EFFECT OF FORWARD AND REVERSE MERGERS ON OPERATIONAL EFFICIENCY IN THE KENYAN BANKING INDUSTRY

BY

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DECLARATION

This research project is my original work and has not been presented for examination to any other university.

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D61/63947/2011

This research project has been submitted for examination with my approval as University Supervisor

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DEDICATION

This research project is dedicated to my parents the late Joseph and Jackline Ong'any for their love and support towards my education and to my wife Dorcas Otieno without whose caring supports it would not have been possible.

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Many thanksare to the Almighty God for giving me good health, strength and guidance throughout the entire period of project writing. I also express my heartfelt gratitude to all my family members for their unconditional support and encouragement during this entire period. Special thanks to my supervisor Mrs. Nyamute, University of Nairobi for continued advice, guidance and encouragement throughout the process. Also thanks to the staff of Department of finance and Accounting for their support without thus making the process easier .

ABSTRACT

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Banks as is for every other firm use mergers as means of attaining higher performance which is the ultimate goal for all entrepreneurs. The objective of this study was to determine the effect of forward and reverse mergers on operational efficiency in the Kenyan banking industry. The independent variables under study were increased capital base, increase market share and cost efficiency.

The type of research design employed in the study was causal study since it relied on control factors. This helped us to establish whether the many mergers that have happened in Kenyan banking sector have resulted in improved operational efficiency .The study surveyed the merged banks within the period of study; the population of the study consisted of 34 banks that merged in the period 1996 to 2014 in Kenya. Secondary sources of data from the audited annual financial reports for four years before and after the mergers were used to analyze changes in the independent variables. Capital Adequacy ratios, Return on Capital Employed ratio, Cost Efficiency ratio and percentage change in Market Share were useful in this analysis. Descriptive statistics was used to explain the characteristical set-up of the study sample while Regression and Correlation analyses were used to explain the relationship between the variables.

The study revealed that both forward and reverse mergers do not have a significant effect on operational efficiency. The independent variables in the study explain up-to 9% of the impact on operational efficiency. The research also revealed a weak positive correlation between operational efficiency and the independent variables. The correlation values recorded were 0.517, 0.561, 0.355 and 0.618 for Capital Adequacy, Return on Capital Adequacy and Cost Efficiency respectively. The study concluded that operational efficiency in commercial banks improve in both forward and reverse mergers. However, other factors such as staff expertise, cost management marketing and corporate governance enhance the success of mergers.

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ABBREVIATIONS

CAR Capital Adequacy Ratios

CBK Central Bank of Kenya

CECost Efficiency

CTBL City Finance Bank Limited

DTB Diamond Trust Bank Limited

DBKL Dubai Bank of Kenya Limited

DBL Dubai Bank Limited

JBBL Jamii Bora Kenya Limited

JBBL Jamii Bora Bank Limited

KNBS Kenya National Bureau of Statistics

KNCCKenya National Capital Corporation

MBL Mashreq Bank Limited

M&A Mergers and Acquisitions

NBK National Bank of Kenya

PBL Prime Bank Limited

PCC Prime Capital & Credit Limited

PSF Premier Saving & Finance Limited

ROCE Return on Capital Employed

SPSS Statistical Package for Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Entrepreneurs may grow their businesses either by internal or external expansion. In the case of internal expansion, the firm grows gradually over time through acquisition of assets, technological replacement and establishment of new product lines. In the external expansion, a firm acquires a running business and grows overnight through corporate combinations. The combinations are in the form of mergers, acquisitions, amalgamations and takeovers. In today's globalize economy, 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 among other.(Kithitu et al.,2012).

Mergers refer to the combination of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock where one company or both loose entity. According to Halpern (1983), mergers occur when an acquiring firm and a target firm(s) agree to combine under legal procedures established in the states in which the merger participants are incorporated. Manne (1965) argued that in a merger, the acquiring concern will be a corporation and not an individual, and the medium of exchange used to buy control will typically be shares of the acquiring company rather than cash.

1.1.1 Forward and Reverse Mergers

Mergers and acquisitions (M&A) are being increasingly used in today's global economy in improving competitiveness of companies through enhancing market share, reduction of business risk through increased portfolios, for entering new markets and geographies, and capitalizing on economies of scale among others (Kemal, 2011). The reasoning behind any corporate merger is that two companies are better than one because they increase shareholder value over and above

that of the two separate firms (Sharma, 2009). Generally, motives behind mergers and acquisitions are economies of scale, increase in market share and revenues, taxation, synergy, geographical and other diversification. Vertical mergers may take the form of forward or backward mergers. When a company combines with a supplier or a customer, these are then referred to as backward and forward mergers respectively. Reverse mergers on the other hand occur when a healthy company merges into a financially company and the former dissolves.

Freidheim (1998) definesmergers as any transaction that forms one economic unit from two or more previous ones. He further argues that mergers have been around for thousands of years: during the ancient times, countries have formed alliances with their neighbours just so to protect themselves or to conquer another country, and for as early as the fifteenth century, international trading was made possible because of alliances. A merger can resemble a takeover but result in a new company name (often combining the names of the original companies) and new branding. In some cases, terming the combination a "merger" rather than an acquisition is done purely for political or marketing reasons. Mergers and Acquisitions produce synergy, hence better use of complementary resources leading to geographical or other diversification (Gardiner, 2006). Merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of their long term profitability. Usually, mergers occur in a friendly setting where executives from respective companies participate in a due diligence process to ensure a successful combination of all parts (Bert, 2003). On other occasions, acquisitions can happen through a hostile takeover by purchasing the majority of outstanding shares of a company in the open market. Managers of firms undertaking mergers and acquisitions often anticipate an improvement in production efficiency. However, such gains to the merging firms do not usually benefit all the stakeholders. For instance, merged firms could easily collude with rival firms and increase prices at the expense of customers. Baldwin, (1998) argues that merged firms may also increase their bargaining power over suppliers by pooling their prices and forcing suppliers to sell their supplies to the combined firm. Higher prices to customers and lower prices charged on supplies imply that the merging firms are able to make higher profits and as a result many mergers are often successful.

1.1.2Operational Efficiency

Firm entry, exit, growth, and mergers are all signs of a vibrant market economy, butunlike the first three, mergers have long been deeply controversial. Both their motives and theireffects remain in dispute. Advocates view mergers and acquisitions as methods for efficiency-enhancing transfers of underperforming assets to firms that can utilize those assets better and thereby realize the value gain. Skeptics note that while many mergers may be beneficial, others are motivated by market power, hubris, or simple mistakes, all of which result in societal costs. Evidence exists supporting each view. Stock market event studies routinely find shareholder gains from merger, at least in the short term, seemingly corroborating the efficient-merger hypothesis. Studies of actual operating effects, on the other hand, more often tend to show that gains from merger are the exception rather than the rule.

Andrade et al endorses that mergers create value for stockholders of the combined firms, with the majority of gains accruing to the stockholders of the target' (Andrade et al, 2001). On the contrary, Scherer and Ross (1990) critique the analogy and summarize evidence on the actual longer-term profit and productivity effects of mergers. From various studies, they conclude that mergers result in a widespread failure, considerable mediocrity, and occasional successes. This is retaliated by Meeks (1977), Hughes (1989), and Hartmann (1996a). Event studies and profit studies dominate the general literature on the effects of mergers, particularly for multi-industry studies. Generally, productivity studies of mergers come to more mixed conclusions.McGuckin and Nguyen (1995), in their study on mergers in mergers 28,000 food plants conclude that ownership changes are more frequent for plants with high labor productivity but also that ownership change improves productivity further. Peristani (1997) examined 2000 U.S. bank mergers for both scale efficiency and cost efficiency. He concluded that acquirers improved their scale efficiency but not their cost efficiency after merger. There are however few studies of the actual performance effects of mergers in the commercial banks.

1.1.3 Relationship between Mergers and Acquisitions and Operational Efficiency

One of the benefits of mergers and acquisitions is to eliminate competition and increase market share of the merged companies (Pandey, 2005). Thus, by limiting competition the merged company can earn super normal profits and strategically employ the surplus fund to further consolidate its position and maximize the shareholders' wealth. A post consolidation problem

that had serious impact on merged bank's profitability is increasing incidence of fraud practices among all cadres of merged banks staff. Fraud contributed significantly to the failure of banks in the 1990s in Nigeria (Ogunleye, 1999). Fraud is one of the serious economic crimes being perpetrated in our banking industry today. This had brought huge financial losses to banks and their customers, which resulted in depletion of shareholders' funds (capital base) and loss of confidence in the sector.

There are insufficient findings on the literature on the consequences of mergers and acquisitions on the overall operational efficiency of an entity. This paper aimed at analyzing prior literature of mergers and acquisitions and its effects on efficiency. Previous studies have used varieties of measures to examine the impact of M&A on overall financial performance of an entity, wheremeasures might be accounting based, market based, mixed measures, or qualitative based. Managers should be aware of such factors and their impact on overall corporate performance so as to accurately evaluate proposed offers and make sound decisions, Feroz et al (2005).

