PROFITABILITY ANALYSIS OF PRE AND POST MERGERS AND ACQUISITIONS FOR COMMERCIAL BANKS IN KENYA.

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DECLARATION

I declare that, this Research Project is my original work and has not been presented for any academic award in any university.

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This Research Project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

To my dad, Eddie Onyango and my lovely husband Denis Nyamwaro

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ABBREVIATIONS

EMH	Efficient Market Hypothesis
MBA	Master of Business Administration
M&A	Mergers and Acquisitions
NSE	Nairobi Securities Exchange
GD	Gross Domestic Product
EPS	Earnings per Share
ROA	Return on Assets
ROE	Return on Equity
ATS	Automated Trading Systems
MIT	Millennium Information Technologies
CDS	Central Depository System
IFC	International Finance Corporation

ABSTRACT

Most studies on the profitability analysis of mergers and acquisitions for commercial banks however seem focused on developed markets. Though in recent times, substantial amount of research is also emerging in African markets. From the literature and empirical evidence review it is still not clear on the direction of the relationship between profitability and mergers and acquisitions. This study used three variables to examine the relationship between profitability and Mergers and Acquisitions. The study used secondary data obtained from Kenya published audited annual reports of accounts for the respective banks. Financial data from statement of financial position, statement of comprehensive income and statement of cashflows of the respective companies before and after mergers was used to calculate and analyze profitability for the merged companies for the period under study. Analyses of the ROA on the banks that merged or were acquired communicate mixed signals. ROA of the new institution improved after the acquisition or the merger. However, ROA of the new institution at times dropped slightly compared to the average of the two institutions before the coming together transaction was concluded.From the findings, the profitability of the new institution formed on the merger/ acquisition registered a higher profitability as depicted by an increase in the ROA and ROE on the merger/acquisition. Merging/ acquisition improved the profitability of the new institution compared to the two separate institutions separately. In some cases however, the improvement was not realized immediately after the merger/acquisition. The increase in profitability was more pronounced in the second and the third year than it was in the year of the merger.

CHAPTER ONE

INTRODUCTION

1.1 Background of study

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 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). The motives behind mergers and acquisitions are economies of scale, increase in market share and revenues, taxation, synergy, geographical and other diversification. Over a long time, the Kenyan economy has been state controlled and to some extent consumer controlled because the consumer is aware of the price differentials, variety, functionalities and qualities in goods. However, liberalization coupled with the opening up of the economy has resulted in competition of the Kenyan Business environment both internally and externally Rankine (1998).

The need for survival for the local firms and the need to penetrate the local and the global market have occasioned mergers, takeovers and buyouts. Little has been done to clearly access the success or failure of mergers and the factors that determine the choice of partners in the Kenyan context Harney (2011).

Profitability is the most influential variable in determining growth of firms through mergers and acquisitions in Kenya. However, industry concentration, sales growth, stock market index and GDP growth also determines growth of firms through mergers and acquisitions but to a lesser extent. The study concludes that firms be encouraged to embrace M&A growth strategy in corporate finance especially when pursuing the profitability and wealth objectives.

1.1.1 Mergers and Acquisitions

Hax and Majluf (1996) define mergers and acquisitions as a means of establishing the organizational purpose in terms of its long-term objectives, action programs and resource allocation. A major obstacle faced by organizations seeking to merge or acquire others has been that of identifying the business area in which a firm should participate in order to maximize its long-term profitability (Hill and Jones 2001).

David (1997) explains a merger as a process that occurs when two organizations of about equal size unite to form one enterprise. Thus, mergers involve friendly restructuring of the assets and resources for the companies involved in the combination David (1997). Majority of mergers are friendly and are recommended by the directors and shareholders of both companies Hill and Jones (2001).

A merger is 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 Halper (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. A merger requires the explicit approval of those already in control of the corporation. And most statutes require more than a simple majority vote by shareholders to effectuate a merger. The term “acquisition” is used to refer to any takeover by one company of the share capital of another in exchange of cash, ordinary shares, or loan stock Halpern (1983). M & As has been popular methods of increasing the size and value of firms in modern times. Compared to the older system of increasing value through organic growth, M & As are faster and in most cases cheaper. The terms M & As have been used interchangeably in this study.

1.1.2 Profitability

Profitability analysis is the most common measure of financial performance. The measures are used to assess how well management is investing the firms' total capital and raising funds. Profitability is generally the most important to the firm's total shareholders. Profits serve as cushion against adverse conditions such as losses on loans, or losses caused by unexpected changes in interest rates. Consequently, creditors and regulators concerned about failure also look to profits to protect their interests although the measures ignore firm's risk. Profits depend on three primary structural aspects of financial institutions: Financial leverage, Net interest Margin and non-portfolio income sources. Return on Equity, (ROE) and Return on Assets (ROA) are the most commonly applied profitability ratios used to assess financial performance Akhavein (1996).

The success of mergers and acquisitions was measured quantitatively in terms of increased profitability and share price, by comparing pre and post-acquisition performance. Mintzberg and Quinn (1991) stated that the classic expressed rationale for mergers have been to increase profits and shareholder value.

1.1.3 Relationship between Profitability and Mergers and Acquisition

In the series of studies that had been carried out elsewhere since 1921, researchers had been unable to demonstrate that merger active firms were more profitable, or had higher stock prices, following the merger activity. Lucey (2000) indicated that the financial performance of the company can be expressed in terms of income generated from its operation, after offsetting expenses when the profitability of the firm is arrived at.

Bidder variables are operationalized by assessing firm profitability which tends to positively influence mergers and acquisitions. Large and profitable firms often have or can better access financial resources that are needed to acquire other firms. More over large firms are expected to engage more in diversifying mergers and acquisitions as there may be few opportunities left for growth in their own industry ceteris paribus. These financial resources can also create value when used to acquire a financially constrained target firm thus a positive relation between profitability, firm size and M&A Gaughan (2002).

1.1.4 Mergers and Acquisitions at Commercial Banks in Kenya

In 2008, the then Finance Minister Amos Kimunya proposed to raise the minimum core capital for banks to 1 billion shillings from 250 million shillings, giving 2012 as the deadline for all banks to comply Kenyan banks consolidation (2010).

Subsequently, Kenyan banks are set for consolidation to meet the deadline to boost minimum core capital. Two lenders, Equatorial Commercial Bank and Southern Credit Bank have already completed a merger this year, 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. Increased competition and capital adequacy requirements under Basel III are likely to be the key drivers behind sector consolidation. Among the recent mergers are CFC/Stanbic Bank mergers, EABS Akiba Bank merger, EABS/ECOBANK.

1.2 Research Problem

In most merger arrangements, there is lack of a systematic and thorough attention paid to potential problems of the integration, particularly in aspects of financial performance Jemison &Sitkin (1986). Harney (2011) reported that over the recent years, most mergers that have occurred in Kenya are yet to show the direct effects in terms of profitability. There is no clear indicator of the benefits of a merger. There exists a high degree of calculated risk-taking to tap opportunities that come the way of business, but there is risk avoidance in business and where risk is low, development is also low and industrial advance merit becomes nearly static Rankine (1998).Merger and acquisition could also be a very expensive venture in terms of fund required to prosecute it successfully Harney (2011).Corrupt practices at public and private sector level are another impediment. This needs to be discouraged and incidence of corrupt practices should be severely punished because mergers and acquisition deal requires confidence and trust to promote consummation Lambrecht (2004).

