

**EFFECT OF MERGER AND ACQUISITION STRATEGY ON  
COMPETITIVE ADVANTAGE OF ICEA AND LION GROUP,  
KENYA**

**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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## **DEDICATION**

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## **ABBREVIATIONS AND ACRONYMS**

<b>ANOVA</b>	:	Analysis of Variance
<b>AKI</b>	:	Association of Kenya Insurers
<b>BPS</b>	:	Book value per share
<b>CAPM</b>	:	Capital asset pricing model
<b>DEA</b>	:	Data envelopment Analysis
<b>DPS</b>	:	Dividends per share
<b>EPS</b>	:	Earnings per share
<b>GDP</b>	:	Gross Domestic Product
<b>ICEA</b>	:	Insurance Company of East Africa
<b>IRA</b>	:	Insurance Regulatory Authority
<b>M&amp;A</b>	:	Mergers and Acquisition
<b>RIV</b>	:	Residual Income Variation
<b>ROI</b>	:	Return on Investment
<b>ROE</b>	:	Return on Equity

## ABSTRACT

Mergers and acquisitions have become a common phenomenon in recent times. Companies have been actively involved in mergers and acquisitions locally as well as internationally. The increased competition in the global market has prompted companies to go for mergers and acquisition as an important strategic choice. Mergers and acquisitions are the strategic growth devices in the hands of many companies not only to stay in the competition but also to extend their margins, market share and dominance globally. It plays an important role in external corporate expansion, acting as a strategy for corporate restructuring and control. It is a different activity from internal expansion decisions, such as those determined by investment appraisal techniques. Mergers and acquisitions can facilitate fast growth for firms and is also a mechanism for capital market discipline, which improves management efficiency and maximizes profits. The scale and the pace at which merger and acquisition activities are coming up are remarkable. In Kenya, mergers and acquisitions have slowed down in the first four months of 2015 compared to a similar period in 2014, despite this, Kenya has kept its position as the leading merger hotspot in East and Central Africa. The term competitive advantage refers to the ability gained through attributes and resources to perform at a higher level than others in the same industry or market. The study sought to establish the effect of merger and acquisition strategy on competitive advantage of ICEA and LION Group insurance company. It reviewed the market based view theory, resource based view theory, capability based theory and relational view of strategy for its literature in relation to mergers and acquisition strategy and competitive advantage. The research took the casual research design framework and data was collected through both primary and secondary data collection methods. The company achieved competitive advantage from the mergers and acquisition strategy through economies of scale which was achieved by selling more of the same product, economies of scope resulting from resources sharing, better control of costs and thereby improve profit margin, increased entry barriers to potential competitors. The firm gained access to an increased human capital resource, increased in quality of services offered to customers and improve the predictability of demand for its output through forward vertical integration. The study found that mergers have a statistically significant effect on fundamental value of the merged or acquired entity hence competitive advantage. Overall, merger and acquisition strategy and competitive advantage coefficients are significant indicating firms performing better after the resulting merger or acquisition. The study concluded that based on the data presented and the summary of the findings the merger and acquisition strategy had a positive impact on the company's competitive advantage. This is because the merger and acquisition strategy brought about higher capital which is an important factor for a firm's positive performance. This implies that indeed the mergers and acquisition strategy has a positive effect on a company's competitive advantage. The implications from the study was that as a result of the merger and acquisition strategy, the company was able to achieve competitive advantage through attaining a globalized outlook, improved efficiency, improved quality of service, better deployment of idle resources, acquisition of synergies and economies of scale. The study therefore recommends more insurance companies in Kenya and beyond to seek to attain positive competitive advantage through consolidating their firms through the merger and acquisition strategy as it has a positive impact on the success of attaining the set out corporate objectives.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the study**

In the fast changing business economic world, companies have to strive hard to achieve quality and excellence in their fields of operation Pinto, Prakash, and Balakrishna C.H, (2006pp 29-35). Profitable growth for the companies can be possible internally as well as externally. The internal growth is achieved either through the process of introducing or developing new products or by expanding the capacity of existing products or sustained improvement in sales Mallikarjunappa, T and P. Nayak, (2007, pp. 53-69). In today's global economy, mergers and acquisitions are used increasingly the world over as a strategy for achieving a larger asset base, entering new markets, generating greater market shares, additional manufacturing capacities and gaining complementary strengths and competencies to become more competitive in the marketplace Mantravadi, P and A. Reddy (2007).

The study sought to situate mergers and acquisitions in the Kenyan insurance industry. In order to achieve this effectively, the study also sought to uncover the relationships that exist between mergers and acquisition strategy and competitive advantage of the resulting merged or acquired firms. The study will enable a better understanding of whether a firm's current approach to management of its operating arrangement is sufficient in aiding its success in its current operating environment. This paper aims to look at the effect of mergers and acquisition strategy on competitive advantage of ICEA and LION insurance company. Although forecasts vary, the expectation is that mergers and acquisitions strategy in the Kenyan insurance industry will continue at healthy levels for the near and medium term, as industry players ranging from small to large seek growth or divestiture opportunities.

Mergers and acquisitions strategy over the last decade has continued to be used globally. Various reasons have driven firms to undertake this strategy. Growing business confidence, consumer demand and improving economic conditions in the region have whetted business executive's appetite for firms in the technology, insurance and financial services sectors.

In the Kenyan business environment mergers and acquisitions have slowed down in the first four months of 2015 compared to a similar period in 2014 despite the multi-billion shilling Equity and Centum share deals ([www.businessdailyafrica.com](http://www.businessdailyafrica.com)). Kenya has kept its position as the leading merger and acquisition strategy hotspot in East Africa despite this. In 2014, the country accounted for the lion's share of the regions 48 deals whose disclosed value stood at shs86.2 billion (\$947 million) In 2013, there were 31 such deals valued at shs27 billion (\$300.6 million) ([www.businessdailyafrica.com](http://www.businessdailyafrica.com)). Analysts have said the insurance sector remains the likeliest focus area for mergers and acquisitions this year, due to its high growth potential as well as the higher capital demands. ICEA and LION group merged in 2011 to create a bigger force thus improving customer service, enhancing internal efficiencies and creating greater competitiveness in the market place.

### **1.1.1 Concept of Merger and Acquisition as a corporate level strategy**

The term merger and acquisition are used interchangeably to mean any transition that forms one economic unit from two or more previous ones Gowrisankaran et al (2004). The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone (Brigham, 1986; Cybo-Ottone and Murgia, 2000; Brealey and Myers, 2003).

The reasoning behind mergers is that two companies together are more valuable than two separate companies. A merger is the voluntary amalgamation of two firms on roughly equal terms into one new legal entity. Owners of each pre-merger firm continue as owners, and the resources of the merging entities are pooled for the benefit of the new entity. Mergers are effected by exchange of the pre-merger stock for the stock of the new firm, this involves stock swap or cash payment to the target (Mueller 1980). Stock swap allows the shareholders of the two companies to share the risk involved in the deal. If the merged entities were competitors, the merger is called horizontal integration, if they were supplier or customer of one another, it is called vertical integration.

An acquisition on the other hand is a corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. The advantages stemming from mergers and acquisitions have been evaluated in terms of the ability to exploit scale and scope economies, gain market control, economize transaction costs, diversify risks, and provide access to existing know how. Nonetheless, empirical evidence on mergers and acquisitions has also suggested that they might fail because of over optimistic expectations of benefits and underestimation of post integration difficulties like lack of market or technology relatedness, business culture clashes, etc. (Sevic, 1999). Examples of mergers include the merger of CFC Bank Limited and Stanbic Bank Limited to form CFC Stanbic Bank Limited, Giro Bank Limited and Commerce Bank Limited to form Giro Commerce Bank Limited. Acquisition examples include: Equatorial Commerce Bank Limited which was acquired by Mwalimu Sacco Society Limited, K-Rep Bank Limited which was acquired by Centum Limited and EABS Bank Limited which was acquired by Ecobank Limited.

### **1.1.2 Competitive advantage**

Competitive advantage is a business concept describing attributes that allow an organization to outperform its competitors. These attributes may include access to natural resources, new technologies, such as robotics and information technology, can also provide competitive advantage, whether as a part of the product itself, as an advantage to the making of the product, or as a competitive aid in the business process for example, better identification and understanding of customers. The term competitive advantage refers to the ability gained through attributes and resources to perform at a higher level than others in the same industry or market Christensen and Fahey (1984 ; Kay, 1994).

Every successful company tailors its own strategy to fit its specific situation. However, there are four major strategies, cost leadership, differentiation, low-cost focus and low-cost differentiation Micheal Porter, (1980). Select the strategy that best fits your business and modify if need be. Competitive advantage seeks to address some of the criticisms of comparative advantage Porter, (1985). Competitive advantage rests on the notion that cheap labor is ubiquitous and natural resources are not necessary for a good economy. Comparative advantage on the other hand can lead countries to specialize in exporting primary goods and raw materials that trap countries in low-wage economies due to terms of trade.

Successfully implemented strategies will lift a firm to superior performance by facilitating the firm with competitive advantage to outperform current or potential players (Passemard and Calantone 2000, p. 18). To gain competitive advantage, a business strategy of a firm manipulates the various resources over which it has direct control and these resources have the ability to generate competitive advantage (Reed and Fillippi 1990 cited by Rijamampianina 2003, p. 362). Superior performance outcomes and superiority in production resources reflects competitive advantage (Day and Wesley 1988 cited by Lau 2002, p. 125).

### **1.1.3 Merger and Acquisition and Competitive advantage**

The business world is never static (Brown et al, 1998). One of the challenges presented by a dynamic environment is increased competition. Competition is indeed a very complex phenomenon that is manifested in customers, suppliers and potential market entrants (Chang'orok, 2009). Achieving competitive advantage is the most important goal of a firm (Porter, 1979). Every merger or acquisition has its own unique reasons why the combining of two companies is a good business decision. The underlying principle behind mergers and acquisitions is:  $2 + 2 = 5$ . The value of Company A is \$ 1 billion and the value of Company B is \$ 1 billion, but when we merge the two companies together, we have a total value of \$ 3 billion.