1.1.4 Commercial Banks

Commercial Banks and Mortgage Finance Institutions are licensed and regulated pursuant to the provisions of the Banking Act and the Regulations and Prudential Guidelines issued thereunder. Currently there are 43 licensed commercial banks and 1 mortgage finance company. Out of the 44 institutions, 31 are locally owned and 13 are foreign owned. The locally owned financial institutions comprise 3 banks with significant shareholding by the Government and State Corporations, 27 commercial banks and 1 mortgage finance institution (www.centralbank.go.ke).The first wave of bank mergers in Kenya occurred in 1997 while the second in 1998 and continues to the present day. Some mergers have been occasioned by the need to meet the increasing minimum core capital requirements and to enhance the institutions' market share in the local banking environment. Mergers and acquisitions of banks are not exactly recent phenomena for Kenya. As early as 1989, Kenya witnessed the merger of 9 insolvent financial institutions to form the Consolidated Bank of Kenya Ltd. This incorporation was under the financial sector reform program established by the Government with the objective of taking over and restructuring various troubled institutions. On 10th November 1994, the Indosuez Merchant Finance merged with Banque Indosuez to form Credit Agricole Indosuez (www.centralbank.go.ke). This has been an ongoing activity as warranted by market forces. The

recent merger in the Kenyan financial industry occurred in 2010 with the first merger being on 1st February 2010 between Savings and Loans (K) Ltd and Kenya Commercial Bank to form Kenya Commercial Bank Ltd. It was subsequently followed by a merger between City Finance Bank Ltd and Jamii Bora Kenya Ltd on 11th February 2010 and finally the merger of the year between Equatorial Commercial Bank Ltd and Southern Credit Banking Corporation to form Equatorial Commercial Bank Ltd on 1st June 2010. (www.centralbank.go.ke).

In 2008, the Kenyan Government proposed to raise the minimum core capital for banks to 1 billion shillings from250 million shillings, giving 2012 as the deadline for all banks to comply; this has however been proposed to be revised upwards to 5 billion shillings, effective 2018 (Kenyan banks consolidation, 2010). Subsequently, two lenders, Equatorial Commercial Bank and Southern Credit Bank already completed a merger in 2010, citing the need to enlarge their branch network and balance sheet. The local implications on banks of enhanced capital rules abroad following the 2008 global financial crisis may also encourage mergers and acquisitions in the sector. Other mergers include CFC/Stanbic Bank mergers, EABS/AkibaBank merger, EABS/ECO Bank.

1.2 Research Problem

Mergers and acquisitions continue to be a highly popular form of corporate development in today's banking industry world over. In Kenya banking industry, the process has been propelled by the requirements as spelt by the banking Act. It is the expectation of all the stakeholders involved in the process of M&A that the organization to emerge from the combination operates in a more efficient manner than the two organizations did separately. The assumption is due to the fact that the synergies drawn from the combination reduce operating costs and/ or capital investments, thus improving cash flow. According to Hitt et al. (2007), the main corporate objectives are to gain greater market power, gain access to innovative capabilities, thus reducing the risks associated with the development of a new product or service, maximize efficiency through economies of scale and scope and finally in some cases, reshape a firm's competitive scope.

Confirmatory research linking merger and acquisition to firm's performance has been little developed. Hence, how mergers influence firms' performance lacks empirical backing as the few

studies that have been conducted on the same provide mixed results (Bansal & Kumar, 2008). The study conducted by Kithitu et al.(2012), on the role of mergers and acquisitions on the performance of commercial banks in Kenya recommended that institutions having weak capital base consolidate to create synergies. This will enable them to enjoy economies of scale as it will improve their profitability instead of going public by listing on the Nairobi Stock Exchange as this may be an expensive venture as it requires lots of funds for listing. In a study carried out on bank mergers, Chesang (2002), concluded that smaller banks have especially been prone to liquidity problems due to their weak capital base, imprudent lending policies, and inefficient management. The study also cited some strategies, which have been used by the bigger banks, such as Barclay's Bank Corporate Restructuring merging with Barclays Merchant Finance Limited, due to dwindling business and its increase in capital base. Habib A.G. Zurich and Habib Africa Bank Limited merged resulting in an increase to capital base of Kshs. 290 million. Kwoka (2002), alludes that mergers have often failed to add significantly to the value of the acquiring firm's shares. This was also echoed by Muya (2006) who from his survey of experiences of mergers found out that mergers do not add significant value to the merging firms. Surveys done on firms that have undergone M&A process reveal that there is little indication of improvement on operations after the process (Ghosh, 2001).

On the contrary, according to Heron & Lie (2002), in their research carried out on post M&A companies revealed that financial performance after a combination does indeed improve. They further found out that comparatively, the new companies surveyed had improved assets turnover and experienced a reduction in capital expenditures. These findings however differed from a survey conducted on 41 large banks that had completed a merger process in the United States of America. This survey reported an average improvement of 13% on cost savings rather than an improvement or increase in income (Houston, James, and Ryngaert, 2001). Due to the fact that little is known about the relationship between forward and reverse mergers to efficiency in commercial banks and the above mixed results, the study sought to fill this gap.

1.3 Objective of the Study

The study sought to determine the effects of forward and reverse mergers on operational efficiency in Kenyan banking industry.

1.4 Value of the study

Studies and findings on reverse and forward mergers and their effect on operational efficiency on firms in Kenya are both limited and inconclusive. Little has been carried out to clearly assess the success of bank restructuring tools used in Kenya. The collapse of some banks e.g. Akiba and Dubai Banks has resulted to authorities trying to contain such crisis situations after realizing that a sound banking system is critical for both economic growth and for economic stability.

Despite the mixed conclusions derived from previous researches, mergers still continue in Kenya. This raises questions such as could the impact of mergers in Kenya have changed? Are advocates for mergers seeking to expand their power base and compensation or to create value for shareholders? Little study focusing on forward and reverse mergers and their resulting impact on operational efficiency in Kenyan banks has been done. This study therefore seeks to fill this knowledge gap and provide significant information to researchers and all stakeholders in the banking industry in Kenya who comprise of customers, employees in the industry, shareholders and government/policy makers.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter engaged different debates on forward and reverse mergers highlighted the major issues relating to operational efficiencies in the Kenyan banking industry .Literature relevant to the study was summarized and discussed thematically; the chapter discussed relevant literatures from a broader and richer perspective to bring out the impact of forward and reverse mergers on the operational efficiency of commercial banks in Kenya. The chapter began with theoretical framework of mergers and acquisitions where it discussed theories relevant to the study and then proceeded to present the empirical studies relevant to this study.

2.2 Theoretical Review

Several theories have been developed by different scholars towards the effects of mergers and acquisition.

2.2.1 Theory of Synergy and mergers

Viverita (2008) states the differential efficiency theory of mergers, which is broken down as follows; if the management of firm **A** is more efficient than the management of firm **B** and if after firm **A** acquires firm **B,** the efficiency of firm **B** is brought up to the level of firm **A**, then this increase in efficiency is as a result of the merger. According to this theory, some firms operate below their potential and consequently have low efficiency. Such firms are likely to be acquired by other, more efficient firms in the same industry. This theory is relevant to the study because firms with greater efficiency usually identify firms with good potential operating at lower efficiency. Through the managerial ability, the latter's performance is improved.

2.2.2 Theory of Financial Synergies and Mergers

Financial synergy theory argues that, with asymmetric information in financial markets, a firm with insufficient liquid assets or financial slack may not undertake all valuable investment opportunities (Myers and Majluf, 1984). In this case, the firm can increase its value by merging

with a rich firm if the information asymmetry between the two firms is smaller than that between the poor firm and outside investors. Takeover may be therefore an efficient means to achieve financial synergies. This theory predicts that firms in financial distress but with good investment opportunities are more likely to be involved in M&A activities, either as targets or as acquirers.

2.2.3 Industry Shock Theory and Mergers

Industry shock theory states that M&A activities within an industry are not usually from specific phenomena but the result of the adaptation of industry structure to a changing economic environment or "industry shocks" such as changes in regulation, changes in input costs, increased foreign or domestic competition, or innovations in technology. This theory directly related to the study as most banks in the Kenyan banking industry merged due to reasons such; changes in CBK regulations such as revisal of the minimum capital base requirements need of entry into new markets especially by foreign banks and increased costs of doing business among others. Mitchell and Mulherin(1996) argue that corporate takeovers are the least costly means for an industry to restructure in response to the changes brought about by economic shocks but that post-takeover performance of firms should not necessarily improve, compared to a pre-shock benchmark.

2.2.4 Theory of Agency Costs and Mergers

The agency cost theory of M&As argues that takeover activity often results from acquiring firm managers' acting in their own self-interests rather than in the interests of the firm's owners (Shleifer and Vishny, 1988 and 1989). Managers may be motivated to increase their compensation by increasing the size of the firm through non-value enhancing mergers or engaging in "expense preference" behavior by over-consumption of perquisites. This theory related to the study since most managers intentionally acquire businesses that require their personal skills in order to make it costly for shareholders to replace them. Therefore if M&As are primarily motivated by managerial self-interest, they are unlikely to generate operating or financial synergies that lead to improvements in efficiency or productivity.