Locally studies on mergers and acquisitions have produced mixed results Katuu (2003) conducted a survey of factors considered important in merger and acquisition decisions by selected Kenyan based firms. Njenga (2006) also conducted a survey on investigation into whether the demerger of coffee market societies have created or eroded owners wealth in parts of Central Kenya. Njenga found mixed results on whether demerger leads to wealth creation or erosion of coffee firms as depicted by both positive and negative returns on post-merger firms. Muya (2006) carried out a survey of experiences of mergers and found that mergers do not add significant value to the merging firms. There are limited studies focusing on the impact of M & As on pre and post profitability of listed commercial banks in Kenya. This study therefore sought to fill this knowledge gap by analyzing the profitability of Commercial banks before and after mergers and acquisition.

1.3 Objective of the study

The main objective of this study was to analyze the profitability of Commercial banks in Kenya before and after mergers and acquisitions.

1.4 Value of the Study

The findings of this study offer valuable contribution to theory and practice. First the study will add to the body of knowledge that exist on profitability of merger announcements and will form the basis of further research by identifying the knowledge gap that arises from this study. The study will create a forum for further discussions and debate on market reactions to profitability among researchers, consultants and practitioners thus contributing to the body of knowledge that already exist.

The study greatly contributes to practice in that it will assist managers in making prudent decisions before undertaking any merger since this may have an effect on value of company stocks. It will also assist shareholders in making informed decisions towards intended mergers. They will participate in safeguarding their investments. Regulators of the business firms in Kenya who include the Capital Markets Authority, Nairobi Securities Exchange and the Central Bank of Kenya will also benefit from the research findings.

Since the regulators have the responsibility of ensuring that investors are protected, they will use the findings to scrutinize and evaluate any proposed mergers and acquisitions activity before giving their approval. The information highlighted by the study will be of great interest to the regulators who have the responsibility of dealing with issues that may arise as a result of insider trading. They will also use the information to ensure that regulations are followed.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter looked at the literature review including discussion of the theoretical framework. Theories relating to mergers and acquisition were explained. The chapter also presented empirical studies where it discussed the research done by other scholars relating to mergers and acquisition and chapter summary.

2.2 Theories of Mergers

2.2.1 Efficiency Theories

The differential efficiency theory states that more firms that are efficient will acquire less efficient firms and realize gains by improving their efficiency. This means that target is not always inefficient but only relatively inefficient. Hence, mergers are driven by differential efficiency between the target and bidder management.

The inefficient management theory suggests that the existing management is simply inefficient, and hence, another management whether best or not, would replace the existing one and increase the efficiency of the business.

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

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

Diversification provides numerous benefits to managers, employees, owners of the firms and to the firm itself. Diversification through mergers is commonly preferred to diversification through internal growth, given that the firm may lack internal resources or capabilities requires

Strategic Realignment to Changing Environment: It suggests that the firms use the strategy of Mergers &acquisition as ways to rapidly adjust to changes in their external environments. When a company has an opportunity of growth available only for a limited period of time slow internal growth may not be sufficient.

Hubris Hypothesis: Hubris hypothesis implies that manager's look for acquisition of firms for their own potential motives and that the economic gains are not the only motivation for the acquisitions. This theory is particularly evident in case of competitive tender offer to acquire a target.

2.2.2 Monopoly Theory

The theory is viewed as acquisitions were executed to achieve market power. The implications of this type of acquisition are; Conglomerates use cross-subsidized products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market.

2.2.3 Valuation Theory

This philosophy viewed acquisitions as being executed by managers who have superior information than the stock market about their exact target's unrealized potential value. The assumption here is that the acquirer possesses valuable and unique information to enhance the value of a combined firm through purchasing an undervalued target or deriving benefits from combining the target's business with its own. The leveraged buyout can be categorized into this theory. One of the most common criticisms about this valuation theory is that it is impossible to acquire accurate and tangible information about the acquisition results, and further stated that "the concept of private information as a basis for mergers warrants further consideration, since it shows away the problematic assumption of capital market efficiency can be avoided."

2.2.4 Empire-building Theory

The agency theory comes into sharp focus here whereby managers maximize their personal goals, rather than their shareholders' value maximization through acquisitions. This theory stems from early study on the relationship between ownership and corporate governance structure.

2.2.5 Process Theory

This approach hinges on rationalization and it indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory, the central role of organization routines, or political power in the decision process rather than completely rational choices. Duhaime and Schwenk (1985) identified the limitations of information processing capacities in acquisition decisions. He found that the

managers' behavior was over-optimistic in the acquisition decision process. They proposed a systematic acquisition process perspective.

He found that political and structural matters affect the acquisition process and outcome, whereas argued that cultural distances between two companies have enormous impacts on acquisition and the post-acquisition integration process. The conclusion is that "the evidence on the process theory can best be described as ambiguous. The available evidence is largely supportive.

2.2.6 Raider Theory.

(Holderness and Sheehan 1985) portrayed the term, "raider," as meaning a person who causes wealth transfers from the shareholders of a target firm. One of the wealth transfer media is abundant compensation after a success full acquisition transaction, called "golden parachute." The primary problem with this assertion is its illogical hypothesis of wealth transfer. In addition to this, there is ample evidence of unfavorable results.

2.2.7 Disturbance Theory

This approach holds that the motives of acquisitions occurred as a result of economic disturbances. According to Gort (1969), economic disturbances cause changes in individuals' expectation and increase the general degree of uncertainty. Thus, they alter the array of individual expectations.

2.3 Review of Empirical Studies

Ravenscraft and Scherer (1989) examine target firm profitability over the period 1975 to 1977 using Line of Business data collected by the FTC. The FTC collected data for

471 firms from 1950 to 1976 by the business segments that the firms operated. This allows Ravenscraft and Scherer to track the post-merger performance of the target firm. They find that the target lines of business suffer a loss in profitability following the merger. They conclude that mergers destroy value on average, which directly contradicts the conclusion drawn from the announcement period stock market reaction.

Healy, Palepu et al Ruback (1992) examine post-merger operating performance for the 50 largest mergers between 1979 and 1984. In particular, they analyze the operating performance for the combined firm relative to the industry median. They find that merged firms experience improvements in asset productivity, leading to higher operating cash flows relative to their industry peers. Interestingly, their results show that the operating cash flows of merged firms actually drop from their pre-merger level on average, but that the non-merging firms in the same Industry drops considerably more. Thus, the post-merger operating performance improves *relative* to the industry benchmark.

Hall (1987) in a detailed study of all U.S. manufacturing firms in the years 1976-85, finds in approximately 600 acquisitions that firms that are acquired do not have higher R&D expenditures (measured by the ratio of R&D to sales) than firms in the same industry that are not acquired. Also, she finds that "firms involved in mergers showed no difference in their pre- and post-merger R&D performance over those not so involved."

Jerold and Steven (2005) carried out a study on planning for a successful mergers and acquisitions in 2005 on Australia firms. The major objectives of the study were to find

out the relationship between corporate strategy and M&A strategy, the criteria organizations use to screen M&A targets, whether M&A experience improves performance. Data from six major industries of about 200 firms was used in this study. They adopted a qualitative research approach. The interviews were undertaken with experienced senior managers of Australian listed companies and Australian based United States of America subsidiaries. The findings were that Mergers &Acquisitions was essential to growing market share in emerging markets. Acquisitions as a strategy to quickly position themselves for changes that occur in the information technology market and to reduce product time to market M&A s were used as a method to obtain strategic objectives and to meet the firms' financial criteria. They also found that additional to capability, scale, and geographical presence as the three major criteria to screen M & As.