Mergers and acquisitions have strategic reasons for the business combination. These strategic reasons include: Positioning which entails taking advantage of future opportunities that can be exploited when the two companies are combined. Filling the gap a company with several short comings such as poor distribution gets support from a firm without this challenge. By acquiring human resources and intellectual capital can help improve innovative thinking and development within the company. Acquiring a foreign company can give a company quick access to emerging global markets (Matt,2000).

Hitt and Pissano (2004) believe mergers and acquisitions are ways by which organizations are able to compete better in changing business environment and strengthen their competitive advantage. According to Daniel & Metclaf (2001) and Schuler Jackson (2001) organizations need to find ways of becoming adaptable, flexible, profitable and efficient to maintain market share and successfully compete in the global economy today.

### **1.1.4 Insurance industry in Kenya**

The macroeconomic environment across much of the world shows significant improvement, with GDP rising in many countries, both the middle class and high net worth is expanding in number and financial resources. These factors bode well for international property-casualty and life-annuity insurance companies. Across all regions, insurers are capitalizing on data analytics, cloud computing and modeling techniques to sharpen their market segmentation strategies, reduce claims fraud and strengthen underwriting and risk management.

In the Kenyan insurance industry, the main players are insurance companies, reinsurance companies, intermediaries such as insurance brokers and insurance agents, risk managers or loss adjusters and other service providers. The insurance industry is regulated by the Insurance Regulatory Authority (IRA), a state corporation, set up in 2008 with the mandate to supervise, regulate and develop the insurance industry players (IRA, 2014). The insurance industry in Kenya operates under an umbrella body, the Association of Kenya insurers (AKI), which was established in 1987. The insurance Act; Laws of Kenya, Chapter 487 is the statute regulating the industry. As at 2013, there were 46 operating insurance companies, 23 companies wrote non-life insurance business only, 11 wrote life insurance business only while 12 were composite (both life and non-life).

A survey by PwC in 2014 ranked Kenya second after Nigeria among the most important companies in terms of growth in Africa over the next three years. Innovative products have led to the emergence of micro insurance which targets customers who have historically not participated in insurance programmes. According to the Kenya Insurance Survey by KPMG in 2004, UAP Life Assurance Limited, ICEA and LION group, the heritage insurance company limited, the jubilee insurance company of Kenya limited, AAR insurance Kenya limited and Shield Assurance Company limited were some of the insurance companies in Kenya.



### **1.1.5 ICEA and LION Group Merger**

As it exists today, the Insurance Company of East Africa (ICEA) and Lion General Insurance Company is an outcome of a merger between ICEA LION Limited and Lion of Kenya Insurance Company in 2011, which came into effect from 1st January 2012. Prior to the merger, the two companies were both fairly well known and significant players in the East Africa insurance market. The ICEA LION Group's business consists of four distinct units namely General Insurance, Life Assurance and Pensions, Investment and Asset Management and Trustee services and Pension scheme Administration. The company is currently in operation across Kenya, Uganda and Tanzania.

The reason for ICEA and LION group merger was to consolidate the companies to create a bigger force whilst also establishing separate life and non-life companies for reasons of specialized focus on core business, enhanced internal efficiencies, improved customer service and greater competitiveness in the market place. The two companies were owned largely by the same shareholder, so it did not make sense for the companies to be in direct competition with each other. The two disparate entities have created an outfit that would be better able to have a competitive advantage within both the Life and General spheres of the highly competitive Kenyan insurance market. With a premium income of Kshs 6.45 billion ( \$74.9million) and Kshs 4.5 billion (\$52.3 million), both Life and the General company currently stand in the Kenyan top five in terms of their size.

A key element of this consolidation has been the establishment of separate life and non-life insurance companies in Kenya. ICEA LION Life Assurance Company is a dedicated life assurer while ICEA LION General Insurance Company is a general insurance company, with both operating as subsidiaries of ICEA LION Insurance Holdings Limited. This separation enables each entity have complete focus on its core business, for enhanced customer service, specialization, internal efficiency and competitiveness. The consolidation was also consistent with the government's declared intention to encourage movement in this direction. Although the law has not yet specifically required composite insurance companies to segregate their businesses, ICEA LION have been proactive, meaning they have already embraced the Government's stated intention.

## **1.2 Research problem**

Businesses operating in today's highly competitive, uncertain and rapidly changing world continue to change in reaction to events such as moves by the competition, shifts in technology or new customer demands. Nothing appears as compelling as the need to survive, to face the challenges and explore the opportunities, firms are going for growth through various strategic alternatives like mergers, acquisitions, alliances, joint ventures etc. Mergers and acquisitions are arguably the most popular strategy among firms who seek to establish a competitive advantage over their rivals. Vasilaki and O'Regan (2008) noted that in 2006, globally, the total value of mergers and acquisitions undertaken reached unprecedented levels, totaling 1.774 billion.

A common feature among Kenyan firms quoted in the Nairobi Stocks Exchange is corporate mergers and acquisitions. The intent to improve firm value and profitability provides the basis for corporate mergers and acquisitions in the insurance sector. Improving in performance through positive competitive advantage exercise has majorly surfaced in form of mergers and acquisitions. The primary argument in favor of mergers and acquisitions is that they are good for industrial efficiency without the threat of their companies being taken over and, in all likelihood, loss of their jobs; managers would act more in their own interest than those of owner (Roll, 1986). This gives rise to agency problem arising from conflict between ownership and management. Mergers and acquisitions are arguably the most popular strategy among firms who seek to establish a competitive advantage over their rivals.

Empirical studies such as Selvam et al (2009); Kling, (2006) provide evidence on the positive impact of corporate mergers and acquisitions on firms. However, it is crucial to note that mergers and acquisitions are capable of having adverse effect as suggested by (Yook, 2004), Yeh and Hoshino, (2002), King et al, (2004); Ismail, Abdou and Annis, (2010). There have been research on effects of mergers and acquisition on performance of firms in the financial sectors in Kenya, i.e. banks and insurance companies. Kithitu, et al, (2012) researched on the role of mergers and acquisitions on the performance of commercial banks in Kenya. The results reveal that mergers and acquisitions do add value to shareholders wealth. However these studies do communicate mixed reactions about the effect of mergers and acquisitions on firms profitably. These past studies have led to conflicting results that make the effect of merger and acquisition as a business strategy inconclusive.

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 marketing societies have created or eroded owners' wealth in parts of Central Kenya. Njenga found mixed results on whether demergers lead to wealth creation or erosion of coffee firms as depicted by both positive and negative returns on post-8 merger firms. Muya (2006) carried out a survey of experiences of mergers and acquisitions and found that mergers do not add significant value to the merging firms. Ireri (2011) conducted a survey on effects of mergers and acquisitions on financial performance of oil companies in Kenya and from the researchers finding on respondent opinion on mergers and acquisitions, financial performance were positively correlated with financial performance after the merger. As a result of the afore-mentioned mixed and inconclusive results, this study seeks to answer the question, what is the effect of mergers and acquisitions strategy on competitive advantage in ICEA LION Group, Kenya?

### **1.3 Research objective**

The objective of the study was to determine the effect of merger and acquisition strategy on competitive advantage of ICEA LION Group, Kenya.

### **1.4 Value of the study**

Empirically, this paper aims to examine the effect of merger and acquisition strategy on competitive advantage. In addition, the study will look at the interaction between merger and acquisition experience and its effect on employees. The research will contribute to organizational learning by looking at the effect of gaining access to knowledge without direct experience in this case, the potential effects of engaging in merger and acquisition deals for companies willing to venture to such deals and the effects on performance.

For the Scholar, the study would be a source of literature and empirical references and a ground of further research, it will act as an eye opener. To the customers, mergers and acquisitions can create monopolies and affect customer welfare through reduction of competition and hence unfair prices to the customer. The study will help the anti-trust authorities in controlling the activities of mergers and acquisitions.

Finally, for the shareholders this will help to broaden the scope of the stakeholders when faced with key decisions on mergers and acquisitions by analyzing the effect of merger and acquisitions strategy on competitive advantage of the firms involved. Theoretically, this research will entail making use of, or exploring the knowledge residing in the mergers through the various theories put forward i.e. Market based view theory which argues that industry factors and external market orientation are the primary determinants of firm performance. Resource based view theory which draws attention to the firm's internal environment as a driver for competitive advantage and emphasizes the resources that firms have developed to compete in the environment. Capability based theory, which argues that capabilities are the source of competitive advantage while resources are the source of capabilities.

In summary, the author has tried to provide a brief introduction to the topic of mergers and acquisitions then through the concept of corporate strategy which defines mergers and acquisitions, the reasoning behind mergers and acquisitions and the advantages stemming from the same. Positive competitive advantage is defined and linked as an outcome that lifts a firm to superior performance. The insurance industry in Kenya has been covered with a brief description of the firm in focus ICEA and LION Group. Finally, the chapter ends with stating the research problem, research objective which is to determine the effect of merger and acquisition strategy on competitive advantage in ICEA and LION Group, Kenya and concludes with the value of the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The literature review chapter explains the development process and the course of research in the corresponding fields, especially development trends and the latest achievements in recent years (Chen, 2012, p.99). Literature reviews help researchers limit the scope of the inquiry, and conveys the importance of studying a topic to a reader (Creswell 2003: 27). This chapter is aimed to summarize information from other researchers, find a gap on the existing research if there is any and if not then a whole new field of study is available for the research.

#### **2.2 Theoretical foundation**

In recent years, the firms have increased in size and geographical reach through both domestic and cross border mergers and acquisition as growth remains one of the most important performance metrics by which a firm is evaluated (Barth et al, 2012, p.27 & Kim et. al, 2011. P.60). There are a number of studies examining the competitive advantage associated with mergers and acquisition while others have studied the risk effects of cross border merger and acquisitions but the research is limited to these areas only. Thus the researcher aims to conduct a research on competitive advantage through the merger and acquisition as a strategy.

##### **2.2.1 Market based view theory**

The market based view of strategy argues that industry factors and external market orientation are the primary determinants of firm performance (Bain 1968; Caves & Porter 1977), sources of value for the firm are embedded in the competitive situation characterizing its end product strategic position. The strategic position is a firm's unique set of activities that are different from their rivals. Alternatively, the strategic position of a firm is defined by how it performs similar activities to other firms, but in very different ways. In this perspective, a firm's profitability or performance are determined solely by the structure and competitive dynamics of the industry within which it operates (Schendel 1994).