2.3 Mergers and Acquisitions

There are three major types of mergers namely; Horizontal merger which is a combination of two or more firms in the same area of business. For example combination of two book publishers or two luggage manufacturing companies to gain dominant market share. Secondly, Conglomerate merger which refers to a combination of firms engaged in unrelated lines of business activity. For example merging of different businesses like manufacturing of cement products, fertilizer products, electronic products, insurance investment and advertising agencies. L&T and Voltas Ltd are examples of such mergers. Lastly, vertical mergers refer to a combination of two or more firms involved in different stages of production or distribution of the same product. For example, joining of a TV manufacturing (assembling) company and a TV marketing company or joining of a spinning company and a weaving company. Vertical merger may take the form of forward or backward merger. When a company combines with the supplier of material, it is called backward merger and when it combines with the customer, it is known as forward merger (Business knowledge resource online).In a reverse merger transaction, an existing public "shell company," which is a public reporting company with few or no operations acquires a private operating company usually one that is seeking access to funding in the capital markets. Typically, the shareholders of the private operating company exchange their shares for a large majority of the shares of the public company. Although the public shell company survives the merger, the private operating company's shareholders gain a controlling interest in the voting power and outstanding shares of stock of the public shell company. Advantages of reverse mergers include lower cost, not susceptible to changes from underwriters regarding initial stock price, less time-consuming for company executives and less dilution. Mergers and in this case forward and reverse mergers are beneficial to an organization as they generate increased capital base, increased portfolio and greater market share and thus impact on operational efficiency.

2.3.1 Capital Base

Capital is an essential element which enhances confidence and permits a bank to engage in bankingthus is a major supporter of business operations.Capital in a bank is very important as it serves as a means of absorbing losses since it acts as a buffer between operating losses and insolvency. Bank capital is fund attributed to the proprietors as published in the balance sheet (Nwankwo, 1991). Adequate capital is the quantum of funds which a bank should have or plan to

maintain in order to conduct its business in a prudent manner. The more capital a bank has, the more losses it can sustain without going bankrupt, capital thus provides the measure for the time a bank has to correct for lapses, internal weakness or negative developments. Mergers result into increased capital base and usually the bigger the size of the capital, the longer the time a bank has before losses completely erode its capital.

2.3.2 Market Share

Market share is defined by the Oxford dictionary as the percentage of an industry or market's total sales that is earned by a particular company over a specified time period. Market share is calculated by taking the company's sales over the period and dividing it by the total sales of the industry over the same period. This metric is used to give a general idea of the size of a company to its market and its competitors. Increases or decreases of market share are a sign of the relative competitiveness of the company's products or services. As the total market for a product or service grows, a company that is maintaining its market share is growing revenues at the same rate as the total market. A company that is growing its market share will be growing its revenues faster than its competitors (Heggestad, 1977).Market share increases can allow a company to achieve greater scale in its operations and improve profitability.

2.3.3 Operational costs

Market portfolio gives a measure of how a bank is exposed to risk. High operating costs gives an indication of a higher risk. Cost efficiency gives a measure of how close a bank's cost is to what a best-practice bank's cost would be for producing the same product under the same conditions (Coelli, Prasada Rao, &Battese 1998). Mergers can significantly improve cost efficiency by increasing scale efficiency, scope (product mix) efficiency, or managerial efficiency. Cost efficiency could be considerably improved by a merger in which a relatively efficient bank acquires a relatively inefficient bank and spreads its superior management talent over more resources (Berger, Hunter, and Timme 1993).Pilloff suggests that cost reductions can occur by eliminating redundant labour, closing overlapping bank branches and consolidating back office functions like check clearing. Mergers with operational overlap can result in cost savings of up to 30% of the target’s non-interest expenses.

2.3.4 Measures of Operational Efficiency

Financial ratios are a useful indicator of the firm's performance and financial health. The ratios are computed from the financial statements (Statement of Financial position, Comprehensive Income Statement as well as the Statement of Cash flow) of firms. The ratios are normally used in analyzing trends within the same industry. They can also be used in comparison of results with competitors and industry benchmarks (Muhammad, 2011).Profitability, solvency and capital adequacy measures can be used to analyze operational efficiency of a bank pre -and post-merger.

2.4 Empirical Evidence

A study of the post-merger profitability of Royal Bank of Scotland (RBS) found out that out of 20 ratios, score for the 'better' ratios after merger was 30% only. The study concluded that the merger of RBS failed to pull up its profitability. From the ratio analysis it was proved that the RBS merger proved to be a failure in banking history(Muhammad, 2011).

In a study conducted by Ndora (2010) on 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.Profitability ratios, solvency ratios as well as capital adequacy ratios were calculated for the firmsto measure financial performance. 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. It was concluded that mergers and acquisition would result to an increase in the financial performance of an insurance company.

Ingham, Kiran and Lovestam (1992) studied the relationship between mergers and firm profitability by surveying 146 of the UK's top 500 companies. The study revealed that is the expected reward of increased profitability which has driven the takeover market and that it is this traditional measure which is used in ex-post evaluation. According to the findings, managers firmly perceive that their takeover activity had been performance enhancing for their company. The evidence presented did suggest that the integration of small acquisitions into an existing organizational structure may be achieved without severe problems of loss of control, and the

subsequent decline in performance which beset large acquisitions. Muthiani (2007) studied the cross cultural perspective of mergers and acquisitions done by GlaxoSmithKline Kenya PLC (GSK) by conducting the study on the 50 senior and middle managers at GSK. It was established that the GSK's staffs were highly motivated and performance driven inherent from organizational culture evolving from the merger. The study thus concluded that culture is a very important element for the success of merger as it is also a key to success of a business and a good culture also leads to better performance of a business.

2.5 Conceptual Framework

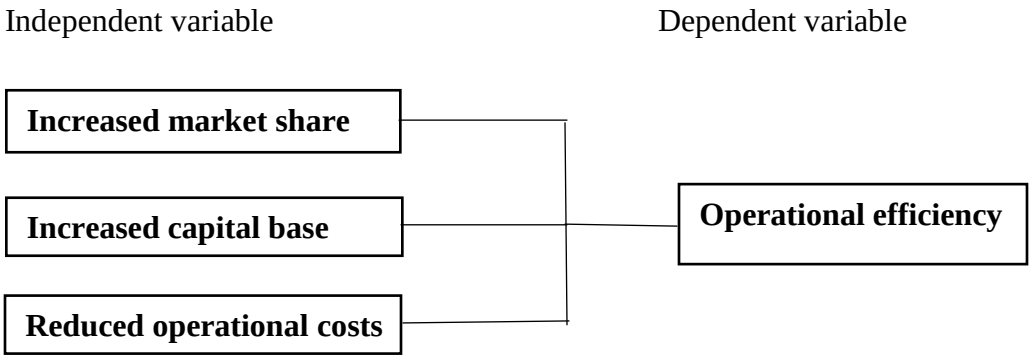

Figure 2.1: Conceptual Framework showing relationship between dependent and independent variables

2.6 Summary of the literature review

This chapter contained literature review which included the discussion of the theoretical framework. Theories relating to mergers and acquisitions were explained. The chapter also presented empirical studies where it discussed the research done by other scholars relating to mergers and acquisition. Also advanced in this chapter are the various types of mergers and acquisitions and finally the measures of operational efficiency for commercial and other financial institutions.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter gave a comprehensive description of the Research Design, Population, Sampling techniques, Data collection instruments and procedures, Data processing and analysis.

3.2 Research Design

Research design refers to the method used to carry out a study. Thornhill et. (2003) defined a research design as a general plan on how the reseacher plans to answer the research question. He further stated that the design should consider the source from which the researcher intends to collect data and the constraints the researcher has to go through such as time, money, access to data and ethical issues. The research adopted a causal study since it relied on control factors. Cooper & Schindler (2003) note that Causal studies are concerned with learning why how one variable produces changes in another; this argument is retaliated by Gay and Airasian (2003). This studytherefore sought to establish the relationship between variables, for example, how increased capital base and customer share relate to operational efficiency.

3.3 Population of the Study

Target population in statistics is the specific population about which information is desired. According to Mugenda and Mugenda (2003), a population is a well-defined or set of people, services, elements, events, group of things or households that are being investigated. This definition ensures that population of interest is homogeneous. By population the researcher means complete census of the sampling frames. In this study, the population of interest comprised of all 27(Appendix I) banks that merged or been acquired in Kenya during the study period of 1996 to 2014. This period provided insightful information on the performance of forward and reverse mergers and acquisition in Kenyan Banking industry.