Mukele (2006) conducted a study on the factors that determine the choice of M & A partners in Kenya. He was looking to establish the determinants of choice of firms that had been through Mergers from 2001 to 2004. He found that firms in the market that had opted for mergers amounted to 53.1% while those that opted for acquisitions were 46.9%. He concluded that the factors that determined the choice included knowledge transfer and management, cultural distance, organizational distance, resource redeployment and revenue based synergistic considerations. He found that the effects after M & A included asymmetry between the firms in terms of joint decision making and political process, location specific acquisition performance, management styles, reward and evaluation systems. In addition, he found that ownership was divided between locally owned (34.3%), foreign (34.4%) and a portion of both locally and foreign owned (31.3%). Other findings in the study show that firms will get into an M &A with a partner who will facilitate transfer of knowledge

based resources. Partners were also concerned about cultural differences and similarities. It was found that firms that had matching core values were the preferred partner. The study also showed that the closer the organizational distance the better because business practices, institutional values, corporation and professional cultures are similar. It was concluded that anticipated economies of scale drive firms into M & A's. Resource deployment and revenue based synergistic considerations showed that M & A's expected increase in the market average through geographic cover and extension of production line.

Healy et al (1992) studied the post-acquisition performance of the 50 largest U.S. mergers between 1979 and 1984. They used accounting data primarily but tested their results by using market valuation measures as well. They analyzed both operating characteristics and investment characteristics, the first two measures of operating characteristics are the cash flow margin on sales and asset turnover. Their third variable measures the effect of the merger on employment. This tested the hypothesis that gains in mergers are achieved by downsizing and reducing the number of employees. Their fourth measure is pension expense per employee. Again, this is to test whether gains from mergers came at the expense of reducing pension protection for employees. They also consider a number of effects on investment; they tested whether gains came from under investing for the future, from selling off assets, or force reducing research and development activities. Their findings were that; industry employment decreased which implies that the merging firms did more restructuring and reorganization than other firms in the industry. But the cash flow margin on sales did not significantly change. However, asset turnover significantly improved. The return on the market value of assets also improved significantly. Pension expense per employee was reduced somewhat but not by statistically significant degree. None of

the investment characteristics were significantly changed on the basis of industry-adjusted performance. Their study only found a significant change on asset turnover and employment.

Kemal (2011) conducted a study to find the profitability of the Royal Bank of Scotland after merger deal with ABN AMRO Bank from 2006-2009 where he calculated 20 ratios and concluded that the merger failed to pull up profitability thus proved to be a failure.

Nyagah (2007) conducted a study on Doctors Perception of Mergers and Acquisitions in the Pharmaceutical Industry Kenyan based firms in 2007. The objective of the study was to determine the perception of doctors on M & A s on the pharmaceutical industry in Kenya. The population of interest in this study comprised of medical doctors in Nairobi. According to the Kenya Medical Directory in 2006 there were 900 practicing medical doctors in Nairobi. A sample size of 50 doctors was considered fairly adequate and representative. The data was analyzed using descriptive statistics to determine doctor's perception of M&As. The findings were that, respondents strongly agreed that merged pharmaceutical companies in Kenya were profit and market oriented. They also agreed that the companies were domineering and arrogant. However, they disagreed with the fact that merged pharmaceuticals companies are caring partners. It is important to evaluate how the perception of these doctors affects the success of pharmaceutical mergers.

Houston and Ryngaert (1994) examined abnormal returns from four days before the target was initially declared a takeover candidate (by any bank) to the announcement day. In their sample of 153 mergers announced between 1985 and 1991, acquirers suffered a loss in value and targets enjoyed a gain. However, there was no significant

aggregate effect on the overall value of the two organizations. The amount of value that was created was highest when acquirers were strong pre-merger performers and when substantial overlap existed. This relationship of value creation with the degree of overlap is consistent with the market expecting mergers best suited for improved efficiency and/or increased market power to experience the greatest level of post-merger benefits.

Korir (2006) carried out a study on Effects of Mergers on Financial Performance of Companies listed at the Nairobi Securities Exchange. The objective of this study was to find out the effects of mergers, if any on performance of companies listed at the NSE. The timeframe observed was from 1994-2005. The population used in this study was 48 companies listed on the Nairobi Stock Exchange. Shares of some of these sampled companies were heavily traded at the NSE. A sample of 20 listed companies was contacted, it consisted of 10 companies that merged and 10 that never merged and were in operation for the period counterparts were merged. Measures of performance used were turnover, volume, market capitalization and profit. They were analyzed on the basis of descriptive statistics. Descriptive statistics describe data on variables with single numbers while analysis of variance (ANOVA) tests for any significance difference between mean values of variables. It was concluded that mergers improves performance of companies listed at the NSE. This is explained by low variation in paired t-test below 0.005 for turnover, volume, market capitalization, and profit.

Katuu (2003) did a Survey on Factors Considered Important in Merger & Acquisition Decisions by Selected Kenyan Based Firms from 2002 – 2003.The Study objectives were to determine the factors those are considered important by firms when

considering M&As, to establish if factors that are considered important by firms in M&A differ across factors and to establish if factors considered important by firms in M&A decisions differ between local and foreign firms. Sample data from six major sectors of about 60 firms was used in this study i.e. selected firms that had merged or had been involved in acquisitions in Kenya between 1993 – 2003, both local and foreign. Quantitative and qualitative techniques were used -descriptive statistics e.g. summarized tabulations of frequencies, mean, standard deviations, percentages and rankings were used to describe the variables under investigations. Factor analysis was also used to identify the factors considered important in M&A decisions. From the study results, the cardinal factors considered by firms when they make merger decisions from top priority to least were: a perfect fit - Synergy (15.5%), improvement of growth and revenues (15.5%), to consolidate and be more competitive (15.5%), Globalization Geographical presence (11.7%), Similar core competence (11.7%), Political factors (7.8%), Cost reduction (6.8%), synergies in R&D (5.8%) and finally human and cultural factors (4.9%).The author noted in his finding that, cultural and human aspects were given minimal consideration. He also noted that Research & Design was a critical factor for only pharmaceutical and air sector only.

Luypaert (2008) investigated the determinants of growth through M&A in Belgium using a sample of 378 Belgian bidders engaged in 816 M&A transactions during 1997–2005. Using logit and probit regression analysis he analyzed firm characteristics, industry and market variables. Found that intangible capital, profitability and firm size significantly positively affected M&A decision whereas ownership concentration and debt had a negative impact. He concluded that M&A

were more likely in industries where incumbents operate in a relatively low scale, less concentrated and recently deregulated.

Lipton (2006) investigated external factors affecting mergers and merger waves by analyzing global M&As from the year 1985 to 2006. Observed that during 1990s merger-waves, as stock prices and earnings ratios increased, mergers volumes increased dramatically from $339 billion in 1991 to $3.3 trillion in 2000 globally, hence positive relationship between stock price increase and M&A activity. Concluded that receptive equity and debt market were critical factors in M&A activity. These findings supported Nelson (1959) who investigated merger movement in American Industry by exploring impact of stock market performance on M&A activity. Found that stock prices increase was followed by merger activity increase. Concluded that M&As were highly concentrated in time clustering during periods of high stock market valuations.

Barasa (2008) conducted a study on the effect of mergers and acquisitions announcement on share prices quoted at the NSE. The study was done on 11 companies that had made merger announcements for the period 1997-2006.It was found out that merger announcement do not affect share prices of the NSE quoted companies.