It's critical that in formulating merger and acquisition strategy, firms should make an overall assessment of their own competitive advantage via an assessment of the external environment based on the five forces model (Porter 1979; 1985). The five forces under consideration consist of the following: barriers to entry, threat of substitutes, bargaining power of suppliers, bargaining power of buyers and rivalry among competitors (Porter 1985). The five-force model enables organisation to analyze the current situation of their industry in a structured way. In this perspective, a firm's sources of market power explain its relative performance. When a firm has a monopoly, it has a strong market position and therefore performs better (Peteraf 1993). High barriers to entry for new competitors in an industry lead to reduced competition and hence better performance. Higher bargaining power within the industry relative to suppliers and customers can also lead to better performance (Grant 1991).

### **2.2.2 Resource based view**

The resource-based view of the firm draws attention to the firm's internal environment as a driver for competitive advantage and emphasizes the resources that firms have developed to compete in the environment. The focus of inquiry of the theory over the period of time has changed from the structure of the industry to the firm's internal structure, with resources and capabilities the key elements of the resource based view. Since then, the resource-based view of strategy has emerged as a popular strategic theory of competitive advantage (Furrer et al. 2008; Hoskisson et al. 1999). Resources possessed, deployed and used by the organisation are really more important than industry structure.

The resource based view can assist firms that when undertaking mergers and acquisitions, only strategically important and useful resources and competencies should be viewed as sources of competitive advantage (Barney 1991). Strategic assets indicate the strategically important resources and competencies, which provide a firm with a potential competitive edge. Strategic assets are the set of difficult to trade and imitate, scarce, appropriable and specialized resources and capabilities that bestow the firm's competitive advantage' (Amit & Shoemaker 1993). Powell (2001) suggested that business strategy can be viewed as a tool to manipulate such resources to create competitive advantage. Core competencies are distinctive, rare, valuable firm level resources that competitors are unable to imitate, substitute or reproduce.

### **2.2.3 Capability based theory**

Grant (1991) argued that capabilities are the source of competitive advantage while resources are the source of capabilities. Amit and Shoemaker (1993) adopted a similar position and suggested that resources do not contribute to sustained competitive advantages for a firm, but its capabilities do. Haas and Hansen (2005), as well as Long and Vickers-Koch (1995) supported the importance of capabilities and suggest that a firm can gain competitive advantage from its ability to apply its capabilities to perform important activities within the firm.

Grant (1996) divides capability into four categories: cross-functional capabilities, broad-functional capabilities, activity-related capabilities and specialized capabilities. It's therefore important when undertaking the mergers and acquisition strategy for firms to stress on the importance of organizational learning. Capabilities and organizational learning implicitly and explicitly are a part of any strategy within a firm. It has been argued (Zack 1999) that the ability to learn and create new knowledge is essential for gaining competitive advantage.

Amit and Shoemaker (1993) defined capabilities in contrast to resources, as a firm's capacity to deploy resources, usually in combination using organizational processes, and effect a desired end. They are information-based, tangible or intangible processes that are firm-specific and developed over time through complex interactions among the firm's resources. Teece et al. (1997) define dynamic capabilities as, the firm's ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments. Grant (1996) defines organizational capability as a firm's ability to perform repeatedly a productive task which relates either directly or indirectly to a firm's capacity for creating value through effecting the transformation of inputs to outputs.

### **2.2.4 Relational view of strategy**

Relational view strategy of competitive advantage focuses on network routines and processes as an important unit of analysis for understanding competitive advantage. Dyer and Singh (1998) suggest that inter firm linkages may be a source of relational rents and competitive advantage. They define a relational 'rent' as a supernormal profit jointly generated in an exchange relationship that cannot be generated by either firm in isolation and can only be created through the joint idiosyncratic contributions of the specific merger, acquisition or alliance partners.

They identify four relational rents as sources of competitive advantage: relation-specific assets, knowledge-sharing routines, complementary resources and capabilities and effective governance. Dyer and Singh (1998) stated that at a fundamental level, relational rents are possible when alliance partners combine exchange or invest in idiosyncratic assets, knowledge, and resources capabilities, and or they employ effective governance mechanisms that lower transaction costs or permit the realization of rents through the synergistic combination of assets, knowledge or capabilities’.

It’s therefore important for merger and acquisition strategies in order to attain competitive advantage should focus on the notion of a business arrangement as the fundamental unit of analysis for business relationships. A business arrangement is any formal or informal business contract between different business partners for the purposes of buying, selling, collaboration or related business activity. These activities could include sharing business information, buying or selling goods, receiving or providing services, participating in buy-side or sell-side coalitions, or collaborating on community projects’ (Wang 2004). The interaction level analysis refers to the analysis of the distinct business arrangements of a specific firm. It provides a new and important intra-organizational unit of analysis that is critical in structuring, analyzing and understanding business relationships. Wang (2004) noted that the relational view of strategy is also inter organizational, and the unit of analysis is, if anything, even coarser grained for the purposes of interaction-level analysis.

Wang (2004) presented a framework for analyzing a business context in terms of business relationship. The three forms of analysis are market-level, firm-level and interaction-level. Both market-level and firm-level analysis are fundamentally inter-organizational in that they analyze a firm from the perspective of its peers and the external market environment. Thus, market-level analysis views a firm in the context of its market environment, while firm-level analysis looks at resources, strengths and capabilities of the firm, but only in the context of those of its peers.



## **2.3 Classification of Mergers and Acquisitions**

There are different classifications of Mergers and Acquisitions, when two or more companies dealing in similar lines of activity combine together then horizontal merger takes place. The merger of Tata Oils Mills Company Ltd. with Hindustan Lever Ltd was a horizontal merger. A vertical merger is one in which the company expands backwards by merging with a company supplying raw materials or expands forward in the direction of the final consumer. The vertical merger brings companies of same industry together who are involved in different stages of production, process or operation. Conglomerate mergers involve integration of companies entirely involved in a different set of activities, products or services.

A friendly acquisition occurs when the management of acquiring and target companies mutually and willingly agree for takeover just like the acquisition of the controlling interest 45 percent shares of Universal Luggage Company Ltd by Blow Plast Ltd. (Sinha, Pradip K.,: 2009, pp. 473-503) and Ranbaxy by Daiichi Sankyo are the examples of a friendly acquisitions. A hostile acquisition occurs when the acquisition is 'forced' or against the will of the target management, Hostile merger or acquisition takes the form of tender offer wherein the offer to buy the shares by the acquiring company will be made directly to the target shareholders without the consent of the target management (Mallikarjunappa, T. and P. Nayak,: 2007, pp. 53-69). The takeover of Ashok Leyland by Hindujas is an example of hostile M&A (Sinha, Pradip K.,: 2009, pp. 473-503).

Bailing out the sick companies to allow the company for rehabilitation as per the schemes approved by the financial institutions is classified as Bailout mergers or acquisitions. Strategic mergers involve operating synergies, i.e., two companies are more profitable combined than separate. In financial mergers or acquisitions, the bidder usually believes that the price of the company's stock is less than the value of company's assets. Reverse merger is the merger of a large financially sound, profit-making company with a small financially weak, loss-making company. Downstream merger is the merger of a parent company with its own subsidiary. Upstream merger is the merger of a subsidiary company with its own parent company.

## **2.4 Empirical studies and knowledge gaps**

Various empirical studies on corporate mergers and acquisitions focused on the effect of merger and acquisition on performance. This is because mergers and acquisitions have been the most used method of corporate strategy to improve firm performance. Yeh and Hoshino, (2002) evaluated the effect of mergers and acquisitions on a firm's operating performance on the basis of its effect on efficiency, profitability, and growth.

The study proxy total productivity as an indicator of the firm's efficiency, return on assets and return on equity as measures of profitability, sales and growth in employment to index for firm's growth rate. Using a sample of 86 Japanese corporate mergers and acquisitions between 1970 and 1994, it was realized that there was insignificant negative change in productivity, significant decline in profitability, significant adverse effect on sales growth rate, and merger and acquisition caused downsizing in the workforce.

Cummins et al. (1999) examined the relationship between mergers and acquisitions, efficiency, and scale economies in the US life insurance industry over the period 1988 to 1995. They estimated cost and revenue efficiency using data envelopment analysis (DEA). Their results found that acquired firms achieved greater efficiency gains than firms that had not been involved in mergers or acquisitions. Furthermore, they found firms operating with non decreasing returns to scale and financially vulnerable firms were more likely to be acquisition targets. From their results they concluded, mergers and acquisitions in the life insurance industry had a beneficial effect on efficiency.

Saboo and Gopi, (2007) investigated the impact of mergers and acquisitions on the operating performance of acquiring firms by examining some pre-merger and post-merger financial ratios of these firms and determined the differences in pre-merger and post-merger financial ratio of the firms that went for domestic acquisitions and firms that opted for international/cross-border acquisitions. The results suggest that there are variations in terms of impact on performance following mergers and acquisitions, depending on the type of firm acquired-domestic or cross border. The main finding shows that merger and acquisitions have had a positive effect on key financial ratios of firms acquiring domestic firms while a slightly negative impact on the firms acquiring cross-border firms.

Mantravadi and Reddy (2008) evaluated the impact of mergers and acquisitions on the operating performance of acquiring corporate in different industries, by examining some pre-merger and post-merger financial ratios, with the sample of firms chosen as all mergers and acquisitions involving public limited and traded companies in India between 1991 and 2003. The results suggest that there are minor variations in terms of impact on operating performance following mergers and acquisitions, in different industries in India. Specifically, mergers and acquisitions seem to have had a slightly positive impact on profitability of firms in the banking and finance industry; the pharmaceuticals, textiles and electrical equipment sectors saw a marginal negative impact on operating performance in terms of profitability and returns on investment. For the chemicals and Agri-products sectors, mergers and acquisitions had caused significant decline both in terms of profitability margins and returns on investment and assets.