3.4 Data Collection

The study embraced quantitative approache in collecting secondary data. According to Silverrman (2001), quantification gives greater confidence in the accuracy of conclusions derived from qualitative data; and it gives the reader a chance to think through the data on their own to cap on the researcher's findings. Nicholas (2011) urgues that data that has been observed, experienced or recorded close to the event are the nearest one can get to the truth, and are called primary data. While written sources that interpret or record primary data are called secondary sources. Secondary data was obtained from published audited annual reports of accounts for the population of interest, Central Bank of Kenya. Capital Market Authority and bank supervision annual reports. Financial data from Balance Sheets, Profit and Loss Accounts,and Cash Flow Statements was used to calculate and analyze the performance indicators including profitability and growth.The data for each specific variable was collected using ratios and percentages. ROCE, CAR and CE ratios were calculated from the secondary data collected to show the change in capital base and operational costs respectively before and after the merger. Market share percentages for the specific banks were calculated for the period before and after the merger.

3.5 Data Analysis

According to Mugenda&Mugenda (2003), data analysis is the process of bringing order, structure and meaning to the mass of information collected. Data analysis methods employed involved quantitative and qualitative procedures. Qualitative analysis was done using content analysis. Content analysis is the systematic qualitative description of the composition of the objects or materials of the study (Mugenda and Mugenda, 2003). The data collected under the questionnaire was analyzed using descriptive statistics. Statistical Package for Social Sciences (SPSS) programme was used to carry out the analysis. The descriptive measures sought to describe the characteristical set-up of the sample under study before and after merger. The factors that formed the parameters of inquiry include; market share, capital base, size of portfolio, performance indicators (profitability ratios) and non-economic factors (staff turn-over and service delivery). The findings then were presented using tables for easier interpretation. The study also sought to establish the association between pre-and post-merger performance by using chi-square test. The Chi-Square test was used to find out whether a relationship between two variables in a sample is likely to reflect a real association between these variables in the

population or if there will be a difference between the variables under study. ANOVA test was conducted in order to ascertain the strength of the relationship between variables.

3.5.1 Analytical Model

The following regression model was applied in finding out the effect of forward and reverse mergers, through the independent variables, on operational efficiency.

For the pre-merger average data (y1)

$Y = \beta 0 + \beta 1X1 + \beta 2X2 \ldots + \varepsilon$

For post-merger average data (y2)

Where;

Y = Operational Efficiency

X1= Return on Assets

X2=Return on Equity

$\boldsymbol{\beta_0}$ = Constant term

$\boldsymbol{\beta_1}$, $\boldsymbol{\beta_2}$ and $\boldsymbol{\beta_3}$**=** Beta coefficients,

ϵ= Error term

3.5.2 Test of Significance

According to Robinson (2002), research validity is the degree to which study results is a real presentation of the trend in the study population. It entails how accurate the results map the existing patterns. The credible sources of information, CBK and KNBS boosted reliability and credibility of the research.

The study tested statistical significance at 95% confidential level. The high significance level will check if the information collected honestly maps the trends in the study populations. The researcher usedanalysis of variance (ANOVA) to determine this significance level using the received data. If the researcher obtains a result with significance level falling within 95%, that will mean the data collected is a true representative of the study population.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

According to Mugenda&Mugenda (2003), data analysis assists in bringing order, structure and meaning to the mass of information collected. Quantitative methods of data analysis were employed. The study used accountingratios to analyse the financial performance of 3 banks that underwent forward mergers and 3 that underwent reverse mergers. Ratios for the individual institutions before the merger were examined and their average and percentage change compared the ratios after the merger periods. The following performance indicators were used: CAR, ROCE, percentage of market share and CE ratio. These variables were determined as indicated in the Table 4.1 below.

Table 4.1: Definition of variables

Variable	Notation	Measure	Author
Capital Adequacy	CA	Equity/Total Assets	Berger (1995)
Return on Capital Employed	ROCE	EBIT/Capital Employed	Berger (1995)
Market Share	LOG A	Natural Logarithm of Total Assets	Smirlock (1985)
Cost Efficiency	CE	Operating Expenses/Operating Revenue	Pilloff (1996)

4.2 Findings

4.2.1 Reverse Mergers

4.2.1.1 National Bank of Kenya

The study sought to establish the performance of National Bank of Kenya and Kenya National Capital Corporation for a period before and after merger. NBK registered the highest CAR of 0.41 in 1996 and the lowest in 1998. On the other hand, KNCC had the highest (0.18) and lowest (0.12) CARs in 1997 and 1999 respectively. The average CAR for both institutions was 0.3,

0.24, 0.27and 0.23 for the years 1996 to 1999 which implied a sustained percentage reduction of -11%, -20% and -7%. After the merger, CAR of the new institution increased compared to the average of the two institutions just before the merger. It however dropped in the second year by 47% to 0.19 and thereafter increased to 0.33 and 0.47 registering a percentage increase of 42% and 30% respectively. The ROCE in the period before merger showed an average of 0.13, 0.18, 0.15 and 0.20. After the merger, the ratio recorded was 0.30, 0.24, 0.27 and 0.31 for the period 2000 to 2003.

In the period before merger NBK registered a market share percentage of 4.7%, 4.9%, 4.8% and 5.0% and KNCC recorded 1.0%, 0.7%, 0.9%, and 0.9% in the similar period. Just after the merger, the market share increased to 5.3% compared to the average of the two institutions (3.0%) in the year 1999. It then dropped to 5.0% thereafter increased to 5.1% before dropping again to 4.9%.

NBK had a CE above 0.5 of 0.73, 0.69, 0.54 and 0.61 for the years 1996 to 2000. KNCC on the other hand had CE of 0.45, 0.66, 0.53 and 0.41 for the years 1996 to the year 1999. After the merger, CE of the new institution increased to 0.61compared to the average of the two institutions just before the merger. The CE figures observed for the period after merger (between 2000 and 2003) were 0.61, 0.022 0.57 and 0.53.

Table 4.2 Analysis of National Bank performance using ratios

INSTITUTION	**PRE MERGER**				**POST MERGER**			
	1996	1997	1998	1999	2000	2001	2002	2003
CAPITAL ADEQUACY RATIO								
National Bank of Kenya	0.23	0.30	0.41	0.35				
Kenya National Capital Corporation	0.17	0.18	0.17	0.12				
Average	0.3	0.24	0.27	0.23				
% Change	-	-11%	-20%	-7%				
National Bank of Kenya					0.28	0.25	0.33	0.47

% Change					-	-13%	42%	30%
RETURN ON CAPITAL EMPLOYED								
National Bank of Kenya	0.17	0.25	0.30	0.28				
Kenya National Capital Corporation	0.09	0.11	0.1	0.12				
Average	0.13	0.18	0.15	0.20				
% Change	-	0%	10%	19%				
National Bank of Kenya					0.30	0.24	0.27	0.31
% Change					-	-10%	8%	10%
MARKET SHARE								
National Bank of Kenya	4.7%	4.9%	4.8%	5.0%				
Kenya National Capital Corporation	1.0%	0.7%	0.9%	0.9%				
Average	2.9%	2.8%	2.9%	3.0%				
% Change	-	-2%	2%	3%				
National Bank of Kenya					5.3%	5.0%	5.1%	4.9%
% Change					-	-6%	2%	-4%
COST EFFICIENCY								
National Bank of Kenya	0.73	0.69	0.54	0.61				
Kenya National Capital Corporation	0.45	0.66	0.53	0.41				
Average	0.59	0.68	0.54	0.51				
% Change	-	13%	-26%	-5%				
National Bank of Kenya					0.61	0.022	0.57	0.53
% Change					-	9%	-18%	-8%

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4.2.1.2 Prime Bank

The study revealed a CA ratio of 0.24, 0.25, 0.30 and 0.32 for Prime Capital and Credit Ltd in the period between 2005 and 2008 that was before the merger. 0.19, 0.18, 0.17 and 0.14 were figures observed as CA ratios for Prime Bank Ltd for the similar period. Immediately after the mergers, the CA ratio increased to 0.25 in 2009 compared the average figure of 0.13 for the separate institutions in 2008. The highest recorded percentage increase in the CA ratio was 23%, observed between 2011 and 2013. The average ROCE for the period before merger was recorded as 0.19, 0.18, 0.26 and 0.20. This indicated a percentage change of 11% in 2006, 30% in 2007 and -29% in 2008. After the merger, ROCE increased to 0.23and remained constant in the subsequent year. A 19% increase was recorded on the ROCE in 2011 and a further 9% increase in 2012.

The Market share percentage for PCC in the period 2005 to 2008 was observed as 0.6%, 0.9%, 0.8% and 0.8% whereas 0.9%, 0.9%, 0.7% and 0.6% were recorded as the percentage market share values for PB. The highest average (0.9%) of percentage market share before the merger was recorded in the year 2006. After the merger, the market share trend was 1.2%, 1.31%, 1.26% and 1.38% in the period 2009 to 2012.

The average CE ratio observed for the individual institutions between 2005 and 2008 was 0.48, 0.48, 0.41 and 0.60. There was however an increase of the ratio to 0.69 in 2009, immediately after the merger, and a further increase to 0.71 in the subsequent year. It was also observed that the ratio dropped to 0.64 and 0.61 in 2011 and 2012 respectively.