Cain and Denis (2009) explicitly examine the valuation analyses underlying the fairness opinion reported in the merger proxy statement for 582 negotiated mergers announced between 1998 and 2005 for evidence on valuation biases that would favor deal advisors. Using data on high and low target valuations produced by the various valuation techniques underlying fairness opinions on both sides of the deal, they

compare the average target valuation against the offer price and thus determine the extent of “bias” in the fairness opinions provided by investment bankers. Although the authors do not observe any bias associated with target fairness opinions, they find that fairness opinions sought by acquirers are optimistically biased in that the valuations underlying the opinion are significantly higher than the offer price (by 20 percent on average). Additionally, Cain and Denis find the bias to be lower when top-tier investment banks provide the fairness opinion and when the advisor has a prior relationship with the firm. They report two other findings. First, the bias does not vary based on whether investment bankers are paid contingent fees. Second, neither does the bias vary based on whether the valuations are performed by unaffiliated investment banks (without the alleged conflicts faced by advisors in the deal) or by affiliated advisors. Cain and Denis interpret their evidence to be consistent with advisors delivering valuations that favor the completion of deals.

Palepu (1986), in the best study to date of the determinants of takeover, finds strong evidence consistent with the free cash flow theory of mergers. He studied a sample of 163 firms acquired in the period 1971-79 and a random sample of 256 firms that were not acquired. Both samples were in mining and manufacturing and were listed on either the New York or the American Stock Exchange. He finds that target firms were characterized by significantly lower growth and lower leverage than the non target firms, although there was no significant difference in their holdings of liquid assets. He also finds that poor prior performance (measured by the net of market returns in the four years before the acquisition) is significantly related to the probability of takeover and, interestingly, that accounting measures of past performance such as return on equity are unrelated to the probability of takeover. He also finds that firms

with a mismatch between growth and resources are more likely to be taken over. These are firms with high growth (measured by average sales growth), low liquidity (measured by the ratio of liquid assets to total assets), and high leverage, and firms with low growth, high liquidity, and low leverage. Finally, Palepu's evidence rejects the hypothesis that takeovers are due to the undervaluation of a firm's assets as measured by the market-to-book ratio.

Loderer and Martin (1992) studied 304 mergers and 155 acquisitions that took place between 1965 and 1986 and observed a negative but insignificant abnormal return over the 5 subsequent years after the mergers and positive but insignificant abnormal return for the acquisitions.

Morck and Yeung (1991) examine 322 foreign acquisitions by U.S.-based firms between 1979 and 1988 and find one-day positive abnormal returns occur only if the firm has substantial intangible assets. They conclude that adopting a multinational structure allows these firms to apply these assets to a larger scale of operations than would be possible within the U.S., while at the same time keeping them out of the hands of potential competitors.

Doukas and Travlos (1988) find shareholders in 202 U.S. firms making foreign acquisitions realize positive abnormal returns at the announcement date if the bidder already has foreign operations, but is not operating in the target's home country. Doukas and Travlos also find that shareholders of U.S. firms expanding internationally for the first time realize insignificant positive abnormal returns at the

announcement date, and shareholders of U.S. firms already operating in the target's home country realize insignificant negative abnormal returns.

Andre, Kooli and L'Her (2004) studied the long term performance of 267 Canadian mergers and acquisitions that took place between 1980 and 2000 using different calendar-time approaches with and without overlapping cases. Their results suggested that Canadian acquirers significantly underperform over the three-year post-event period. Further analysis showed that their results are consistent with the extrapolation and the method-of-payment hypotheses, that is glamour acquirers and equity financed deals underperform. Andre, Kooli and L'Her also found that cross border deals perform poorly in the long run.

Ingham, Kiran and Lovestam (1992) studied 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.

Jensen and Ruback (1983) reviewed 13 merger announcements in Japanese oil companies. The study sought to whether there were abnormal stock returns around takeover announcements. They found that the average excess returns to target firms' stockholders are of 30% and 20% for the successful tender offers and mergers

respectively while bidding firms' stockholders gained an average of 4% around tender offers but no abnormal return around the merger. (Eckbo,1992) however, found no evidence to support significant abnormal returns of acquiring firms over a three-year period after the bid date. Agrawal, Jeffrey, Jaffe and Mandelker (1992) concluded that bidding firms lost from the acquisitions over several years.

2.4 Summary of Literature Review

The literature has tackled the concepts of profitability, mergers and acquisitions. Understanding profitability of mergers and acquisitions will help advocate for intervention by NSE to control M&A. Empirical review has been provided with studies on M&A being evaluated.

Little has been done to clearly assess the success of mergers and acquisition in Kenya. As it can be noted, the debate on the relationship between profitability and mergers and acquisition is not yet settled. Further, most of these studies were done in different environments which cannot be generalized to developing countries especially Kenya. Hence, the present study seeks to bridge the gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology introduces the logical framework to be followed in the process of conducting the research. This chapter outlines how the research will be conducted. It contains the research design, population of the study, sample and sampling design, data collection, data analysis techniques and data validity and availability.

3.2 Research Design

The research design is a detailed plan on how the research study was executed. It is a blueprint for the collection, measurement and analysis of data. The research design serves as a framework for specifying the relationships among the study variables Cooper and Schneider (1999). The research design to be used is causal study design that seeks to study causal relationship between variables also referred to as interrelationship because they trace relationship among the facts obtained to gain a deeper insight into the situation.

3.3 Population

A population is a well defined or set of people, services, elements, events, groups of things or households that are being investigated Ngechu (2006). The target population for this study is all 35 Commercial banks in Kenya that merged or being acquired.

3.4 Sample Sampling Design

A sample size should be chosen in a way that it gives a wide scope for the aim of the study Ngechu (2006). Sampling design is a definite plan for obtaining a sample from

a given population. It refers to the technique or the procedure the researcher would adopt in selecting item for the sample Kothari (2004). It should be representative of the whole target population. This study used six merged Commercial banks. The sampling frame is the period in which the merger took place .The study covers a 10 year period, 5 years pre merger and 5 years post merger.

3.5 Data collection

The study used secondary sources of data from published audited annual reports of accounts for the respective companies. Financial data from the statement of financial position, statement of comprehensive income and statement of cash flows of the respective companies before and after mergers was used to calculate and analyze profitability for the merged companies for the period under study.

3.6 Data analysis

According to Mugenda and Mugenda (2003), data analysis is the process of bringing order, structure and meaning to the mass of information collected. Data analysis methods to be employed involve quantitative and qualitative procedures. The study used accounting ratios to analyze the financial performance of the mergers under study. For the pre-merger/acquisition period, ratios for both the acquirers and the targets will be examined so as to get an indication of the relative performance of the acquirer and the target. For the post merger period, the focus of the analysis is on the combined institution. Pre-merger average data was compared with the post-merger average data in determining the changes that occurred in profitability following the merger or acquisition. 3 profitability performance indicators: EPS, ROA & ROE was used.

ROA=Return on asset as measured by comparing net income to average total assets.

ROE=Return on equity measured by comparing net income to shareholder's equity.

EPS=Earnings per share measured by comparing net income to average outstanding shares.