Locally, Marangu (2007) studied the effects of mergers and acquisition on financial performance of non-listed commercial banks in Kenya. The research focused on the profitability of non-listed banks which merged from 1994 to 2001 and used four measures of performance: profit, return on assets, shareholders equity/total assets, and total liabilities/ total assets. Comparative analysis of the bank's performance for the pre and post merger periods was conducted to establish whether mergers and acquisitions lead to improved financial performance before or after merging. The results of the data analysis showed that three measures of performance: profit, Return on Assets and shareholders' equity/total assets had values above the significance level of 0.05 with exception of total liabilities/total assets. His results concluded that there was significant improvement in performance for the non-listed banks which merged compared to the non-listed banks that did not merge within the same period. Vera Mitema, (2013) in her study on effects of M&A on value creation of insurance companies in Kenya concluded that M&A have a statistically significant effect on book value and fundamental value of merged entity.

In summary, the literature review encompasses the theories to be reviewed which are market based, resource based view, capability based and relational view of strategy. It looks at the different classification of mergers and acquisitions which are horizontal merger, vertical merger, hostile acquisitions and bailout mergers among others. The chapter then concludes with the various empirical knowledge and study gaps.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter provides an overview of the research method implemented by the researcher to test the theoretical framework. It details the adopted research design, continuing with the explanation of data collection and data analysis methods employed by the researcher with the justification for the methods used and approaches.

#### **3.2 Research design**

The design for the study was causal research design framework. Based on a study of two firms Gay and Airasian (2003) noted that causal research designs are used to determine the causal relationship between one variable and another; in this case, the cause and effect relationship between merger and acquisition strategy and competitive advantage in ICEA LION insurance group. Causal research design is consistent with the study's objective which was to determine the effect of merger and acquisition strategy on competitive advantage in ICEA LION insurance group.

Casual research is advantageous in that casual studies play an instrumental role in terms of identifying reasons behind a wide range of processes, as well as, assessing the impacts of changes on existing norms, processes etc, and casual studies usually offer the advantages of replication if necessary. On the contrary it may be difficult to reach appropriate conclusions on the basis of casual research findings due to the impact of a wide range of factors and variables in social environment.

#### **3.3 Data collection**

The source of the researcher's data was both secondary data available for the individual companies showing the pre and the post financial results and the primary data available from the use of an interview guide. The secondary data was obtained from the financial statements of ICEA LION group official website ([www.icealion.com](http://www.icealion.com)) and from the Association of Kenya Insurers (AKI) historical market statistics data to assess the financial performance.

Primary data was collected through an interview guide. The Finance, Human resource, Accounting and Marketing management staff of ICEA and LION Group insurance company were interviewed through the use of an interview guide designed to establish the effect of Merger and acquisition strategy on competitive advantage. The data collected was used to support the secondary data.

### 3.4 Data analysis

The financial data was analyzed using the fundamental valuation method. This is a valuation model developed by Guest et al. (2010) which involves the application of the Residual Income Approach. The primary data from the interview guide was analyzed using Statistical Package for Social Sciences (SPSS). Residual Income Approach is the net income less a charge (deduction) for a common shareholder's opportunity cost in generating income.

The fundamental value post merger or acquisition was achieved through the following:

$$V_{\text{Post}} = \frac{(DPS_o)}{1+r_e} + \frac{(BPS_o)}{1+r_e} + \frac{(EPS_{1-r_e} \cdot BPS_o)}{(1+r_e)^2} + \frac{(EPS_{2-r_e} \cdot BPS_1)}{(1+r_e)^3} + \frac{(EPS_{3-r_e} \cdot BPS_2)}{(1+r_e)^3 r_e} \dots\dots\dots 1$$

Where:

- $V_{\text{Post}}$ - Value of post merger or acquisition of entity
- $DPS_t$ – Dividend per share of year T
- $BPS_t$ – Book value per share of year T
- $EPS_t$  – Earnings per share of year T
- $r_e$  – cost of equity capital

The fundamental value pre merger or acquisition for each entity was as follows

$$V_{\text{pre}} = \frac{(DPS_{-3})}{1+r_e} + \frac{(BPS_{-3})}{1+r_e} + \frac{(EPS_{-2-r_e} \cdot BPS_{-1})}{(1+r_e)^2} + \frac{(EPS_{-1-r_e} \cdot BPS_{-2})}{(1+r_e)^3} + \frac{(EPS_0 - r_e \cdot BPS_{-1})}{(1+r_e)^3 r_e} .2$$

Where:

- $V_{\text{pre}}$  – Value of pre-merger or acquisition
- $DPS_t$  – Dividends per share of year T
- $BPS_t$ – Book value per share of year T
- $EPS_t$ – Earnings per share of year T
- $r_e$ - cost of equity capital

Year 0 was the year of consolidation, the accounting year following the completion date of the merger or acquisition. The second, third and fourth terms described residual income. The fifth term described the terminal value, which were the abnormal earnings of year 3 discounted in perpetuity.

The difference between the sum of the pre merger or acquisition fundamental values of both firms and the post merger fundamental value of the combined entity were then examined. A positive difference implied that the merger or acquisition created value. A comparison of equations 1 and 2 was done to give the impact of the merger or acquisition on the fundamental value. If the above result from the formula was positive then the merger or acquisition created value hence it gained competitive advantage.

The data collected from the interview guide was analyzed using descriptive statistics. The data was entered and coded into the Statistical Package for Social Sciences (SPSS). The basis of using descriptive measure was to give a basis for determining the weights of the variables under the study. Tables, pie charts, and bar graphs were used to present the data for easier interpretation. The qualitative analysis was used to analyze the respondents' views about the effect of merger and acquisition strategy on competitive advantage in ICEA and LION Group, Kenya. Qualitative data analysis makes general statements on how categories or themes of data are related (Mugenda and Mugenda, 2003). The qualitative analysis was done using content analysis.

### **3.4.1 Variable estimation of residual income valuation**

A number of assumptions were required for the estimation techniques involved. The techniques and assumptions used were designed to be consistent with those used in other RIV studies. The RIV model variables consisted of book value at year T, dividends at year T, residual incomes over years T and T+1 and forecast terminal value. For post merger or acquisition valuation, we estimated future EPS by multiplying forecast ROE by predicting beginning of year book value per share in each future year. Our forecast of future ROE is the mergers or acquisition average historical ROE. Using pre-merger or acquisition historical ROE to predict future ROE is consistent with takeover profitability studies and previous applications of the residual income model (Lee et al., 1999).

Book value per share was estimated for year 0 as book value per share in year -1, to which we added forecast EPS in year 0 minus expected dividends per share in year 0. Book value per share for year 1 was estimated, book value per share in year 0, to which we added forecast EPS less expected dividends per share in year 1, and so on for years 2 and 3.

Future dividends were estimated per share as forecast EPS multiplied by estimated dividend payout ratio. Our estimated payout ratio is the average dividend payout ratio in year's -3 to -1. If any of the year's -3 to -1 has negative earnings, they are excluded from the calculation. For the cost of equity (*re*) a firm-specific time-varying discount rate using the Capital Asset Pricing Model (CAPM) was calculated. For the CAPM discount rate, at the financial year end in years -1 to 3, sample firm betas were obtained from Bloomberg. According to Guest et al. (2010) it is important to allow for a time-varying, firm-specific discount rate because firms experience a significant increase in leverage and the cost of equity following mergers and acquisition.

In summary, the research methodology chapter covered through the research design framework for the study which was casual research design because it's used to determine the relationship between one variable and another and in this case the effect relationship between mergers and acquisition strategy on competitive advantage. The chapter goes through the method of data collection which was both primary and secondary data collection; the primary was used to support the secondary data. Primary data was collected through an interview guide; secondary data was collected through analyzing the company's financial statements before the merger or acquisition and post merger or acquisition. The primary data from the interview guide was analyzed using the Statistical Package for Social Sciences (SPSS) tool while the secondary data was analyzed using fundamental valuation method which involves application of the Residual Income Approach. Residual income approach is the net income less a charge for a common shareholders opportunity in generating income. The difference between the sum of the pre-merger or acquired fundamental values of both firms and the post-merger fundamental value of the combined or acquired entity was examined. If the merger or acquisition created value, the difference would be positive hence concluding that it created competitive advantage.

## **CHAPTER FOUR**

### **DATA ANALYSIS, FINDINGS AND DISCUSSIONS**

#### **4.1 Introduction**

This chapter presents analysis and findings of the study. The study findings are presented on the effect of merger and acquisition strategy on competitive advantage of ICEA and LION insurance company. For the interview guide, purposive sampling technique was used to come up with a sample of 30 respondents from whom the interview was taken, making a response rate of 100%. This response rate was excellent, representative and conforms to Mugenda and Mugenda (2003) stipulation that a response rate of 50% is adequate for analysis and reporting.

#### **4.2 Residual income approach**

Residual income valuation is an approach to equity valuation that formally accounts for the cost of equity capital. Residual means in excess of any opportunity costs measured relative to the book value of shareholders equity, residual income is then the income generated by a firm after accounting for the true cost of capital. The underlying idea is that investors require a rate of return from their resources i.e. equity under the control of the firm's management, compensating them for their opportunity cost and accounting for the level of risk resulting. This rate of return is the cost of equity and a formal equity cost must be subtracted from the net income. Consequently to create shareholder value, management must generate returns at least as this cost. Thus although a company may report a profit on its income statement, it may actually be economically unprofitable.

##### **4.2.1 ICEA Insurance Company Ltd**

The study sought to establish the effect of merger and acquisition strategy on competitive advantage thus calculated the fundamental value of ICEA Insurance Company Ltd and Lion Kenya Insurance Company Ltd before the merger in 2012 and the fundamental value of the combined entity after the merger in 2012 as the researcher established that the companies merged and was not acquired.



For the residual income valuation approach, data required included dividends per share, earnings per share and book value per share for the pre and post-merger period. A four year forecast horizon of accounting performance was chosen before and after the merger. The figures are well illustrated in table 4.1, 4.2 and 4.3 below.