Table 4.3: Analysis of Prime Bank Ltd performance using ratios

INSTITUTION	**PRE MERGER**				**POST MERGER**			
	2005	2006	2007	2008	2009	2010	2011	2012
CAPITAL ADEQUACY RATIO								
Prime Capital & Credit Ltd	0.24	0.25	0.30	0.32				
Prime Bank Ltd	0.19	0.18	0.17	0.14				
Average	0.22	0.23	0.23	0.23				
% Change	-	-6%	0%	-27%				

Prime Bank Ltd					0.25	0.28	0.30	0.34
% Change					-	11%	21%	23%
RETURN ON CAPITAL EMPLOYED								
Prime Capital & Credit Ltd	0.13	0.10	0.21	0.15				
Prime Bank Ltd	0.24	0.26	0.30	0.25				
Average	0.19	0.18	0.26	0.20				
% Change	-	11%	30%	-29%				
Prime Bank Ltd					0.23	0.23	0.29	0.31
% Change					-	0%	19%	9%
MARKET SHARE								
Prime Capital & Credit Ltd	0.6%	0.9%	0.8%	0.8%				
Prime Bank Ltd	0.9%	0.9%	0.7%	0.6%				
Average	0.8%	0.9%	0.8%	0.7%				
% Change	-	17%	-20%	-7%				
Prime Bank Ltd					1.20%	1.31%	1.26%	1.38%
% Change					-	8%	-4%	9%
COST EFFICIENCY								
Prime Capital & Credit Ltd	0.46	0.38	0.29	0.51				
Prime Bank Ltd	0.49	0.57	0.53	0.69				
Average	0.48	0.48	0.41	0.60				
% Change	-	0%	-16%	32%				
Prime Bank Ltd					0.69	0.71	0.64	0.61
% Change					-	3%	-11%	-5%

4.2.1.3 Diamond Trust Bank Kenya Ltd

The research observed that DTB recorded a CA ratio of 0.22, 0.23, 0.30 and 0.32 in the period 1996 to 1999 while PSF recorded 0.12, 0.18, 0.17 and 0.23 in the same period. The average CA for the two institutions in the same period was 0.17, 0.22, 0.28 and 0.23. For the period after the merger, 2000 to 2003, the CA observed was 0.28, 0.28, 0.30 and 0.35.The highest CA ever recorded in the period 1996 to 2003 was in the year 2003. DTB also recorded ROCE ratio values of 0.22, 0.31, 0.27 and 0.35 in the pre-merger period while PSF, in the same period, registered 0.14, 0.17, 0.2 and 0.21 for the same ratio. The average observed ROCE for the period 1996 to 1999 was 0.18, 0.24, 0.24 and 0.23. This indicated an increase from 0.23 to 0.32 immediately after the merger.

The lowest market share percentage for DTB in the period before the merger was 0.9% in the year 1996 while the highest was at 1.4% in 1999. On the other hand, PSF recorded the highest market share percentage of 0.69% in 1999 and the lowest value of 0.14% in 1996. The average market share for the two institutions in the pre-merger period was observed as 0.5%, 0.6%, 0.8% and 1.0%. After the merger, the percentage market share increased from 1.9% by 9% in 2001 then dropped by -2% in 2002 and thereafter increased by 4% to 2.14% in 2003.

Before the merger, DTB recorded the highest CE ratio of 0.66 in 1996 and lowest value of 0.55 in 1998 while PSF recorded the highest CE ratio of 0.59 in 1998 and the lowest value of 0.45 in 1996. In comparison with the average value of the CE ratio for the two institutions before the merger that were recorded as 0.56, 0.54, 0.57 and 0.57, the ratio increased from 0.57 to 0.60 in 2000. This ratio was sustained at the same value in 2001 before dropping to 0.57 in 2002 thereafter increasing by 3% to 0.59 in 2003.

Table 4.4: Analysis of Diamond Trust Bank (K) Ltd performance using ratios

INSTITUTION	PRE MERGER				POST MERGER			
	1996	1997	1998	1999	2000	2001	2002	2003
CAPITAL ADEQUACY RATIO								
Diamond Trust Bank (K)	0.22	0.23	0.30	0.32				
Premier Saving & Finance Ltd	0.12	0.18	0.17	0.23				
Average	0.17	0.22	0.28	0.23				
% Change	-	12%	3%	-3%				
Diamond Trust Bank (K)					0.28	0.28	0.30	0.35
% Change					-	0%	14%	16%
RETURN ON CAPITAL EMPLOYED								
Diamond Trust Bank (K)	0.22	0.31	0.27	0.35				
Premier Saving & Finance Ltd	0.14	0.17	0.2	0.21				
Average	0.18	0.24	0.235	0.23				
% Change	-	25%	-2%	18%				
Diamond Trust Bank (K)					0.32	0.30	0.37	0.41
% Change					-	-13%	29%	9%
MARKET SHARE								
Diamond Trust Bank (K)	0.90%	1.00%	1.30%	1.40%				
Premier Saving & Finance Ltd	0.14%	0.17%	0.30%	0.69%				
Average	0.5%	0.6%	0.8%	1.0%				
% Change	-	11%	27%	23%				
Diamond Trust Bank (K)					1.90%	2.09%	2.05%	2.14%
% Change					-	9%	-2%	4%
COST EFFICIENCY								
Diamond Trust Bank (K)	0.66	0.59	0.55	0.61				
Premier Saving & Finance Ltd	0.45	0.49	0.59	0.52				
Average	0.56	0.54	0.57	0.57				
% Change	-	-3%	5%	-1%				
Diamond Trust Bank (K)								

					0.60	0.60	0.57	0.59
% Change					-	0%	-5%	3%

4.2.2 Forward Mergers

4.2.2.1 Dubai Bank

The study sought to find out the performance of Dubai Bank of Kenya Limited before and after the merger with Mashreq Bank Limited.In terms of Capital Adequacy, MBL had 0.12,0.15,0.14 and 0.16 between 1997 and 2000 while DBL had 0.13,0.15,0.17 and 0.19 in the same period before the merger. This gave an average 0.125,0.155,0.155 and 0.175 for the two institutions hence gave a percentage change of 19% and 11% in 1998 and 2000.After the merger, DBK an increase in CAR to 0.17 and 0.19 in 2001 and 2002,thereafter dropped to 0.18 and 0.14 in 2003 and 2004 respectively.The ROCE for MBK before the merger were 0.15,0.15,0.17 and 0.18 while DBL registered values of 0.19,0.21,0.22 and 0.24 in 1997 to 2000.This gave a positive percentage increase in ROCE of 6%,8% and 7% for the two institutions .After the merger,DBK displayed a positive percentage increase in ROCE of 5% which then dropped by 24% and 6% in the following years.

MBL had a market share percentage of 0.05%, 0.05%, 0.06% and 0.04% while DBL had 0.09%, 0.10%, 0.20% and 0.29% in the period before the merger. Just after the merger DBK recorded a substantial increase in market share to 0.35% thereafter dropped to 0.31% in 2002, down to 0.27% in 2004.

MBL recorded considerably high CE ratio of 0.64,0.69,0.022 and 0.61 as compared to DBL which had 0.43,0.41,0.37 and 0.41 between 1997 to 2000.There was a drop in this ratio after the merger to 0.50 in 2001 which later increased to 0.60 in 2002 and further dropped to 0.57 and 0.53 in 2003 and 2004 as illustrated in the Table 4.5 below.

Table 4.5: Analysis of Dubai Bank of Kenya Limited using ratios

INSTITUTION	PRE MERGER				POST MERGER			
	1997	1998	1999	2000	2001	2002	2003	2004
CAPITAL ADEQUACY RATIO								
Mashreq Bank Limited	0.12	0.15	0.14	0.16				
Dubai Bank Limited	0.13	0.16	0.17	0.19				
Average	0.125	0.155	0.155	0.175				
% Change	-	19%	0%	11%				
Dubai Bank of Kenya Limited					0.17	0.19	0.18	0.14
% Change					-	11%	-6%	-29%
RETURN ON CAPITAL EMPLOYED								
Mashreq Bank Limited	0.15	0.15	0.17	0.18				
Dubai Bank Limited	0.19	0.21	0.22	0.24				
Average	0.17	0.18	0.195	0.21				
% Change	-	6%	8%	7%				
Dubai Bank of Kenya Limited					0.2	0.21	0.17	0.16
% Change					-	5%	-24%	-6%
MARKET SHARE								
Mashreq Bank Limited	0.05%	0.05%	0.06%	0.04%				
Dubai Bank Limited	0.09%	0.10%	0.20%	0.29%				
Average	0.1%	0.1%	0.1%	0.2%				
% Change	-	3%	44%	21%				
Dubai Bank of Kenya Limited					0.35%	0.31%	0.31%	0.27%
% Change					-	-13%	0%	-15%
COST EFFICIENCY								
Mashreq Bank Limited	0.64	0.69	0.022	0.61				
Dubai Bank Limited	0.43	0.41	0.37	0.41				

Average	0.54	0.55	0.52	0.51				
% Change	-	3%	-6%	-2%				
Dubai Bank of Kenya Limited					0.50	0.60	0.57	0.53
% Change					-	17%	-5%	-8%

4.2.2.2 Jamii Bora Bank Limited

The research findings relating to Jamii Bora Bank Limited before and after the merger with City Finance Bank Limited are as reflected in the Table 4.6 below.CTBL recorded CAR of 0.12,0.12,0.14 and 0.16 from 2007 to 2010 while JBBL had 0.13,0.15,0.18 and 0.19 before the merger. This gave an average percentage increase of 7%, 16% and 9% between the two institutions. After the merger the CAR improved to 0.17, 0.18, 0.18 and 0.20 in the period 2011 to 2014. ROCE for CTBL indicated a high of 0.18 in 2010 and a low of 0.15 in 2008 while JBKL had a high of 0.27 in 2010 and a low of 0.2 in 2007.These however continually improved to 0.2, 0.23, 0.25, and 0.27 after the merger.