3.7 Data Validity and Reliability

Mugenda and Mugenda (2003) define reliability as a measure of the degree to which a research instrument yields consistent results or data after repeated trial while Validity is defined as the accuracy and meaningfulness of inferences, which are based on the research results Mugenda and Mugenda (1999). The results obtained from the analysis of the data will actually represent the phenomena under study.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data findings on ROA, ROE and EPS aimed at determining the pre and post profitability analysis after Mergers & Acquisitions. Data analysis methods employed involved quantitative and qualitative procedures. The study used accounting ratios to analyse the financial performance of the 6 banks mergers under study. For the pre-merger/acquisition period, ratios for both the acquirers and the targets were examined so as to get an indication of the relative 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 was compared with the post-merger average data in determining the changes occurred in performance following the merger or acquisition. 3 profitability performance indicators: EPS, ROA & ROE was used.

4.2 Data Presentation

Both Kenya Commercial Bank and Kenya Commercial Finance Company had positive ROA before the merger. Kenya Commercial Finance Company had ROA of 1.14, 1.18, 0.98, 1.25 and 1.39 for the years 1996 to the year 2000 respectively. Kenya Commercial Bank on the other hand had a positive ROA of 1.32, 0.98, 1.16, 1.24 and 1.1 for the period 1996 to 2000 respectively. The average ROA for the two banks before the merger was 1.23, 1.08, 1.069, 1.245 and 1.245 respectively for the period 1996 to 2000. After the merger, ROA of the new institution posted mixed signals. In the year of the merger, ROA was a positive at 0.19. In the second year after the

merger ROA dropped further to -3.5 before picking an upward momentum to 0.93, 1.32, and 1.83 for the period 2003 to 2005.

Table 4.1: Kenya Commercial Bank Limited ROA

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Kenya Commercial Finance Co.	1.14	1.18	0.978	1.25	1.39					
Kenya Commercial Bank	1.32	0.98	1.16	1.24	1.1					
Average	1.23	1.08	1.069	1.245	1.245					
Kenya Commercial Bank Ltd						0.19	-3.5	0.93	1.32	1.83

Source: Research data (2014)

Kenya Commercial Finance Company had a positive ROE of 5.58, 12.54, 9.68, 4.29 and 3.21 for the years 1996 to 2000. Kenya Commercial Bank on the other hand had negative ROE of 21.37, -5.29, 2.9, 2.67 and 3.21 for the years 1996 to the year 2000. After the merger, ROE of the new institution dropped compared to the average of the two institutions just before the merger. In the second year after the merger, ROE dropped further to -74.1 before picking ground in the third year after the merger to stand at 10.6. In the year 2004, the ROE increased further to 13.5 and 19.2 in the year 2005.

Table 4.2: Kenya Commercial Bank Limited ROE

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Kenya Commercial Finance Co.	5.58	12.54	9.68	4.29	5.98					
Kenya Commercial Bank	-21.37	-5.29	2.9	2.67	3.21					
Average	-7.95	3.625	6.3	3.48	4.6					
Kenya Commercial Bank Ltd						2.65	-74.1	10.6	13.5	19.2

Source: Research data (2014)

The average EPS for the two institutions over the five years before the merger was weakly positive. The average EPS was 0.54, 1.14, 1.38, 1.34 and 1.28 for the period 1996 to 2000 respectively. In the year of the merger, the new institution registered a slightly improved EPS of 1.32 compared to the average of the year before the merger of 1.28. In the second year after the merger, EPS dropped drastically to -20.06 before picking a positive trend of 3.57, 3.21, and f6.73 for the period 2002 to 2005 respectively.

Table 4.3: Kenya Commercial Bank Limited EPS

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Kenya Commercial Finance Co.	1.57	1.3	1.45	1.52	1.36					
Kenya Commercial Bank	-0.5	0.98	1.3	1.15	1.2					
Average	0.54	1.14	1.38	1.34	1.28					
Kenya Commercial Bank Ltd						1.31	-20.06	3.57	3.21	6.73

Source: Research data (2014)

Both banks (National Bank of Kenya and Kenya National Capital Corp) had negative ROA before the merger/acquisition National Bank of Kenya had ROA of -1.6, -1.98, -2.6, -2.5 and -2.4 for the years 1994 to the year 1998 respectively. Kenya National Capital Corp on the other hand had a positive ROA of 0.17, 1.12, 1.5, 1.4 and 1.3 the period 1994 to 1998 respectively. The average ROA for the two banks before the merger was -0.715, -0.43, -0.55, and 0.55 respectively for the period 1994 to 1998. After the merger, ROA of the new institution posted mixed signals. In the year of the merger, ROA was a positive at 0.12. In the second year after the merger ROA dropped further to 0.19 before dropping to 0.3, 1.2, and 1.83 for the period 1999 to 1.2.

Table 4.4: National Bank of Kenya ROA

Institution/Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
National Bank of Kenya	-1.6	-1.98	-2.6	-2.5	-2.4					
Kenya National Capital Corp	0.17	1.12	1.5	1.4	1.3					
Average	-0.715	-0.43	-0.55	-0.55	-.055					
National Bank of Kenya						.012	0.19	-3.5	0.3	1.2

Source: Research data (2014)

The study also sought to establish the ROE of the two banks before and after the merger. National Bank of Kenya limited had a negative ROE of -10.54, -39.1, -8.5, -18.5 and -12.3 for the years 1994 to 1998. Kenya National Capital on the other hand had positive ROE of 3.26, 2.36, 4.12, 3.78, and 3.27 for the years 1994 to 1998. After the merger, ROE of the new institution dropped compared to the average of the two institutions just before the merger to -6.27. In the second year after the merger, ROE dropped further to -8.13 and kept the trend in the year 2001 to stand at -14.5. In the year 2002, the ROE improved slightly to -12.3 and -9.21 in 2003.

Table 4.5: National Bank of Kenya ROE

Institution/Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
National Bank of Kenya	-10.54	-39.1	-8.5	-18.5	-12.3					
Kenya National Capital Corp	3.26	2.36	3.78	4.12	3.27					
Average	-3.64	-18.32	-2.36	-7.19	-4.515					
National Bank of Kenya						-6.27	-8.13	-14.56	-12.34	-9.21

Source: Research data (2014)

The average EPS for the two institutions over the five years before the merger was weakly positive. The average EPS was -1.975, -1.24, -1.325, -0.615 and -0.72 for the period 1994 to 1998 respectively. In the year of the merger, the EPS was -2.16, -2.79, -3.2, -4.2 and -3.78 for the years 1999 to 2000 respectively.

Table 4.6: National Bank of Kenya EPS

Institution/Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
National Bank of Kenya	-5.21	-4.27	-4.19	-3.12	-2.89					
Kenya National Capital Corp	1.26	1.79	1.54	1.89	1.45					
Average	-1.975	-1.24	-1.325	-0.615	-0.72					
National Bank of Kenya						-2.16	-2.79	-3.2	-4.2	-3.78

Source: Research data (2014)

Co-operative Merchant Bank Limited and Co-operative Bank Limited merged in the year 2002 to form Co-operative Bank of Kenya Limited. The ROA of the two institutions before the merger were both negative. Co-operative Merchant Bank's ROA for the year 1997-2000 was -10.4, -13.7, -6.34-3.58 and -8.63. Co-operative Bank Limited's ROA was -9.58, -7.35, -5.19, -5.08, and -1.43 for the same period 1997 to 2001 respectively. After the merger, ROA improved to stand at positive 0.2 in the year of merger, 2002. The ROA increased steadily thereafter. In 2004, ROA stood at 0.57. It further increased to 0.99 and 1.6 for 2005 and 2006 respectively. A comparison of the ROA with the average ROA of the two institutions before the merger indicates tremendous growth. From the year of the merger, the ROA grew continuously from 0.2 in 2002 to stand at 1.6 in the year 2006.