**Table 4.1** ICEA Insurance Company Ltd, Pre-Merger data  
Kshs '000

	2008	2009	2010	2011
Dividends	137,500	120,000	127,500	122,500
Earnings	163,399	205,258	261,033	438,204
Book Value	1,086,045	1,171,323	1,304,875	1,620,569

Source: Research Findings

Table 4.1 shows ICEA Insurance Company's pre-merger data. The earnings and Book value increased each year with the highest growth in 2011. ICEA dividends decreased in 2008 to 2011 prior to the merger. The discount rate was the cost of equity of year 2010 (before the merger) which was calculated using a risk free rate of 2.28% in 2010, beta of 1 and market risk premium of 8%. The fundamental value of the company pre merger based on the RIV model was approximately Kshs 1.5 billion.

#### **4.2.2 LION Kenya Insurance Company**

**Table 4.2** Lion Kenya Insurance Company Ltd Pre- Merger Data  
Kshs '000

	2008	2009	2010	2011
Dividends	107,500	132,500	145,000	157,500
Earnings	391,202	254,656	438,345	530,517
Book Value	1,314,705	1,499,536	1,924,240	2,329,872

Source: Research Findings

Table 4.2 shows Lion Kenya Insurance Company’s pre merger data. Lion Kenya dividends increased from 2008 to 2011 before the merger. The company showed a growth of 20% from 2010 to 2011 with earnings and book value increasing each year. The discount rate was the cost of equity at year 2010 (before the merger) which was calculated using a risk free rate of 2.28% in 2010, beta of 1 and market risk premium of 8%. The fundamental value of the company Pre merger based on the RIV model was Kshs 1.8 billion

### 4.2.3 ICEA Lion Insurance Company

**Table 4.3** ICEA Lion Insurance Company Ltd, Post Merger Data

Kshs ‘000

	2011	2012	2013	2014
Dividends	280,000	142,500	860,000	
Earnings	968,721	1,252,989	1,021,274	
Book Value	3,950,441	5,391,795	9,958,824	

Source: Research Findings

Table 4.3 shows ICEA Lion Insurance Company post merger data. Dividends increased significantly after the merger with the highest dividends being recorded in 2013. The earnings and Book value similarly increased each year. The average cost of equity over years 2011 to 2014 (post merger) was used as the discount rate. The fundamental value of the combined entity post merger based on the RIV model was approximately Kshs 4 billion.

Table 4.4 reports the results of estimating equation 1 and the components parts. Section A reports the sum of the pre merger valuation, Section B the post merger valuation while Section C the difference between the two. For each sample, the pre and post merger value components parts and total values are normalized by the total pre merger value and multiplied by 100. Thus for each sample the normalized total pre merger value is 100. The differences in Section C are the differences between each of these normalized values. Hence the difference in total is a difference in percentages and the difference in components show how this is divided among the individual component.

**Table 4.4** Effect of merger and acquisition strategy on value/competitive advantage

<b>Variable</b>	<b>Fundamental Value</b>
<b>Section A: Pre merger value ICEA + LION</b>	
Book Value Per Share in year 3	65.53
Dividends Per Share in year 3	6.68
Residual Income in year 2 and 1	14.81
Terminal Value	12.96
Total Value	100.00
<b>Section B: Post merger value ICEA LION</b>	
Book Value Per Share in year 0	99.74
Dividends Per Share in year 0	7.07
Residual Income in year 1 and 2	10.17
Terminal Value	3.03
Total Value	120.02
<b>Section C: Difference between Pre and Post merger value</b>	
Book Value Per Share	34.21
Dividends Per Share	0.39
Residual Income	-4.64
Terminal Value	-9.93
Total Value	20.02

Source: Research Findings

From above, it can be seen that the fundamental value of ICEA Lion Insurance company post merger was greater than the fundamental value of ICEA and Lion Insurance Company's combined Pre merger values. Therefore, our main conclusion from the study was that the merger strategy of ICEA LION limited and Lion of Kenya Insurance Company had statistically significant effect on the fundamental value implying a positive effect on its competitive advantage.

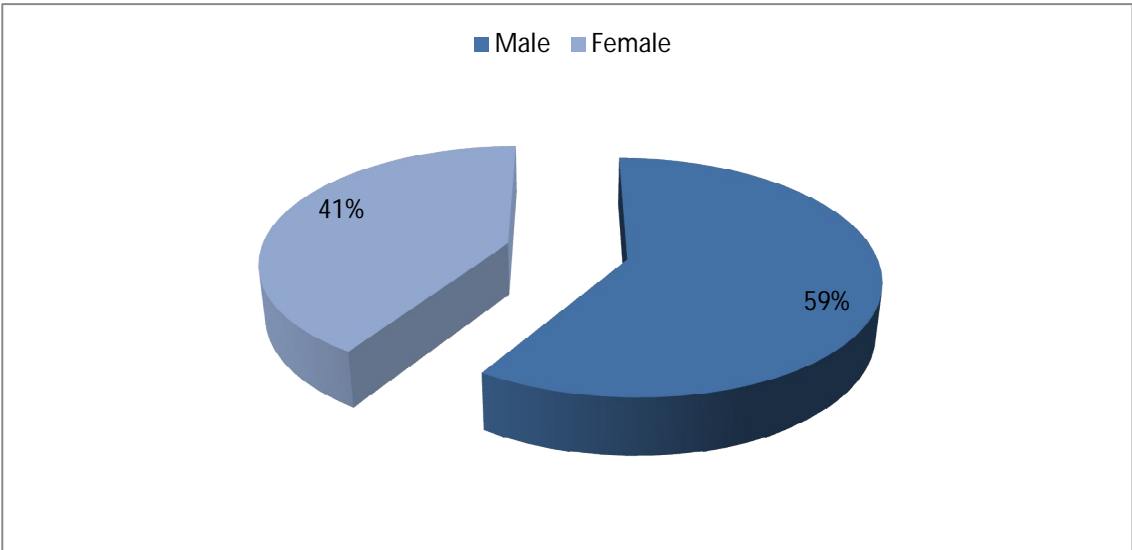
### 4.3 Respondents Bio Data

This contains all factual information about a respondent which include; gender of the respondent, working duration at the company and the respondents level of management as illustrated from the interview guide. It focuses on personal information other than just the person’s education and career experience to enable us determine the effect of merger and acquisition strategy on competitive advantage.

#### 4.3.1 Respondents Gender

The study sought to establish the proportion of the employees working in the company based on their gender. The figure 4.1 below shows the data finding.

**Figure 4.1: Respondents gender**



From the data above 59% of the respondents were male while 41% were female. This illustrates that there are slightly more men than women employed in ICEA and LION Group company.

### 4.3.2 Respondents working duration at the company

The study sought to establish the respondents working duration at the company. The data findings were presented in table 4.5 below.

**Table 4.5**

Duration	Frequency	Percentage %
1-5 years	10	33.3
6-10 years	12	40.0
11-15 years	7	23.3
16-20 years	1	3.4
Over 20 years	0	0
Total	30	100.0

The data findings in table 4.5 above illustrate that 33.3% of the respondents had worked for the pre and post merged companies between 1 to 5 years, 40% of the respondents had worked for 6 to 10 years, 23.3% had worked there for between 11 and 15 years and only 3.4% had worked there for 16 to 20 years.

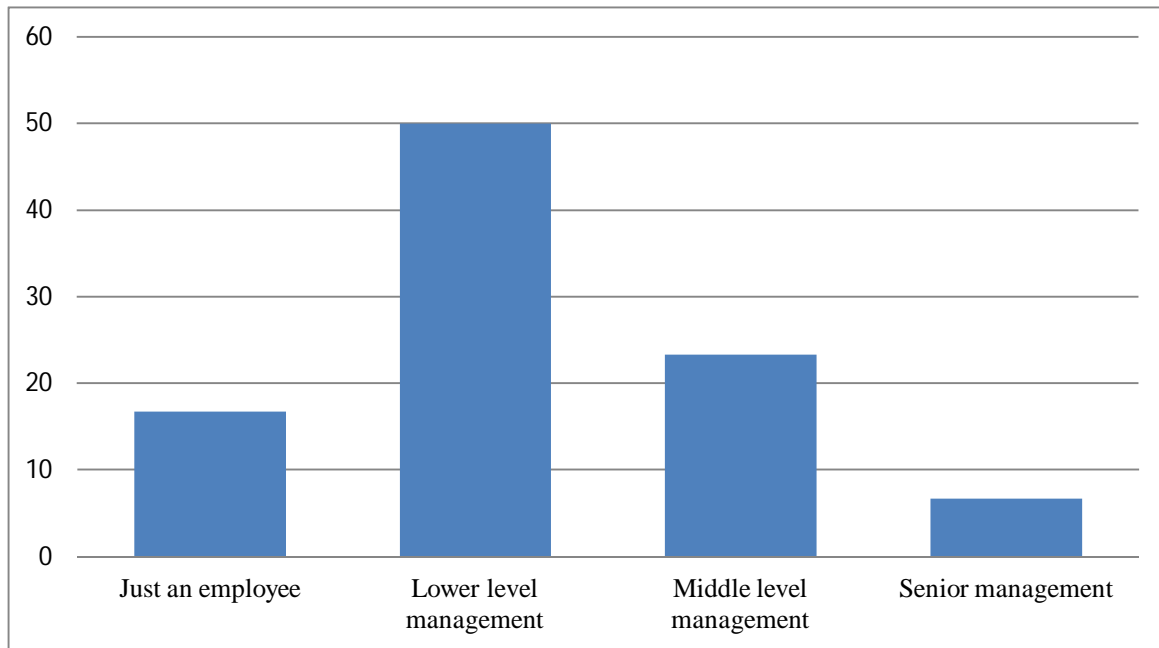
This shows that majority of the respondent had worked for more than 6 years indicating that they had interacted well with the company for long enough and therefore the information they would give would be substantial and accurate to enable the researcher determine the effects of merger and acquisition on competitive advantage.

Respondents who are well versed with the happenings of the company as a result of the work experience they've had in the company assist the researcher to achieve their research objectives conclusively. It's normally important for the researcher to get accurate responses from the respondents for quality and accountability purposes.

### 4.3.3 Respondents level of management

The study sought to establish the level of management held by the various respondents in the company. Figure 4.2 below illustrates the data findings.

