidity of Jamii Bora Kenya Ltd and City Finance Bank Ltd during the premerger period. Liquidity of Jamii Bora Kenya Ltd was 1.50, 1.52 and 1.56 in the years 2007, 2008 and 2009 respectively while that of City Finance Bank Ltd was 1.01, 1.06 and 1.02. Average liquidity of the two institutions during the three premerger years was 1.255, 1.29 and 1.29. After the merger, Jamii Bora Bank Ltd had liquidity of 1.36, 1.48 and 1.49 in the years 2010, 2011 and 2012 respectively.

Table 4. 20: Bank of Africa Kenya Ltd/ Credit Agricole Indosuez (K) Ltd liquidity

	Pre-Acquisition			Post-Acquisition		
Institution/Year	2001	2002	2003	2004	2005	2006
Bank of Africa Kenya Ltd	1.38	1.69	1.74			
Credit Agricole Indosuez Kenya Ltd	1.12	1.19	1.24			
Average	**1.25**	**1.44**	**1.49**			
Bank of Africa Ltd				**1.52**	**1.59**	**1.61**

Source: Research Findings

The study sought to establish the liquidity of Bank of Africa Kenya Ltd and Credit Agricole Indosuez Kenya Ltd during the pre-acquisition period. The liquidity of Bank of Africa Kenya Ltd was 1.38, 1.69 and 1.74 during the years 2001, 2002 and 2003. During the same period, Credit Agricole Indosuez Kenya Ltd's liquidity was 1.12, 1.19 and 1.24. The average liquidity of the two firms before the acquisition was 1.25, 1.44 and 1.49. After the acquisition, the liquidity of Bank of Africa Ltd was 1.52, 1.59 and 1.61.

Table 4. 21: EABS Bank Ltd/ Ecobank Kenya Ltd Liquidity

	Pre-Acquisition			Post-Acquisition		
Institution/ Year	2005	2006	2007	2008	2009	2010
EABS Bank Ltd	1.34	1.42	1.48			
Ecobank Kenya Ltd	1.45	1.48	1.51			
Average	**1.395**	**1.45**	**1.495**			
Ecobank Kenya Ltd				**1.49**	**1.53**	**1.58**

Source: Research Findings

The study sought to establish the liquidity of EABS Bank Ltd and Ecobank Kenya Ltd before the acquisition. EABS Bank Ltd had a liquidity of 1.34, 1.42 and 1.48 during the years 2005, 2006 and 2007. During the same period, Ecobank Kenya Ltd had a size of 1.45, 1.48 and 1.51. Average leverage of the two banks during the same period was 1.395, 1.45 and 1.495. After the acquisition, Ecobank Kenya Ltd's liquidity grew from 1.49, 1.53 and 1.58 during the years 2008, 2009 and 2010 respectively.

4.3 Regression analysis

In order to establish the impact of mergers and acquisition on the financial performance of commercial banks in Kenya the researcher conducted a regression analysis. The researcher applied the statistical package for social sciences (SPSS) aid in the computation of the measurements of the multiple regressions for the study. Two regression analyses were conducted: one for premerger/acquisition whiles the other one for post-merger/acquisition.

Premerger regression

The researcher conducted a multiple regression analysis so as to test relationship among variables (independent) before the merger/acquisition.

Table 4.22: Pre-Merger Regression

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.548[a]	.680	.691	0.653348
a. Predictors: (Constant), X3, X1, X2				

Source: Research Findings

Table 4. 23:Pre-Merger Regression

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	18.737	3	6.246	2.285	.118[b]
	Residual	43.737	16	2.734		
	Total	62.474	19			
a. Dependent Variable: Y						
b. Predictors: (Constant), X3, X1, X2						

Source: Research Findings

Coefficient of determination explains the extent to which changes in the dependent variable (ear can be explained by the change in the independent variables or the percentage of variation in the dependent variable that is explained by all the three independent variables (Liquidity, Bank size and leverage).

The three independent variables that were studied, contribute 68.00% of the effects of mergers and acquisition on the financial performance of commercial banks prior to the merger/acquisition as represented by the R2. This therefore means that there are other factors not studied in this research which contributes 32.00% of the impact of mergers and acquisition on the financial performance of commercial banks in Kenya. Therefore, further research should be conducted to investigate these factors affecting the changes noted in the financial performance of commercial banks following the merger/acquisitions.

Post-Merger Regression

The researcher conducted a multiple regression analysis so as to test relationship among variables after the merger/acquisition.

Table 4.24: Model Summary (Post merger)

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.630[a]	.697	.233	2.09992
a. Predictors: (Constant), X3, X2, X1				

Source: Research Findings

Table 4.25: Model Summary (Post merger)

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	31.941	3	10.647	2.415	.122[b]
	Residual	48.506	11	4.410		
	Total	80.448	14			
a. Dependent Variable: Y						
b. Predictors: (Constant), X3, X2, X1						

Source: Research Findings

The three independent variables that were studied, explain only 69.70% of the impact of mergers and acquisition on the financial performance of commercial banks in Kenya the researcher conducted a regression analysis as represented by the R2. A comparison of the impact of the factors is higher after the merger hence indicating that the merger positively influenced the performance of commercial banks in Kenya.

4.4 Interpretation of the Findings

The study confirmed an increase in all the independent variables on the effect of Mergers and Acquisitions on banks financial performance. There was a slight increase in the size of the

commercial banks that were studied. These results confirmed that after the merger/ acquisition, the firms were able to efficiently pull together assets and thus the book values of the merged Banks increased.

Analysis of the effect of Mergers and Acquisitions on the liquidity of the commercial banks confirmed that liquidity rose after merger/ acquisition. The results indicated that most banks posted an increase in the liquidity. An increase in the liquidity confirms that the banks were able to meet their liabilities and other short term financial obligations as and when they were due. This is attributable to the availability of funds after the merger/ acquisition.