Table 4.7: Cooperative Bank of Kenya Limited ROA

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Co-operative Merchant Bank Ltd	-10.4	-13.7	-6.34	-3.58	-8.63					
Co-operative Bank Ltd	-9.58	-7.35	-5.19	-5.08	-1.43					
Average	-9.98	-10.5	-5.77	-4.33	-5.03					
Co-operative Bank of Kenya Ltd						0.2	0.36	0.57	0.99	1.6

Source: Research data (2014)

Before the merger, Co-operative merchant Bank Ltd ROE was 5.3, -3.85, -4.86, -3.58 and -5.08 for the years 1997 to 2001 respectively. Co-operative Bank Limited had a positive ROE of 95.5, 143.98, 189.8, 202.2 and -22.05 in the year 1997 to 2001 respectively. After the merger, the ROE grew steadily to stand at 5.7 in 2002, 8.94 10.72, 17.39 and 25.64 from 2003 to 2006 respectively.

Table 4.8: Cooperative Bank of Kenya Limited ROE

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Co-operative Merchant Bank Ltd	5.3	-3.85	-4.86	-3.58	-5.08					
Co-operative Bank Ltd	95.5	143.98	189.8	202.2	-22.1					
Average	50.4	70.1	92.5	99.3	-13.6					
Co-operative Bank of Kenya Ltd						5.7	8.94	10.72	17.39	25.64

Source: Research data (2014)

Co-operative Merchant Bank Ltd had the following EPS 9.5, 4.2, 1.4, -3.64 and -4.5 for the period 1997 to 2001 respectively while Co-operative Bank Ltd had a positive EPS of 3.8, 8.5, 5.6, 6.75 and -4.75 for the period 1997 to 2001 respectively. The EPS of the new institution formed after the merger showed a positive trend. It grew steadily after the merger from 6.38, 7.58, 9.72, 9.12, and 8.95 for the years 2002 to 2006 respectively.

Table 4.9: Co-operative Bank of Kenya EPS

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Co-operative Merchant Bank Ltd	9.5	4.2	1.4	-3.64	-4.5					
Co-operative Bank Ltd	3.8	8.5	5.6	6.75	-4.75					
Average	6.65	6.35	3.5	1.555	-4.625					
Co-operative Bank of Kenya Ltd						6.38	7.58	9.72	9.12	8.95

Source: Research data (2014)

First American Bank and Commercial Bank of Africa before the acquisition to form Commercial Bank of Africa Kenya Limited in 2005. Both institutions had positive ROAs. First American Bank had an ROA of 1.62, 2.71, 2.3, 2.23 and 2.23 for the five year period starting 2000 to 2004 respectively. Commercial Bank of Africa's ROA was 2.55, 2.34, 1.8, 1.8 and 1.94 for the five year period starting from the year 2000 to 2004 respectively. After the acquisition, the new firm was Commercial Bank of Africa Limited. The ROA of the new bank in 2005 to 2009 was: 1.68, 2.9, 3.5 and 3.3 respectively. The ROA grew at a stable rate since the formation of the new company. An analysis of the average ROA over the five year period gives 2.015 as the lowest before the acquisition. However, on acquisition, the ROA reduced to 1.68
in the year of the merger and then picked an upwards trend from 2006 to 2007 stand at 2.9, 3.5 respectively before reducing slightly to 3.3 in 2008. In 2009, it stood at 3.4.

Table 4.10: First American/CBA ROA

Institution/Year	2000	20001	2002	2003	2004	2005	2006	2007	2008	2009
First American	1.62	2.71	2.3	2.23	2.23					
Commercial Bank of Africa	2.55	2.34	1.8	1.8	1.94					
Average	2.085	2.525	2.05	2.015	2.085					
Commercial Bank of Africa Ltd						1.68	2.9	3.5	3.3	3.4

Source: Research data (2014)

The ROE of First American Bank were 19.87, 15.9, 15.6 and 16.18 from 2001 to 2004 respectively. After the acquisition, ROE for the new institution was 26.3, 36.1, 31.03 and 34.2 from 2005 to 2008 respectively. These findings are well illustrated in table 11. An analysis of the average ROE suggests an improvement in firm performance after the merger. Before the merger, the ROE was 23.95, 19.2, 19.1 and 19.57 from 2001 to 2004 respectively. After the merger, ROE shot up to stand at 26.3, 36.1, 31.03, 34.2 and 35.6respectively for the period from 2005 and 2009.

Table 4.11: First American/CBA ROE

Institution/Year	2001	2002	2003	2004	2005	2006	2007	2008	2009
First American	19.87	15.9	15.6	16.18					
Commercial Bank of Africa	28.02	22.4	22.6	22.95					
Average	23.95	19.2	19.1	19.57					
Commercial Bank of Africa Ltd					26.3	36.1	31.03	34.2	35.6

Source: Research data (2014)

From the data findings, all banks had a positive EPS. The average EPS for the two institutions before the acquisition was 4.41, 5.66, 4.76 and 6.58 for the period 2001 to 2004 respectively. In the year of the acquisition, the EPS of the new institution dropped steadily to 2.38 before gaining momentum in the second year of the merger to 9.17, 9.15 5.9 and 6.25 for the years (2006- 2009).

Table 4.12: First American/CBA EPS

Institution/Year	2001	2002	2003	2004	2005	2006	2007	2008	2009
First American	3.56	4.25	4.51	5.23					
Commercial Bank of Africa	5.26	7.06	5	7.93					
Average	4.41	5.66	4.76	6.58					
Commercial Bank of Africa Ltd					2.38	9.17	9.15	5.9	6.25

Source: Research data (2014)

The ROA of Bullion Bank Ltd and Southern Credit banking Corporation before the acquisition. The acquisition took place in the year 2001. Before the acquisition, both institutions had negative ROAs. Bullion Bank's ROA was 7.2, 4.27, -11.7, -12.3 and -15 and Southern Credit Banking Corp. was 1.57, 1.25, 1.42, 0.65 and -0.7. After the acquisition, the ROA of the new organization was 1.63, 0.4, 1.37 and 0.62 from 2001 to 2005 respectively. The average ROA was established by the researcher. In the year 2000, average ROE stood at -7.85. From the negative average ROA, the ROA of the new institution grew steadily to 1.63 in the year of the merger after which the ROA dropped to 0.4 in 2002, 0.92 in 2003, and 1.37 in 2004 and 0.62 in 2005.

Table 4.13: Southern Credit Banking Corporation ROA

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bullion Bank Ltd	7.2	4.27	-11.7	-12.3	-15					
Southern Credit Banking Corp	1.57	1.25	1.42	0.65	-0.7					
Average	4.385	2.76	-5.14	-5.825	-7.85					
Southern Credit Banking Corporation						1.63	0.4	0.92	1.37	0.62

Source: Research data (2014)

Both institutions had negative ROE before the acquisition. Bullion had an ROE of -14.67 while Southern Credit Corp has ROE of -0.7. However after the acquisition, the ROE of the new institution deteriorated further to -5.79 in the year of acquisition (2001). However, thereafter, the ROE improved tremendously to stand at 3.2% in 2002, 12.07 in 2004 and 5.98 in 2005. The average ROE was 4.55, 6.2, 6.91,-4.8, and -7.69 from the year 1996 to 2000 respectively. From the negative ROE, the performance of the new institution improved slightly to -5.79 in the year of the merger in 2001. Thereafter, the ROE grew steadily to 3.2, 7.25, and 12.07 for the period 2002 to 2004 respectively before reducing to 5.98 in 2005.