**Figure 4.2**



This indicated that 16.7% of the respondents were just employees, 50% were in the lower level management, 23.3% were in the middle level management and only 6.7% were in senior management. It therefore indicates that majority of the respondents were at least in the lower level management. This means owing to the position the respondents held they were in a position of giving valuable information in regards to the merger.

The respondent level of management is well spread out making it easy for reaching conclusive results, this also implies that the information they would give would be accurate to enable the researcher determine the effects of merger and acquisition on competitive advantage. Conclusive accurate results from the respondents in the company in terms of their level of management will assist the researcher to achieve their research objectives.

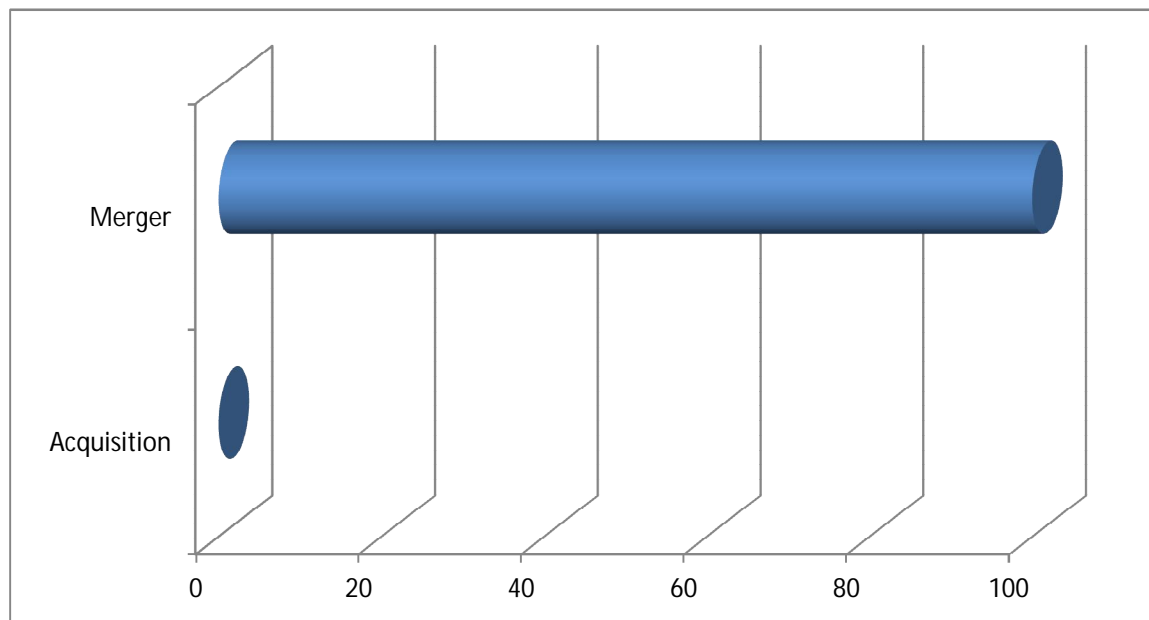
## 4.4 Organization corporate strategy

This is located as an emergent set of practices which has distinctive power effects on organizations and subjectivity. A corporate strategy provides management with a benchmark to measure a company's success or failure.

### 4.4.1 Nature of organization corporate strategy

The study also sought to establish the nature of strategy the company undertook. Figure 4.3 below shows the data finding.

**Figure 4.3**



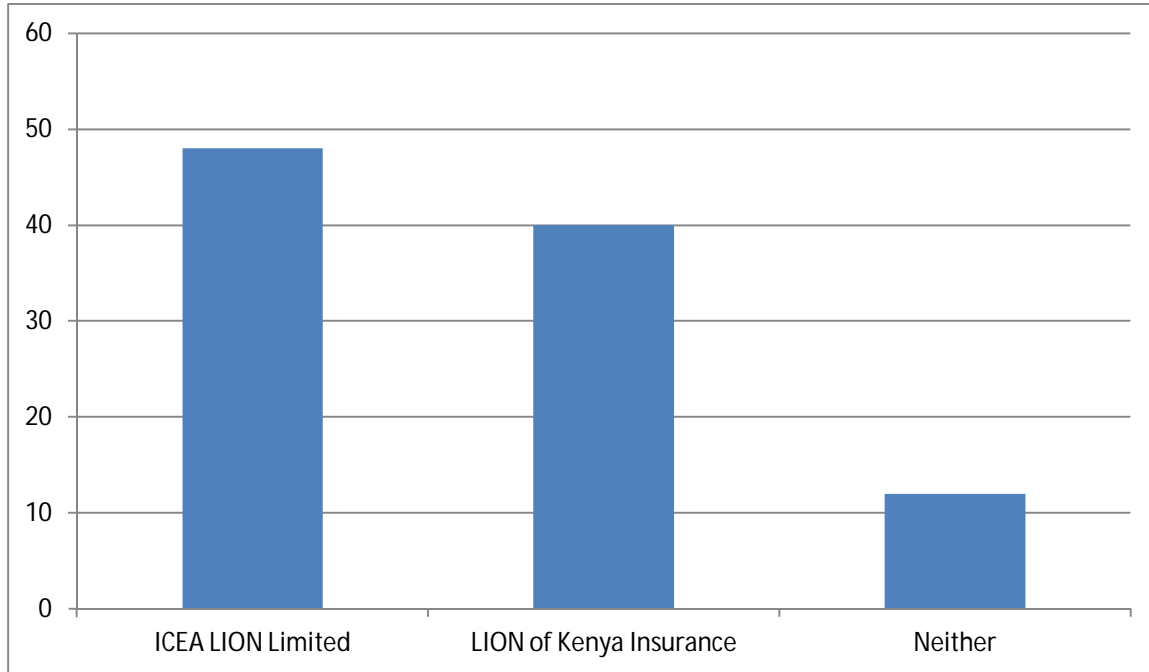
The data findings illustrate that 100% of the respondent indicated that the nature of strategy the firm undertook was a merger. Although the term merger and acquisition go hand in hand from the findings we see that ICEA and LION Group Company preferred the merger strategy.

This was to enable it attain competitive advantage where both organizations combine together to combine synergies and form one firm as opposed to one firm completely acquiring the other. Mergers and acquisitions enable firms to gain greater market power, gain access to innovative capabilities, thus reducing the risks associated with the development of a new product or service.

#### 4.4.2 Company the respondent worked for

The study also sought to establish which company the respondent was working for before the merger. Figure 4.4 below illustrates the data findings.

**Figure 4.4**



The data findings illustrate that 12% of the respondents were not working with either of the companies during the time of the merger, 48% of the respondents were in ICEA Lion limited and 42% worked in LION of Kenya insurance. This implies that majority of the employees were working for the separate companies prior to the merger. Implying that a bigger working force was established as a result of the merger leading to the company attaining competitive advantage.

#### 4.4.3 Merger and Acquisition statements on competitive advantage

The study sought to establish the relevance of the various statements in relation to effects of the merger and acquisition strategy on competitive advantage, the results were presented in table 4.8. According to the findings, the economies of scale was created and a higher competitive power achieved were some of the strong reasons given by respondents for effects of merger strategy of their companies in relation to competitive advantage as shown by a mean of 4.60.



The business was expanded had a mean score of 4.57 and a standard deviation of 0.496. Profitability increased upon the merger, merger strategy put the firms on a globalized scale, and quality of service was created. The merger of the companies created more efficiency, the merger created monopolies and fought competition, The idle resources were deployed as a result of the merger hence an effect on competitive advantage and employees were given top priority during the merger were other reasons with mean scores of 4.23 , 4.07, 4.00 ,4.00 , ,3.80 ,3.63 ,2.97 and 2.73 respectively as perceived by the respondents which were considered during merger. These findings therefore indicate that as a result of the merger economies of scale was created, the firms had a higher bargaining power, and the business expanded were the some of the effects in relation to the firms merger and acquisition strategy on competitive advantage.

#### **4.4.4 Respondent Opinion about the Merger and Acquisition**

The study further sought to establish the opinion of the respondents with regard to the merger of the companies and the results were presented in table 4.9. According to the findings, “as far as I am concerned, the process is smooth” was found to be the most important opinion in relation to the merger with a mean of 1.900. I felt uncertain and confused, management orientation remained the same, and behavioral tendencies have remained the same.

I experienced no difference on my work, the values of the organization remained the same, work procedures and processes remained the same, I received adequate information on what was going to happen, I received regular updates on what was happening, I clearly understood the implications of the merger process” were the other opinions given with regard to the merger of the companies with means of 1.767, 1.667, 1.633, 1.600, 1.567, 1.500, 1.333, 1.300, and 1.233 respectively. This implies employee’s involvement is key for success of the merger and acquisition to attain a positive competitive advantage.

## 4.5 Effect of Merger and Acquisition strategy on competitive advantage

Linear regression model was also used in analyzing the effect of the merger and acquisition strategy on competitive advantage. The regression model was of the form:  $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \dots + \varepsilon$  Whereby Y is the independent variables,  $\beta_0$  is the regression constant or Y intercepts,  $\beta_1 \dots \beta_x$  are the coefficients of the regression model and  $\varepsilon$  is the error term, signified by the model's significance.

### 4.5.1 Regression analysis

This is a statistical process for estimating the relationships among variables. It includes many techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent variable and one or more independent variables. For this study competitive advantage is the dependent variable and merger and acquisition strategy the independent variable.

**Table 4.6: ANOVA Statistics**

Model					
R	.789				
R Square	.889				
Adjusted R Square	.394				
Std. Error of Estimate	.23173				
	Sum of squares	Df	Mean Square	F	Sig
Regression	73427.43	5	45325.45	.136	.001
Residual	45362.81	25	4340.836		
Total	114359.24	30			

The processed data from the ANOVA statistics which were the respondent parameters had a significance level of 2% that shows that the data is not ideal for making a conclusion on the respondent's parameter. The R is known as correlation value that shows the strength of relationship between independent and dependent variable.

From the table 4.6 there was strong relationship between the merger and acquisition strategy and competitive advantage of ICEA and LION Group as shown by correlation factor of 0.789. The adjusted R2 is known as coefficient of determination and it shows the variation in effect of the merger and acquisition strategy and competitive advantage. There was 39.4% variation in merger and acquisition strategy and competitive advantage of ICEA and LION Group.