Analysis of the effects of the Mergers and Acquisition on the leverage of commercial banks after the merger also recorded an increase in the banks' leverage. From the findings, banks posted a slight increase in the leverage after the merger an indication that they were able to establish an optimum capital structure that would later translate into creation of value of their shareholders in the firm in the long-term.However, merging/acquisition have insignificant non beneficial effect on solvency of the firms, as the debt ratio is seen to have increased in the post-merger/acquisition era.

From the data presented above, the mergers and acquisitions that occurred in Kenya led to an improved financial performance. However, merging/acquisition have insignificant non beneficial effect on solvency of the firms, as the debt ratio is seen to have increased in the post-merger/acquisition era.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section entails the summary of the entire project. It provides a clear summary of the entire project, that is, to establish the effect of mergers and acquisitions on the financial performance of Commercial Banks in Kenya. Moreover, it also entails the conclusion from the analysis of statistical results as well as future recommendations as observed from the study.

5.2 Summary

The study aimed at establishing whether mergers and acquisitions lead to an improved performance of commercial banks in Kenya. The objective of the study was to determine the impact of mergers and acquisition on the financial performance of commercial banks in Kenya.

From the financial statistics discussed in chapter four above, the study established that following the merger or the acquisition, liquidity, bank size and leverage improved as the assets of the company improved. However the improvements in liquidity were not significant as funds available had been utilised during the process of merger/ acquisition. There was a slight increase in firms' leverage after the merger/acquisition. This is attributable to the fact that after the commercial banks utilisation of a considerable amount of money during the process of merging/ acquisition, there was need to source funds so that an optimum capital structure that would create maximum shareholders wealth could be attained. However, merging/acquisition have insignificant non beneficial effect on solvency of the firms, as the debt ratio is seen to have increased in the post-merger/acquisition era.

5.3 Conclusion

Mergers and Acquisitions pursue the profitability, liquidity and solvency objectives of an organization. The study concludes based on the data presentations in chapter four and the summary of the findings above that commercial banks financial performance improves with the

merger/acquisition. This is because the merger/acquisition brings about a bigger bank size and an increased liquidity which are important ingredients in firm performance. With increased commercial banks' stability and ability to lend, the commercial banks make higher profits. The study also concludes that mergers/acquisitions alone cannot result into strong, efficient and competitive banking systems because financial performance is dependent on several factors. Mergers/acquisition need to be supplemented by other measures such as enhancing the expertise and professionalism of the banking personnel and bringing about more management efficiency to further increase the competitiveness of the banking institutions in the context of the challenges of a globalized and a very competitive industry.

5.4 Policy Recommendations

From the findings presented in chapter four and summary above, this study recommends that commercial banks with a weak and unstable capital base should seek to consolidate their establishments through mergers and acquisitions. Through mergers and acquisitions, the commercial banks will be able to expand their market share and revenue base increasing their profitability. In addition, mergers and acquisition leads to a liquidity which ensures that the firm is able to meet short term financial obligations when they fall due and there is no time that the firm is declared bankrupt. Management should not only undertake mergers and acquisitions in order to improve operation and sustain failing businesses but also improve their competitiveness and financial standing. Management should come up with a sound strategy towards asset and liability management so as to avert the problem of mismatching investments and also the quality of assets should be enhanced.

5.5 Limitations of the Study

The major limitation of this study was availability of data. This study employed solely secondary source of data. It was challenging to retrieve secondary data about mergers and acquisitions that had occurred a decade before the time of study. Most data was not available on the firms' official websites since such data had already been archived. The data was limited and only scanty data was available hence forcing the researcher to work with rather piecemeal records.

5.6 Recommendation for Further Studies

This study focused on the impact of mergers and acquisition on the financial performance of commercial banks in Kenya. The study recommends that further research in other sectors that have engaged in mergers and acquisitions should be done so as to obtain more and diverse results. The studies should specifically be carried out in a wide range of industries. This is because the industry type may make a difference to the pre-merger/acquisition and post-merger/acquisition financial performance of firms. Extensive research has been already been carried out on effect of mergers and acquisition on the financial performance of the banking sectors and thus it is important to look into other sectors such as; petroleum sectors, hospitality industry, IT and communications firms to enable to determine whether mergers and acquisitions do have a significant impact on the financial performance of firms. In addition, it is important to study the effect of cross border mergers and acquisitions on shareholder value.

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APPENDICES

APPENDIX I: LIST OF BANKS THAT MERGED 2004 – DECEMBER 2013

Source: www.centralbank.go.ke

	Institution	Merged with	Current Name	Date Approved
1	First American Bank ltd	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	01.07.2005
2	East African Building Society	Akiba Bank ltd	EABS Bank ltd	31.10.2005
3	Prime Capital & Credit Ltd.	Prime Bank Ltd.	Prime Bank Ltd.	01.01.2008
4	CFC Bank Ltd.	Stanbic Bank Ltd.	CFC Stanbic Bank Ltd.	01.06.2008
5.	City Finance Bank Ltd.	Jamii Bora Kenya Ltd.	Jamii Bora Bank Ltd.	11.02.2010
6.	Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010

APPENDIX II: COMMERCIAL BANKS ACQUISITION 2004-DECEMBER 2013

Source: www.centralbank.go.ke

	Institution	Acquired by	Current Name	Approved
1	Credit Agricole Indosuez (K) Ltd.	Bank of Africa Kenya Ltd.	Bank of Africa Bank Ltd.	30.04.2004
2	EABS Bank Ltd.	Ecobank Kenya Ltd.	Ecobank Bank Ltd.	16.06.2008