The market share average for the two financial institutions gave an average of 0.11%, 0.11%, 0.14% and0.15% before the merger while after the merger this increased to 0.32%, 0.41%, 0.79% and 1.20%.This indicated a positive percentage growth of market share of 22%,48% and 34% for JBBL.

While assessing the CE ratio, CTBL registered high ratios of 0.50, 0.45, 0.51 and 0.53 for period 2007 to 2010.JBKL on the other hand had 0.61, 0.65, 0.66 and 0.66.After the merger, the ratio increased to 0.64 in 2011reduced to a low of 0.49 in 2012,0.55 and 0.53 in 2013 and 2014 respectively.

Table 4.6: An analysis of Jamii Bora Bank Limited using ratios

INSTITUTION	PRE MERGER				POST MERGER			
	2007	2008	2009	2010	2011	2012	2013	2014
CAPITAL ADEQUACY RATIO								
City Finance Bank Limited	0.12	0.12	0.14	0.16				
Jamii Bora Kenya Limited	0.13	0.15	0.18	0.19				
Average	0.125	0.135	0.16	0.175				
% Change	-	7%	16%	9%				
Jamii Bora Bank Limited					0.17	0.18	0.18	0.2
% Change					-	6%	0%	10%
RETURN ON CAPITAL EMPLOYED								
City Finance Bank Limited	0.16	0.15	0.17	0.18				
Jamii Bora Kenya Limited	0.2	0.21	0.25	0.27				
Average	0.18	0.18	0.21	0.225				
% Change	-	0%	14%	7%				
Jamii Bora Kenya Limited					0.2	0.23	0.25	0.27
% Change					-	13%	8%	7%
MARKET SHARE								
City Finance Bank Limited	0.12%	0.12%	0.14%	0.13%				
Jamii Bora Kenya Limited	0.09%	0.10%	0.13%	0.17%				
Average	0.11%	0.11%	0.14%	0.15%				
% Change	-	5%	19%	10%				
Jamii Bora Kenya Limited					0.32%	0.41%	0.79%	1.20%
% Change					-	22%	48%	34%
COST EFFICIENCY								
City Finance Bank Limited	0.50	0.45	0.51	0.53				

Jamii Bora Kenya Limited	0.61	0.65	0.66	0.66				
Average	0.56	0.55	0.59	0.60				
% Change	-	-1%	6%	2%				
Jamii Bora Kenya Limited					0.64	0.49	0.55	0.53
% Change					-	-31%	11%	-4%

4.2.2.3 CFC Stanbic Bank Ltd

The research observed a CA ratio of 0.18, 0.19, 0.16 and 0.19 for CFC Bank in the period 2005 to 2008 while a CA trend of 0.19, 0.17, 0.15 and 0.18 for Stanbic Bank was observed for the same period. An average value of the CA ratio for the two institutions for the prior mentioned period was recorded as 0.16, 0.16, 0.14 and 0.19. After the merger, the CA increased to 0.21 in 2009 from the average comparable figure of 0.17 in 2008. The value later dropped by -11% to 0.19 in 2010 and thereafter increased by 14% and 4% to 0.22 and 0.23 in 2011 and 2012 respectively. The ROCE ratios recorded for CFC Bank in the pre-merger period were o.19, 0.16, 0.14 and 0.21while the ROCE ratios for Stanbic Bank in the same period were 0.17, 0.22, 0.21 and 0.24. The average values for the ROCE ratios for the individual institutions in the pre-merger period were 0.18, 0.19, 0.18, and 0.23. In the post-merger period, the ROCE recorded values were 0.23, 0.18, 0.2 and 0.22.

The market share CFC Bank Limited in the period 2005 to 2008 stood at 5.2%, 5.3%, 5.3% and 5.1% while that of Stanbic Bank was 2.4%, 2.5%, 2.8% and 3.2% in the same period. This charactised a percentage increase of the average market share for the two institutions of 3%, 4% and 2%.After the merger CFC Stanbic Bank records an increased market share of 7.2%, 7.8%, 7.9% and 8.1% from 2009 to 2012 respectively.

CFC Bank recorded the highest cost efficiency ratio of 0.73 in 2008 and a low of 0.61 in 2006.Stanbic Bank on the other hand had a high of 0.70 in 2008 and a low of 0.59 in 2005.The percentage change for the average CE of the two institutions stood at 2%,11% and 3% before the merger. There was a drop immediately after the merger to 0.48 in 2009 and then a continued

increase of 0.56, 0.61 and 0.64 in the subsequent years as shown by the positive percentages of 14%, 8% and 5%.

Table 4.7: Analysis of CFC Stanbic Bank Ltd performance using ratios

INSTITUTION	PRE MERGER				POST MERGER			
	2005	2006	2007	2008	2009	2010	2011	2012
CAPITAL ADEQUACY RATIO								
CFC Bank Ltd	0.18	0.19	0.16	0.19				
Stanbic Bank Ltd	0.19	0.17	0.15	0.18				
Average	0.17	0.18	0.15	0.19				
% Change	-	0%	-15%	27%				
CFC Stanbic Bank Ltd					0.21	0.19	0.22	0.23
% Change					-	-11%	14%	4%
RETURN ON CAPITAL EMPLOYED								
CFC Bank Ltd	0.19	0.16	0.14	0.21				
Stanbic Bank Ltd	0.17	0.22	0.21	0.24				
Average	0.18	0.19	0.18	0.23				
% Change	-	5%	-9%	22%				
CFC Stanbic Bank Ltd					0.23	0.18	0.2	0.22
% Change					-	-28%	10%	9%
MARKET SHARE								
CFC Bank Ltd	5.2%	5.3%	5.3%	5.1%				
Stanbic Bank Ltd	2.4%	2.5%	2.8%	3.2%				
Average	3.8%	3.9%	4.1%	4.2%				
% Change	-	3%	4%	2%				
CFC Stanbic Bank Ltd					7.2%	7.8%	7.9%	8.1%
% Change					-	8%	1%	2%
COST EFFICIENCY								
CFC Bank Ltd	0.62	0.61	0.72	0.73				
Stanbic Bank Ltd	0.59	0.63	0.022	0.70				
Average	0.61	0.62	0.70	0.72				
% Change	-	2%	11%	3%				
CFC Stanbic Bank Ltd					0.48	0.56	0.61	0.64
% Change					-	14%	8%	5%

4.3 Regression Analysis

To determine the overall effect of CA, ROCE, Market share and CE on Operational Efficiency, a multiple regression analysis was conducted. The results were as presented in Tables 4.8, 4.9 and 4.10.

Table 4. 8: Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.843[a]	.710	.56	.837

a. Predictors: (Constant),CA,ROCE,Market Share,CE

From table 4.8, the R square reveals that CA, ROCE, Market share and CE collectively affect operational efficiency by up to 71 %. This is the cumulative effect of the three variables on operational efficiency.

Table 4. 9: ANOVA table

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.295	3	.098	.140	.035[a]
	Residual	32.205	46	.700		
	Total	32.500	49			

a. Predictors: (Constant), CA, ROCE, Market share, CE

b. Dependent Variable: Operational Efficiency

The significance value of 0.035 (< 0.05) reveals that the combined effect of the three predictor variables on operational efficiency is statistically significant.

Table 4. 10: Table of Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.163	.919		3.442	.001
	CA	.047	.163	.042	.032	.047
	ROCE	.097	.192	.076	.507	.015
	Market share	.023	.186	.018	.121	.228
	CE	.025	.243	.017	.103	.019

a. Dependent Variable: operational efficiency

Table 4.10 presents the coefficients of the independent variables; CA, ROCE, Market share and CE. From the table, the derived regression model is:

$Y = 3.163+0.047X_1 + 0.097X_2 + 0.023X_3 +0.025X_4$

Where; Y - Operational Efficiency

X_1 - CA

X_2 -ROCE

X_2 – Market Share

X_4 – Cost Efficiency

4.4 Correlation Analysis

Correlation analysis was conducted to establish the effects of Cost Adequacy, Return on Capital Employed, Market share and Cost Efficiency on Operational Efficiency. The results were as presented in Table 4.11.