**Table 4.7 Coefficients of Results**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig
	B	Std.Error	Beta		
(Constant)	1.465	4.984		0.896	0.122
Merger strategy	0.166	2.97	0.059	0.393	0.698
Respondents opinion about the merger	-0.925	5.349	-0.278	-1.669	0.107
Competitive advantage	0.944	2.744	0.136	0.701	0.489

The coefficients in table 4.7 above was used in coming up with the model below:  $Y = 1.465 + 0.166 X_1 - 0.925X_2 + 0.944 X_3 + 0.171 X_4$ . According to the model on the merger and acquisition strategy, respondent opinion about the merger, and merger strategy were positively correlated with competitive advantage after the merger. A unit increase in the mergers strategy would lead to increase in competitive advantage by factor of 0.166. The coefficient of respondent opinion about the merger is quite low and thus insignificant which might have been as a result of different experiences during mergers. Overall, mergers and acquisition strategy and competitive advantage coefficients are significant indicators of firms performing better after the resulting merger.

## **4.6 Conceptual discussions**

This section seeks to discuss the previous studies, theories and policies on conceptual studies and compare them with the current findings from the researcher's findings. The study's objective was to determine the effect of merger and acquisition strategy on competitive advantage in ICEA LION Group Kenya. The study concluded that based on the data presented and the summary of the findings the merger and acquisition strategy had a positive impact on the company's competitive advantage. This is because the merger and acquisition strategy brought about higher capital which is an important factor for a firm's positive performance. Despite this, the researcher seeks to broaden their scope through discussion of previous studies and understand the concepts and compare them with the current findings.

Competitive advantage being a unique position that a firm develops in comparison to its competitors with a good plan can assist in protecting the market against new entrants or small local rivals. The use of competitive advantage to help realize corporate goals only delivers the results when well understood in the organization. Porter (1985) states clearly that competitive advantage should be seen in terms of discrete activities a firm performs in designing, producing, marketing, delivering and supplying its products and services. Industry leaders are consequently building their competitive advantage through collaboration, mergers and acquisitions, customer relationship and loyalty programs (Naragandas, 2005). Firms of all sizes need to see competitive advantage as an integral part of ensuring long term survival and prosperity. Creating competitive advantage is dependent of having the right source of competitive advantages which can be within or without the firm.

A new economic business climate suggests that firms must be more aggressive and competitive to survive harsh economic times (Milman, D'Mello, Aybar, & Arbalaez, 2001). Mergers and acquisitions is often an effective way of competing in a tough global environment. There are a lot of reasons why companies may opt to go through a merger and acquisition. However the most general and obvious reason is the fact that the firms considers the merger or acquisition to be a profitable investment. Economies of scale efficiencies, synergy creation, attaining competitive advantage cost efficiency and diversification are some other reasons that firms make decisions to undertake mergers and acquisitions.

Firms enjoy economies of scale efficiencies when they combine their operations through mergers and acquisitions to reduce production costs, increase output, improve product quality, obtain new technologies and introduce new products. Potential economies of scale and efficiencies result from both managerial and operational efficiencies. Operational efficiencies may arise from economies of scale, improved resource allocation, more resources, and better technology in the production phase.

Managers believe that together they could achieve objectives far more effectively than would be possible if they were separated. Synergy occurs in elimination of duplicate staff, departments and combining sales forces and distribution systems. Ball and McCulloch (1996) illustrate that mergers and acquisitions take place when a firm is faced with expanding global competition, growth in research related costs and product development as well as growth.

Cost efficiency is the magic force that allows for enhanced cost efficiencies of the new firm after a firm goes through a merger and acquisitions. This takes the form of revenue enhancement such as cost efficiencies. Reduction in the number of staff after mergers or acquisition take place repeated roles in staff positions are likely to occur as a results companies tend to restructure and job losses occur. This leads to reduction to costs associated with staff (Pautler, 2001).

The need for diversification is one of the reasons that firms make decisions to undertake mergers and acquisitions. Diversification enables firms reduce risks as combined firms risks is less than the weighted average of the risks of the two firms prior to the merger. Firms merge to become more diverse, gain market share and penetrate new markets (Sekaran, 1992). Mergers and acquisitions enable firms reduce competition to manage interdependence with sources of input/output (Pfeffer, 1972). Both firms no longer compete but now compete more effectively with other firms (Yash, 2005).

Financial efficiencies may arise especially if a firm opts to diversify their earnings by acquiring other firms with different income streams. This lessens variation in profitability reducing risk of bankruptcy. When one firm has made losses and the other profits, the loss making company pays no taxes, while the tax burden of the second firm will be smaller if the firms merge hence the aggregate net profit will lead to a lower tax liability.

In cases of increased borrowing the merged firms enjoy the tax liability because of debt in tax deductible expenses. This in return helps increase profits as well as value of shares of the firm (Yash, 2005). A market power effect occurs automatically as a merger calls for a higher market share making the new firm the market leaders (Pautler, 2001).

Various empirical studies on corporate mergers and acquisitions focused on the effect of merger and acquisition on performance. This is because Mergers & Acquisitions have been the commonest method of corporate strategy to improve firm performance. (Yeh and Hoshino, 2002) evaluated the effects of mergers and acquisitions on firms operating performance on the basis of its effect on efficiency, profitability, and growth. The study proxy total productivity as an indicator of the firm's efficiency, return on assets and return on equity as measures of profitability, and sales and growth in employment to index for firms growth rate.

Using a sample of 86 Japanese corporate mergers between 1970 and 1994, it was realized that there was insignificant negative change in productivity, significant decline in profitability, significant adverse effect on sales growth rate, and mergers and acquisition caused downsizing in the workforce. (King et al. 2004) employed a meta-analysis technique to assess the impact of mergers and acquisition on firms using the findings of published research on post-acquisition performance. Their study revealed that merger and acquisition does not result to superior financial performance. It further showed that M & A has a moderate unfavorable effect on the long term financial performance of the acquiring firms and no evidence to support and explain variations in performance as a result of mergers and acquisitions using the factors that were supported by the literature.

(Jin et al, 2004) examined the impact mergers and acquisitions had on the operational aspects of the publicly traded firms in China. They used changes in revenue, profit margin, return on assets and the total asset turnover ratio before and after the mergers and acquisitions as proxies for firm performance and conducted tests to determine whether mergers and acquisitions resulted in significant changes. Their study showed that there were significant improvements in total revenue, profit margin, and return on assets following mergers and acquisitions but there was no evidence of any significant impact on asset turnover ratio. They also found evidence of significant market anticipation and over reaction to the mergers and acquisitions announcements.

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

Studies by Zander and Kogut (1996) that was conducted in Pennsylvania, USA, where qualitative analysis of managers attitude towards mergers and acquisitions established that the fundamental aim of mergers and acquisitions (M&As) is the generation of synergies that can, in turn, foster corporate growth, increase market power, boost profitability, and improve shareholders wealth. Accordingly, M&As should constitute positive net present value projects. This study's findings concur with both Production and Market Power Theories of mergers and acquisitions as tools for modern corporate control. This is supported by Zander and Kogut (1996) argument that firms engage in M&As to deal with the dilemma of how to achieve superiority over markets as productivity grows with the division of labor but specialization increases the costs of communication and coordination. The findings also support the Market Power Theory based on the argument that a firm is distinct from a market because coordination, communication, and learning are situated not only physically in locality, but also mentally in an identity.

Empirical evidence aimed at testing the validity of market imperfections theory was conducted by Alam and Sickles (2006). They evaluated technical efficiency of the US airline industry, which had either merged or undergone acquisitions, and explored the link between market structure and economic performance. DEA scores of technical efficiency for a sample of eleven (11) U.S.A carriers were quarterly observed, during the time period 1970-1990. The results indicated that the scores moved together and in fact, the firms were becoming more alike one another in terms of efficiency. According to the study, there is significant positive relationship between stock market returns and changes in technical efficiency scores in the US airline industry.

A study by Sharma and Thistle (1996) was carried out to test the validity of market power theory of mergers in USA. The study looked into the motives of horizontal mergers by utilizing a sample of acquiring firms based on same SIC codes. The goal of the study was to examine the role of the market power in influencing the mergers and acquisitions. A three factor Arbitrage pricing model was utilized, with Tobin's q ratio as a measure of market power, to study the performance of the firms involved in the mergers. The results indicate the acquisition of market power not to be a significant motive for the mergers.

On their part, Wu and Ray (2005) analyzed mergers and acquisition in the US manufacturing industry and found significant relationships between abnormal returns from mergers and acquisition and technical efficiency. This study tested the Market Imperfections Theory in M & As. For example, for acquirers there is a negative relationship between efficiency and abnormal returns, which the authors explain by saying the market interprets mergers and acquisitions as attempts to improve efficiency, such that less efficient firms have the most to gain. This interpretation is at odds with the usual rationale, which suggests that efficient acquirers are more likely to gain because they can improve the efficiency of the targets and are more likely to avoid inefficiencies in post-merger integration.

Saboo and Gopi, (2007) investigated the impact of mergers and acquisition on the operating performance of acquiring firms by examining some pre-merger and post-merger financial ratios of these firms and determined the differences in pre-merger and post-merger financial ratio of the firms that went for domestic acquisitions and firms that opted for international/cross-border acquisitions. The results suggest that there are variations in terms of impact on performance following mergers, depending on the type of firm acquired-domestic or cross border. The main finding shows that merger have had a positive effect on key financial ratios of firms acquiring domestic firms while a slightly negative impact on the firms acquiring cross-border firms.

Mantravadi and Reddy, (2008) evaluated the impact of mergers and acquisitions on the operating performance of acquiring corporate in different industries, by examining some pre-merger and post-merger financial ratios, with the sample of firms chosen as all mergers and acquisitions involving public limited and traded companies in India between 1991 and 2003.



The results suggest that there are minor variations in terms of impact on operating performance following mergers and acquisitions, in different industries. Specifically, mergers and acquisition seem to have had a slightly positive impact on profitability of firms in the banking and finance industry; the pharmaceuticals, textiles and electrical equipment sectors saw a marginal negative impact on operating performance in terms of profitability and returns on investment. For the chemicals and Agri-products sectors, mergers and acquisition had caused significant decline both in terms of profitability margins and returns on investment and assets.