Table 4.14: Southern Credit Banking Corporation ROE

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bullion Bank Ltd	5.9	10.8	12.4	-11.2	-14.7					
Southern Credit Banking Corp	3.2	1.6	1.42	1.6	-0.7					
Average	4.55	6.2	6.91	-4.8	-7.7					
Southern Credit Banking Corporation						-5.79	3.2	7.25	12.07	5.98

Source: Research data (2014)

Both banks had negative EPS. Bullion Bank Ltd had -4.56, while Southern Credit Banking Corp had 1.6, 1.4,-2.4, -5.2 and -5.36 from the year 1996 to 2000 respectively. The average EPS for the two banks was 1.4, -0.6, -2.8, -6.05 and -4.96 for the financial years 1996 to 2000. After the merger, the EPS dropped further in the year of the merger to -4.25 before picking up points to stand at 2.45 in the year 2002. Thereafter, EPS of the new institution grew steadily to 4.36, 5.32 and 6.7 in the years 2003 to 2005.

Table 4.15: Southern Credit Banking Corporation EPS

Institution/Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bullion Bank Ltd	1.6	1.4	-2.4	-5.2	-4.56					
Southern Credit Bank Corp	1.2	-2.6	-3.2	-6.9	-5.36					
Average	1.4	-0.6	-2.8	-6.05	-4.96					
Southern Credit Banking Corporation						-4.25	2.45	4.36	5.32	6.7

Source: Research data (2014)

Both institutions (Biashara Bank Limited and Investments and Mortgages) had positive ROAs before they came together to form a new institution. Biashara Bank Ltd had ROA of 2.4, 1.98, 2.59, 2.49 and 2.57 for the years 1997 to 2001 respectively while Investments and Mortgage has ROA of 1.2, 1.7, 1.3, 1.59 and 1.14 for the same period of 1997 to 2001 respectively. The average ROA was 1.8, 1.84, 1.94, 2.04 and 1.86 in the year 1997 to 2000 respectively. In the year of the merger, the ROA dropped compared to the average before the merger to 1.2 in 2002. Thereafter, the ROA grew to 1.84 and 2.37 for the years 2003 and 2004 respectively before dropping to 2 in 2005 and picking up an upward trend in 2006 to stand at 3.1%.

Table 4.16: Investment & Mortgage Bank Ltd ROA

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Biashara Bank Ltd	2.4	1.98	2.59	2.49	2.57					
Investments & Mortgage	1.2	1.7	1.3	1.59	1.14					
Average	1.8	1.84	1.945	2.04	1.855					
Investment & Mortgage Bank Ltd						1.2	1.84	2.37	2	3.1

Source: Research data (2014)

Both banks had positive ROEs. Biashara Bank's ROE was 9.2, 12.4, 8.65, 4.6, and 16.21 in the year 2000 and 18.83 in 2001. Investments and mortgages had ROE of 6.25, 3.84, 4.57, 3.58, and 12.88 in the year 1997 to 2000 respectively. After the Merger/ Acquisition, ROE stood at 113.45, 17.53, 20.62, 25.53, and 35.15 for the years 2002 to 2006 respectively. The study sought to establish the average ROE for the two institutions before the merger. The ROE in 2000 was 2.04 and improved to 14.1 in the year 2001 just before the merger. After the merger, ROE dropped slightly to 10 in year of the merger. Thereafter, ROE grew steadily to 16.59, 21.61, 23.79 and 33.5 for the period 2003 to 2006 respectively.

Table 4.17: Investment & Mortgage Bank Ltd ROE

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Biashara Bank Ltd	9.2	12.4	8.65	4.6	16.21					
Investments & Mortgage	6.25	3.84	4.57	3.58	12.88					
Average	7.71	8.1	6.6	4.09	14.55					
Investments & Mortgage Bank Ltd						13.5	17.5	20.6	25.5	35.1

Source: Research data (2014)

EPS before the merger was positive for both banks. The average EPS for the two banks was 7.725, 8.12, 6.61, 4.09 and 14.545 for the years 1997 to 2001 respectively. After the merger, the EPS grew steadily to 13.45, 17.53, 20.62, 25.53 and 35.15 for the years 2002 to 2006 respectively.

Table 4.18: Investment & Mortgage Bank Ltd EPS

Institution/Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Biashara Bank Ltd	9.2	12.4	8.65	4.6	16.21					
Investments & Mortgage	6.25	3.84	4.57	3.58	12.88					
Average	7.725	8.12	6.61	4.09	14.545					
Investments & Mortgage Bank Ltd						13.45	17.53	20.62	25.53	35.15

Source: Research data (2014)

4.3 Discussion of Research Findings

Analyses of the ROA on the banks that merged or were acquired communicate mixed signals. ROA of the new institution improved after the acquisition or the merger. However, ROA of the new institution at times dropped slightly compared to the average of the two institutions before the coming together transaction was concluded. For example, using the case of Commercial Bank of Africa saw its ROA drop in the year of the acquisition but improved steadily thereafter to exceed the average of the two institutions before the acquisition. The ROA moved from the highest average of 2.085 just before the acquisition dropped to 1.68 in the year of the acquisition after which it picked a positive trend to 2.9 in one year after the merger and maintained an average of above 3.3 thereafter. Further, a look at cooperative bank revealed the same

trend. Before the merger, the average ROA was -5.03 which improved on merging to positive 0.2 in the year of the merger and continuously increased to 1.6 by the end of five years after the merger. The same trend is observed across all the institutions that underwent merger or acquisition between the year 2000 and 2010.

An analysis of ROE reveals a similar trend to that revealed by ROA. ROE improved gradually from the year of merger/acquisition. Commercial Bank of Kenya Limited average ROE of the two institutions before the acquisition improved from 19.57 just before the acquisition to 26.3 in the year of the acquisition and 36.1 one year after the acquisition. Thereafter, the ROE dropped to 31.03 after which it picked an upward trend to stand at 34.2 and 35.6. Further looks at other mergers reveal the same trend. Cooperative bank merger saw ROE improve from an average of -13.66 to positive figures of 5.7, 8.94, 10.72 17.39 and finally 25.64 in the fifth year after the merger. Just like ROA trend, a drop in the year of the merger was followed by an increase beyond the average ROE witnessed just before the merger.

An analysis of EPS posted mixed reactions. In most cases, EPS of the new institution formed after the merger improved tremendously after the merger/acquisition. An analysis of the confidence and significant levels showed that the three ratios were significant in explaining the changes in the performance of organizations before and after the merger.

Analysis of ROE reveals similar trend before the merger or acquisition. The same banks that had negative ROA also had negative ROE. The rest of the institutions had positive ROE. However, the average ROEs were slightly lower than the ROE of the

new institution after the merger. EPS before the merger/acquisition indicate mixed results. Most of the institutions had both negative and positive EPS before the merger. However, if EPS was negative for the two institutions before the merger, the performance in the first years of the merger were low. The institutions however picked up as time passed to become more profitable.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of findings, conclusion limitations, recommendations and suggestions for further research. The objective of the study was to examine the profitability as a result of mergers and acquisitions for Commercial banks in Kenya.

5.2 Summary of Findings

The objective of the study was to examine the pre and post profitability of Commercial banks after mergers and acquisitions.