Table 4. 11: Correlation Analysis

		Capital Adequacy	ROCE	Market share	Cost Efficiency	Operational Efficiency
Capital Adequacy	Pearson Correlation	1	.038	.128	.094	.517
	Sig. (1-tailed)		.022	.188	.284	.012
	N	6	6	6	6	6
ROCE	Pearson Correlation	.038	1	.232	.225	.561
	Sig. (1-tailed)	.022		.053	.084	.032
	N	6	6	6	6	6
Market Share	Pearson Correlation	.128	.232	1	.225	.355
	Sig. (1-tailed)	.188	.053		.084	.387
	N	6	6	6	6	6
Cost Efficiency	Pearson Correlation	.094	.225	1	1	.618
	Sig. (1-tailed)	.284	.084			.042
	N	6	6	6	6	6
Operational Efficiency	Pearson Correlation	.517	.561	.355	.618	1
	Sig. (1-tailed)	.012	.032	.387	.042	
	N	6	6	6	6	6

Table 4.11 presents the correlation between the research variable.

4.5 Interpretation of findings and Discussions

4.5.1 Capital Adequacy Ratio and Return on Capital Employed

The research revealed mixed results on the effect of reverse and forward mergers on Capital Adequacy and Return on Capital Employed ratios on banks, as a measure of operational efficiency. Banks that posted an increase in CA ratio and ROCE ratio after the merger revealed efficiency in utilizing assets in generating revenue and the institution's ability to absorb a higher amount of risk. On the other hand, reduction in the ratios indicated inefficiency in utilizing assets in generating revenue and a drop in the bank's ability to absorb risk. For example, Mashreq and Dubai banks registered a before merger CA and ROCE ratios of 0.16, 0.18 and 0.19 and 0.24 respectively. Immediately after the merger, the CA and ROCE dropped, in relation to Dubai bank, to 0.17 (from 0.19) and 0.20 (0.24). The CA however picked by 11% to 0.19 and later steadily dropped in the subsequent year by -6% and -29%. Notwithstanding, Jamii Bora Bank experienced a steady increase in both CA and ROCE ratios after the merger, implying an improvement in risk absorption ability and asset utilization efficiency. The registered percentage increase in both ratios was between 0% to 10% and 7% to 13%.

The Pearson Correlation value of .517 indicates a strong positive correlation which implies that capital adequacy positively affects operational efficiency. The significance value of 0.012 (< 0.05) however indicates that the relationship is statistically significant. On the other hand, the Pearson Correlation value of .561 indicates a strong positive correlation which implies that ROCE positively affects operational efficiency. The significance value of 0.032 (< 0.05) also indicates that the relationship is statistically significant. According to the regression model, a unit increase in Capital Adequacy and Return on Capital results to increase in operational efficiency by a factor of 0.047 and 0.097 respectively.

4.5.2 Market Share

The study also revealed mixed results in the analysis of the effect of forward and reverse mergers on the market share of a bank, as a measure of operational efficiency. A higher market share signifies greater sales hence and lesser effort to sell and stronger barriers to entry for competitors. On the other hand, a decrease in market share implies a reduction in sales and increased penetration by competitors. Looking at National Bank and Kenya National Capital

Corporation that underwent a reverse merger, both institutions had a total market share of 5.9% and average market share of 3.0% just before the merger. The aggregate percentage however dropped to 5.3% immediately after the merger then dropped further to 5.0% before increasing to 5.1% and dropping again to 4.9%. A similar trend is also revealed in the analysis of Dubai Bank that undertook a forward merger. However, a further look at the Jamii Bora Bank that undertook a forward merger reveals an opposite positive trend. The market share percentage increased to 0.32% from an earlier aggregate value of 0.30%. This increase is sustained in the following years to 0.41%, 0.79% and 1.2% subsequently.

The study also revealed a weak Pearson Correlation value of .355 between market share and operational efficiency which implies that market share positively affects operational efficiency. The significance value of 0.387 (> 0.05) however indicates that the relationship is not statistically significant. The regression model on the other hand implies that a unit increase in market share results to an increase in operational efficiency by a factor of 0.023.

4.5.3 Cost Efficiency

An analysis of the effect of forward and reverse mergers on cost efficiency of banks as a measure of operational efficiency posted mixed results too. The results indicated that some banks experienced an increase in CE ratio while others registered a decrease. An increase in in CE ratio indicates a higher operating expenses and/or a lower operating revenue while a decrease in the CE ratio indicates a lower operating expense and a higher operating revenue. For example, DTB that undertook a reverse merger posted an increase in the ratio to 0.60, in the year after the merger. This value was maintained the following year before dropping by -5% to 0.57 and thereafter increasing by 3% to 0.59. A further look at CFC Stanbic Bank reveals that the forward merger process resulted to an increase in the CE ratio from 0.48 in 2009 to 0.64 in 2012.

Similarly, the Pearson Correlation value of 0.517 indicates positive relationship that implies that cost efficiency positively affects operational efficiency. The significance value of 0.012(<0.05) further indicates that the relationship is statistically significant. Besides, the regression model reveals that a unit increase in the Cost Efficiency results to an increase in operational efficiency by a factor of 0.025

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter summarizes the results on the impact of forward and reverse mergerson the operational efficiency of commercial banks in Kenya. The study also gives recommendations to the management on the steps to be taken in order to positively affect the operational efficiency of any merger process; this is based on the findings. The study finally gives recommendations for further studies considering the limitations of this research.

5.2 Summary

The research sought to establish whether forward and reverse mergers influence operational efficiency of commercial banks in Kenya. The key objective of the study was to determine the effect of forward and reverse mergers on the operational efficiency of commercial banks in Kenya.

The research findings revealed that after a reverse or forward merger process, the operational efficiency of the new institution improved. The improvements were however at some instances not significant. For instance, Capital Adequacy Ratio immediately improved and these trends were sustained in most of the newly formed institutions: the higher the ratio, the lesser the risk of exposure to insolvency the new institution has. On the other hand, the new institutions recorded an increase in their market shares, this was however not immediate. The increase in market share further implied improved profitability due to increased sales and stronger barriers against competitors. The high levels of the Cost Efficiency ratio recorded after the mergers also affirm that both reverse and forward mergers do not have a negative effect the operational efficiency. This high ratio values indicate efficiency in expenditure control and/or improved revenue.

Pearson correlation test generally indicates a strong relationship between the independent variables; Capital Adequacy, Return on Capital Employed, Market share & Cost Efficiency and operational efficiency. The relationships are however positive for each of the variables. This summarily implies that an increase in any of the variables results to an increase in the level of

operational efficiency achieved. The relationships are statistically significant. The regression model also indicates a unit change in CA, ROCE, Market share and CE result to a change in operational efficiency by a factor of 0.047, 0.097, 0.023 and 0.025 respectively. Generally, the independent factors under study explain upto 71% of the impact of forward and reverse mergers on operational efficiency of commercial banks in Kenya.

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5.3 Conclusions

Based on the research' findings, the study concluded that operational efficiency in commercial banks improves in both forward and reverse merger processes. The study further affirms that both mergers assist in creation of synergy for the merging banks. This conclusion is resounded by Kithuti et al (2012) in their research on role of mergers in the performance of commercial banks. Marembo (2011) in his research on impact of mergers and acquisition on financial performance of commercial banks in Kenya also concludes that mergers and acquisition improve the profitability of commercial banks which is a facet of improved operational efficiency. The improved operational efficiency is indicated by an increase in market share and capital base, improved cost management and revenue generation. According to the study, these factors have an insignificant effect on the operational efficiency of commercial banks in Kenya.

Adequate capital is the quantum of funds which a bank should have or plan to maintain in order to conduct its business in a prudent manner. The more capital a bank has, the more losses it can sustain without going bankrupt, capital thus provides the measure for the time a bank has to correct for lapses, internal weakness or negative developments. Adequate capital confers other benefits which are: Protection of depositors and creditors in time of failure. Strengthening of banks' ability to attract funds at lower cost and enhances a bank's liquidity position. On the other hand, the percentage of an industry or market's total sales that is earned by a particular company over a specified time period. A company that is growing its market share will be growing its revenues faster than its competitors (Heggestad, 1977).Market share increases can allow a company to achieve greater scale in its operations and improve profitability. According to Smirlock (1995), market size has a positive significant relationship with profits. Once market share has positive impact on bank's revenue invariably it will create wealth to the shareholders.

Mergers can potentially improve cost efficiency by increasing scale efficiency, scope (product mix) efficiency, or managerial efficiency.

5.4 Limitations of the Study

This study defined its limitations as factors that would otherwise affect the research outcome but were outside the researcher' influence. The main limitations of this study was secondary data only was used to carry out the analysis. The data could only be best obtained from the website and at some instances scanty information was available. The collected data was further limited to only four performance ratios namely Capital Adequacy ratio, Return on Capital Employed, Market share ratio and Cost Efficiency ratio.

Another limitation of the study entails changes in government rules and regulations that govern the operations of commercial banks from time to time. For example the changing of reserves kept with the central banks and minimum capital requirements that may affect the ability of commercial banks to lend hence their operational activities and in the long run their profitability. The effect of government regulations on the industry' operational efficiency was however excluded in the research.