Analyses of the ROA on the banks that merged or were acquired communicate mixed signals. ROA of the new institution improved after the acquisition or the merger. However, ROA of the new institution at times dropped slightly compared to the average of the two institutions before the coming together transaction was concluded. An analysis of ROE reveals a similar trend to that revealed by ROA. ROE improved gradually from the year of merger/acquisition.

EPS before the merger/acquisition indicate mixed results. Most of the institutions had both negative and positive EPS before the merger. However, if EPS was negative for the two institutions before the merger, the performance in the first years of the merger were low. The institutions however picked up as time passed to become more profitable.

5.3Conclusion

The profitability of the new institution formed on the merger/ acquisition registered a higher profitability as depicted by an increase in the ROA and ROE on the merger/acquisition. Merging/ acquisition improved the profitability of the new institution compared to the two separate institutions separately. In some cases however, the improvement was not realized immediately after the merger/acquisition. The increase in profitability was more pronounced in the second and the third year than it was in the year of the merger.

This was supported by the improvement in the ROAs and ROEs of the new institution after the merger/ acquisition. An analysis of EPS indicates that the profitability of the banks increased tremendously after merger/acquisitions. The effects of the merger/acquisition in the financial institutions profitability were evident when looking at the average ROA and average ROE of the institutions before the merger/acquisition and the ROA and ROE of the new institution formed on the merger/ acquisition. In majority of the mergers/acquisitions, the merger improved the profitability of the new institution as the ROA and ROE kept on increasing immediately after the merger/acquisition. However, the profitability increased more in the second year after the merger/acquisition as compared to immediately after the merger/acquisition. EPS indicates the mergers and acquisitions improve the profitability of the financial institutions.

5.4 Recommendations

Following the findings from the analysis of the selected ratios of the financial institutions that have undergone mergers/acquisition in Kenya, the study recommends

that institutions having weak capital base consolidate to create synergies so as to enjoy economies of scale as this 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 much funds for listing.

The study also recommends that those firms facing constraints on the market should consolidate their energies by resorting to merger/acquisition so as to expand their profitability as the merger/ acquisition is not just for the best interest of the managers but also shareholders as it leads to an increase in shareholders' wealth as opposed to each financial institution operating separately on its own.

5.5 Limitations of the study

The study was carried out on firms in the same industry and considered three variables only.

This study focused primarily on the banking sector and used a representative sample of 6 banks mergers.

There are many challenges facing the formation of mergers. A study should be carried to find out the challenges on formation of mergers and why many firms had not formed mergers despite the advantages got from formation of the mergers.

5.6 Suggestions for Further Research

This research considered three variables; ROA, ROE and EPS. Other studies may do using additional variables. Future research should not be restricted to these variables only, but can consider other major variables. Significance of the results could possibly

be improved upon by applying more variables. The use of more variables may better capture the dynamics of profitability.

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APPENDICES

Commercial Banks that have merged or participated in acquisitions as well as the dates when mergers and acquisitions were approved as at 31.12.2013

Appendix I: Mergers

No.	Institution	Merged with	Current Name	Date approved
1	9 Financial Institutions	All 9 Financial Institutions Merged together	Consolidated Bank of Kenya Ltd	1989
2	Indosuez Merchant Finance	Banque Indosuez	Credit Agricole Indosuez	10.11.1994
3	Transnational Finance Ltd	Transnational Bank Ltd	Transnational Bank Ltd	28.11.1994
4	Ken Baroda Finance Ltd	Bank of Baroda (K) Ltd	Bank of Baroda (K) Ltd	02.12.1994
5	First American Finance Ltd	First American Bank Ltd	First American Bank (K) Ltd	05.09.1995
6	Bank of India	Bank of India Finance Ltd	Bank of India (Africa) Ltd	15.11.1995
7	Stanbic Bank (K) Ltd	Stanbic Finance (K) Ltd	Stanbic Bank Kenya Ltd	05.01.1996

8	Mercantile Finance Ltd	Ambank Ltd	Ambank Ltd	15.01.1996
9	Delphis Finance Ltd	Delphis Bank Ltd	Delphis Bank Ltd	17.01.1996
10	CBA Financial Services	Commercial Bank of Africa Ltd	Commercial Bank of Africa Ltd	26.01.1996
11	Trust Finance Ltd	Trust Bank (K) Ltd	Trust Bank (K) ltd	07.01.1997
12	National Industrial Credit Bank Ltd	African Mercantile Banking Corp	NIC Bank Ltd	14.06.1997
13.	Giro Bank Ltd	Commerce Bank Ltd	Giro Commercial Bank Ltd	24.11.1998
14	Guardian Bank Ltd	First National Finance Bank Ltd	Guardian Bank Ltd	24.11.1998
15	Diamond Trust Bank (K) Ltd	Premier Savings & Finance Ltd	Diamond Trust Bank (K) Ltd	12.02.1999
16	National Bank of Kenya Ltd	Kenya National Capital Corp	National Bank of Kenya Ltd	24.05.1999
17	Standard Chartered Bank (K) Ltd	Standard Chartered Financial	Standard Chartered Bank (K) Ltd	17.11.1999

		Services		
18	Barclays Bank of Kenya Ltd	Barclays Merchant Finance Ltd	Barclays Bank of Kenya Ltd	22.11.1999
19	Habib A.G Zurich	Habib Africa Bank Ltd	Habib Bank A.G Zurich	30.11.1999
20	Guilders Interbank Ltd	Guardian Bank Ltd	Guardian Bank Ltd	03.12.1999
21	Universal Bank Ltd	Paramount Bank Ltd	Paramount Universal Bank	11.01.2000
22	Kenya Commercial Bank	Kenya Commercial Finance Co.	Kenya Commercial Bank Ltd	21.03.2001
23	Citibank NA	ABN Amro Bank Ltd	Citibank NA	16.10.2001
24	Bullion Bank Ltd	Southern Credit Banking Corp Ltd	Southern Credit Banking Corp Ltd	07.12.2001
25	Co-operative Merchant Bank Ltd	Co-operative Bank Ltd	Co-operative Bank of Kenya Ltd	28.05.2002
26	Biashara Bank Ltd	Investment & Mortgage Bank	Investment & Mortgage	01.12.2002

		Ltd	Bank Ltd	
27	First American Bank Ltd	Commercial Bank of Africa Ltd	Commercial Bank of Africa Ltd	01.07.2005
28	East African Building Society	Akiba Bank Ltd	EABS Bank Ltd	31.10.2005
29	Prime Capital & Credit Ltd	Prime Bank Ltd	Prime Bank Ltd	01.01.2008
30	CFC Bank Ltd	Stanbic Bank Ltd	CFC Stanbic Bank Ltd	01.06.2008
31	Savings & Loan (K) Ltd	Kenya Commercial Bank Ltd	Kenya Commercial Bank LTD	01.02.2010
32	City Finance Bank Ltd	Jamii Bora Kenya Ltd	Jamii Bora Bank Ltd	11.02.2010
33	Equatorial Commercial Bank Ltd	Southern Credit Banking Corp Ltd	Equatorial Commercial Bank Ltd	01.06.2010

Appendix II: Acquisitions

No.	Institution	Acquired by	Current Name	Date approved
1	Mashreq Bank Ltd	Dubai Kenya Ltd	Dubai Bank Ltd	01.04.2000
2	Credit Agricole Indosuez (K) Ltd	Bank of Africa Kenya Ltd	Bank of Africa Bank Ltd	30.04.2004
3	EABS Bank Ltd	Ecobank Kenya Ltd	Ecobank Bank Ltd	16.06.2008

Source: Central Bank of Kenya (2013)