The study also limited its sample size to six banks out of which three underwent reverse mergers and three undertook forward mergers. The sample only represented approximately 18% of the entire number of both forward and reverse mergers that have taken place until 2014. 33% and 12.5% of the banks that undertook reverse mergers and forward mergers respectively were selected.

The research also sought to determine the cumulative effect of the independent variables; Capital Adequacy, Return on Capital employed, Market share and Cost Efficiency on operational efficiency. This was carried out through a regression model that was limited to the post merger period for the sampled institutions.

5.5 Recommendation for Further Studies

5.5.1 Policy Recommendations

In line with its findings, the study recommends that institutions with a limitation on the market size and low capital base should seek a merger to enable them widen their market scope and capital base that would otherwise disadvantage their operations. The consolidation will in the long run impact the profitability of the organization through improving the revenue base. Both forward and reverse mergers also act as a means of raising more capital easily and cheaply especially for organizations that would not qualify to be listed in the stock market.

The study however recommends further that the merging process should be coupled with other intentional moves that will enhance the merger process for example improved cost management and revenue generation. Such moves include enhancing bank staff expertise and professionalism through training, being aggressively involved in marketing and sales and bringing about more effective corporate governance to further increase the resilience and competitiveness. Banks' Management should also give proper attention to scope and scale of economies; eliminate redundancy, duplication, corrupt and inefficient staff. Aggressive marketing improve and/or sustain the market size. Embracing technological changes also has an impact on financial product design and delivery with implications for staff training, internal controls and operating cost.

5.5.2 Recommendation for Further Studies

This study only sought to establish the effect of forward and reverse mergers on operational efficiency in commercial banks in Kenya through assessing independently factors such as market share, capital base and cost efficiency. The researcher therefore recommends that other studies be done to establish the cumulative impact that these factors will have on operational efficiency. Studies on other features such as aggressive marketing and staff training and their relationship to the prior mentioned aspects and influence to operational efficiency should also be carried out. Further studies can also be carried out on the impact of forward and reverse mergers on operational efficiency in banks outside the Kenyan borders so as a comparison can be carried and isolated factors identified.

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APPENDICES

APPENDIX 1: LIST OF COMMERCIAL BANKS IN KENYA AS AT 2015

No.	Name of Bank	No. of Branches
1.	African Banking Corporation	10
2.	Bank of Africa Kenya Ltd.	18
3.	Bank of Baroda (K) Ltd.	11
4.	Bank of India	**5**
5.	Barclays Bank of Kenya Ltd.	103
6.	CFC Stanbic Bank Ltd.	20
7.	Charterhouse Bank Ltd. (Under Statutory Mgt.)	10
8.	Chase Bank (K) Ltd.	18
9.	Citi Bank N.A. Kenya	4
10.	Commercial Bank of Africa Ltd.	20
11.	Consolidated Bank of Kenya Ltd.	14
12.	Co-operative Bank of Kenya Ltd.	87
13.	Credit Bank Ltd.	7
14.	Development Bank of Kenya Ltd.	3
15.	Diamond Trust Bank (K) Ltd.	36
16.	Dubai Bank Kenya Ltd.	5
17.	Ecobank Kenya Ltd.	20
18.	Equitorial Commercial Bank Ltd.	12
19.	Equity Bank Ltd.	123
20.	Family Bank ltd.	52

21.	Fidelity Commercial Bank ltd.	7
22.	Fina Bank Ltd.	15
23.	First Community Bank ltd.	18
24.	Giro Commercial Bank Ltd.	7
25.	Guardian Bank Ltd.	7
26.	Gulf African Bank Ltd.	15
27.	Habib Bank A.G. Zurich	5
28.	Habib Bank Ltd.	4
29.	Imperial Bank ltd.	16
30.	I & M Bank Ltd.	19
31.	Jamii Bora Bank Ltd.	1
32.	Kenya Commercial Bank Ltd	165
33.	K-Rep Bank Ltd.	31
34.	Middle East Bank (K) Ltd.	3
35.	National Bank of Kenya Ltd.	54
36.	NIC Bank Ltd.	16
37.	Oriental Commercial Bank Ltd.	6
38.	Paramount Universal Bank Ltd.	6
39.	Prime Bank Ltd.	14
40.	Standard Chartered Bank (K) Ltd.	33
41.	Trans-national Bank Ltd.	18
42.	UBA Kenya Bank Ltd.	4
43.	Victoria Commercial Bank Ltd.	3
44.	Housing Finance Ltd.	11

Source: *Central Bank of Kenya*

APPENDIX 2: LIST OF FORWARD MERGERS IN KENYAN BANKS BETWEEN 1996 & 2014

No	Institution	Merged with	Current Name	Date
1	Stanbic Bank (K) Ltd.	Stanbic Finance (K) Ltd.	Stanbic Bank Kenya Ltd.	05.01.1996
2	Mercantile Finance Ltd.	Ambank Ltd.	Ambank Ltd.	15.01.1996
3	Delphis Finance Ltd.	Delphis Bank Ltd.	Delphis Bank Ltd.	17.01.1996
4	CBA Financial Services	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	26.01.1996
5	Trust Finance Ltd.	Trust Bank (K) Ltd.	Trust Bank (K) Ltd.	07.01.1997
6	National Industrial Credit Bank Ltd	African Mercantile Banking Corp.	NIC Bank Ltd.	14.06.1997
7	Barclays Bank of Kenya Ltd.	Barclays Merchant Finance Ltd.	Barclays Bank of Kenya Ltd.	22.11.1999
8	Habib A.G. Zurich	Habib Africa Bank Ltd.	Habib Bank A.G. Zurich	30.11.1999
9	Guilders Inter. Bank Ltd.	Guardian Bank Ltd.	Guardian Bank Ltd.	03.12.1999
10	Universal Bank Ltd.	Paramount Bank Ltd.	Paramount Universal Bank	11.01.2000
11	Kenya Commercial Bank	Kenya Commercial Finance Co.	Kenya Commercial Bank Ltd.	21.03.2001
12	Citibank NA	ABN Amro Bank Ltd.	Citibank NA	16.10.2001
13	Bullion Bank Ltd.	Southern Credit Banking Corp. Ltd.	Southern Credit Banking Ltd.	07.12.2001
14	Co-operative Merchant Bank ltd	Co-operative Bank ltd	Co-operative Bank of Kenya ltd	28.05.2002
15	Biashara Bank Ltd.	Investment & Mortgage Bank Ltd.	I & M Bank Ltd.	01.12.2002
16	First American Bank ltd	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	01.07.2005

17	CFC Bank Ltd.	Stanbic Bank Ltd.	CFC Stanbic Bank Ltd.	01.06.2008
18	Savings and Loan (K) Limited	Kenya Commercial Bank Limited	Kenya Commercial Bank Limited	01.02.2010
19	City Finance Bank Ltd.	Jamii Bora Kenya Ltd.	Jamii Bora Bank Ltd.	11.02.2010
20	Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010
21	Mashreq Bank Ltd.	Dubai Kenya Ltd.	Dubai Bank Ltd.	01.04.2000
22	Credit Agricole Indosuez (K) Ltd.	Bank of Africa Kenya Ltd.	Bank of Africa Bank Ltd.	30.04.2004
23	EABS Bank Ltd.	Ecobank Kenya Ltd.	Ecobank Bank Ltd.	16.06.2008
24	Fina Bank Ltd	Guaranty Trust Bank Plc	Guaranty Trust Bank (Kenya) Ltd	08.11.2013

Source: www.centralbank.go.ke

APPENDIX 3: LIST OF REVERSE MERGERS IN KENYAN BANKS BETWEEN 1996 & 2014

1	Guardian Bank Ltd.	First National Finance Bank Ltd.	Guardian Bank Ltd.	24.11.1998
2	Giro Bank Ltd.	Commerce Bank Ltd.	Giro Commercial Bank Ltd.	24.11.1998
3	Diamond Trust Bank (K) Ltd.	Premier Savings & Finance Ltd.	Diamond Trust Bank (K) Ltd.	12.02.1999
4	National Bank of Kenya Ltd.	Kenya National Capital Corp.	National Bank of Kenya Ltd.	24.05.1999
5	Standard Chartered Bank (K) Ltd.	Standard Chartered Financial Services	Standard Chartered Bank (K) Ltd.	17.11.1999
6	Citibank NA	ABN Amro Bank Ltd.	Citibank NA	16.10.2001
7	East African Building Society	Akiba Bank ltd	EABS Bank ltd	31.10.2005
8	Prime Capital & Credit Ltd.	Prime Bank Ltd.	Prime Bank Ltd.	01.01.2008
9	Equatorial Commercial Bank Ltd	Mwalimu Sacco Society Ltd	Equatorial Commercial Bank Ltd	31.12.2014
10	K-Rep Bank Ltd	Centum Ltd	K-Rep Bank Ltd	29.10.2014

Source: www.centralbank.go.ke