A study by Selvam et al. (2009) conducted a study on the impact of mergers and acquisition on the corporate performance of acquirer and target companies in India. A sample of companies which underwent merger and acquisitions in the same industry during the period of 2002-2005 listed on the Bombay Stock Exchange. The study focused on comparing the liquidity performance of the thirteen sample acquirer and target companies before and after the period of mergers by using ratio analysis and t-test. It was found out that the shareholders of the acquirer companies increased their liquidity performance after the merger event.

On their part Ullah et al., (2010) examined whether merger and acquisitions delivers value, taking the case of Glaxo Smith/cline Merger. They analyzed the pre and post-merger performance of the firm by applying the net present value approach of valuation. The study found that mega pharmaceutical merger hasn't delivered value. The stock prices underperform both in absolute and relative terms against the index. The merger resulted into substantial research and development reduction and downsizing instead of a potential employment haven.

Ismail et al., (2010) conducted a study to explore improvements in the corporate performance of firms involved in merger and acquisition. Using a sample of Egyptian companies in the period from 1996 to 2005 in the construction and technology sectors, their results show that merger and acquisition in the construction sector has contributed in improving the profitability of firms while in the technology sector, no improvements were discovered. For both sectors, M & As did not improve efficiency, liquidity, solvency and cash flow positions.

A study by Mishra and Chandra, 2010 assessed the impact of merger and acquisition on the financial performance of Indian pharmaceutical companies over the period from 2000 – 01 to 2007 – 08. By applying panel data estimation techniques, they found that the profitability of a firm depends directly on its size, selling efforts and exports and imports intensities but inversely on their market share and demand for the products. Their empirical findings suggests that M & A does not have any significant impact on profitability of the firms in the long run possibly due to the resultant X-inefficiency and entry of new firms into the market.

Muchae (2010) studied challenges of cross border mergers and acquisitions and the factors influencing the same in Tiger Brands Limited. Muchae found that performance related factors such as perceived synergies, wider product scope, and new market for products were the driving factors for merger and acquisition of Tiger Brands Limited (HACO). The study however found that following acquisition the staff were less motivated with loss of incentives and there uncertainty regarding their job security and challenges experienced in bedding down the new structure were such as redundancy which was were addressed by offering retirement package and excess capacity was deployed which negated performance.

On her part Chesang (2002) studied how merger and acquisition of commercial banks in Kenya influence their financial performance. Chesang found that firm size and financial performance of acquiring firms can be the determinants of poor performance in the post-acquisition period.

A study by Cummins et al. (1999) examined the relationship between mergers and acquisitions, efficiency, and scale economies in the US life insurance industry over the period 1988 to 1995. They estimated cost and revenue efficiency using data envelopment analysis (DEA). Their results found that acquired firms achieved greater efficiency gains than firms that had not been involved in mergers or acquisitions. Furthermore, they found firms operating with non decreasing returns to scale and financially vulnerable firms were more likely to be acquisition targets. From their results they concluded, mergers and acquisitions in the life insurance industry had a beneficial effect on efficiency.

Cybo-Ottone and Murgia (2000) analyzed merger and acquisition transactions in 13 European countries over the period 1988 to 1997. Their sample included 54 deals, either the target or the acquiring firm had to be a bank. The share price impact of the acquisition on the combined performance of both the bidder and the target was tested statistically. Their results found significant market value gains for within-country, bank-to-bank acquisitions, and for transactions where banks acquired insurance companies. However, they did not find market value gains for cross-border transactions or transactions involving banks and securities firms.

Akhigbe and Madura (2001) measured the valuation effect of Intra-industry US insurance company mergers and acquisitions. They applied the event study methodology to a sample of 68 mergers during the period 1985 to 1995. Their results found value-creation for both acquirers and targets, however value-creation for targets was significantly larger than for acquirers. They reported positive and significant abnormal return for acquiring insurers and concluded that this favorable valuation effect was driven by the similarity of services provided by both the acquirers and the acquired. In other words, the somewhat standardization in their products made the merger of operations, for both parties, easier. Interestingly, Akhigbe and Madura (2001) document a higher positive and significant market reaction for acquirers who are non-life insurers.

Floreani and Rigamonti (2001) examined the stock market valuation of mergers and acquisition in the insurance industry between 1996 and 2000 in Europe and the US. They formed a sample of 56 deals in which the acquiring company was listed. They used an event study methodology. Their data analysis revealed that insurance company mergers enhanced value for bidder shareholders. Over the event window (-20,+2) their abnormal return was 3.65%. Furthermore, they found the abnormal returns for acquiring firms increased as the size of the deal increased. They also found that mergers and acquisitions occurring between insurance companies located in the same European country were not valued positively by the market, while cross-border deals appeared to increase shareholder's wealth.

An analysis of a sub-sample of simultaneously listed bidders and targets revealed that the combined insurance companies experienced significantly positive abnormal returns and consistent with previous findings, target shareholders substantially increased their wealth. Indeed, Cummins and Weiss (2004) report a small negative valuation effect on the bidder's shares following transactions that do not involve pure insurance partners. Cummins and Rubio-Mises (2003) studied the effects of deregulation and consolidation in the Spanish insurance industry over the period 1989 to 1998. The sample period 1989-1998 spanned the introduction of the European Union's Third Generation Insurance Directives, which deregulated the EU insurance market. Deregulation led to dramatic changes in the Spanish insurance market; the number of firms declined by 35 percent and average firm size increased by 275 percent.

They analyzed the causes and effects of consolidation using modern frontier efficiency analysis, as well as Malmquist analysis to measure the total factor productivity change. Their results showed that many small, inefficient, and financially underperforming firms were eliminated from the market due to insolvency or liquidation and acquirers preferred relatively efficient target firms. As a result, the market experienced significant growth in total factor productivity over the sample period. Furthermore, consolidation reduced the number of firms operating with increasing returns to scale but also increased the number operating with decreasing returns to scale. They concluded many large firms should focus on improving efficiency rather than on further growth.

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.

Franks, Harris, and Titman (1991) studied companies' performance following corporate takeovers of 399 acquisitions during the 1975-1984 periods. The study used multifactor benchmarks from the portfolio evaluation literature that overcome some of the known mean-variance inefficiencies of more traditional single-factor benchmarks. After adjusting for systematic risk and size, but not for the book-to-market ratio, they found positive and significant long-term abnormal returns only for small transactions. The study concluded that previous findings of poor performance after takeover were likely due to benchmark errors rather than mispricing at the time of the takeover.

Loderer and Martin (1992) studied the post-acquisition performance of acquiring firms of 304 mergers and 155 acquisitions that took place between 1966 and 1986. They observe a negative but insignificant abnormal return over the five subsequent years (significant when measured over three years) for the mergers and positive but insignificant abnormal return for the acquisitions.

They observed evidence of negative performance in the second and third post-acquisition years, but that performance occurs mainly in the 1960s and 1970s, and disappears in the 1980s. Thus, especially in the later years, the post-acquisition years do not provide convincing evidence of wasteful corporate acquisitions, or strong evidence that contradicts market efficiency.

A study by Agrawal, Jaffe and Mandelker (1992) examined the post-merger performance of acquiring firms. They found negative and significant abnormal returns for 937 mergers over the five subsequent years, and positive but insignificant abnormal returns for 227 tender offers that occurred between 1955 and 1987.

Ansof, Bradenburc, Porter and Radosevlch (1971) found that after an acquisition, low sales growth companies showed significantly higher rates of growth, whereas, high sales growth companies showed lower rates of growth. However, even though low sales growth companies showed higher rates of growth after acquisitions, they actually suffered decreases in their mean P/E ratios, mean EPS and mean dividend payouts. The similar pattern of inconsistency found in the high sales growth companies whereby their performance levels for EPS, PE ratio, earnings and dividend payouts were greater. Low sales growth companies financed their acquisitions through decreased dividend payouts and the use of new debts.

In contrast, high sales growth companies with other strategies tended to decrease debts but increase dividend payouts. Acquisitions were in general unprofitable, as they did not contribute to increases in all of the variables of the companies' growth. Acquiring firms registered lower rates of growth as compared to the non-acquiring firms and this was more pronounced for low sales growth acquiring firms.

Firm size and financial performance of acquiring firms can be the determinants of poor performance in the post-acquisition period (Schmidt, Dennis, Fowler and Karen, 1990). Investors do not hold more favorable expectations for related mergers than for unrelated ones and stockholder value appreciates most for vertical mergers. Hence, acquisition involving vertical integration creates more value to large companies (Lubatkin, 1987) despite the findings of many studies concluded that firms participated in related acquisitions experienced superior economic returns in comparison with unrelated acquisitions. Hence, the rationale for the superior economic performance was due to the synergetic effect especially via complementary resources.

Ingham, Kiran and Lovestam (1992) studied the relationship between mergers and acquisitions 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.

Allen (1990) investigated whether excessive premiums for acquisitions dilute performance and reiterated that an acceptable premium should be no more than the discounted cash flows of a firm, as adjusted for any efficiencies or synergies the acquisition would exploit. In the Asian context, most value creation (cost reduction) materialized from either worker layoffs or renegotiating supplier contracts during the merger process.

Firth (1979) examined merger and takeover activity in the United Kingdom specifically, the impact of takeovers on shareholder returns and management benefits was analyzed, and some implications for the theory of the firm are drawn from the results. The study showed that mergers and takeovers resulted in benefits to the acquired firms' shareholders and to the acquiring companies' manager, but that losses were suffered by the acquiring companies' shareholders. The results were consistent with takeovers being motivated more by maximization of management utility reasons, than by the maximization of shareholder wealth.

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.

Cummins and Xie (2006) analyzed the productivity and efficiency effects of mergers and acquisitions in the U.S. property-liability industry during the period 1993-2003. They used data envelopment analysis (DEA) and Malmquist productivity indices. Their aim was to determine whether M&As are primarily driven by value maximizing versus non-value maximizing objectives. The analysis examined the efficiency and productivity change for acquirers, acquisition targets, and non-M&A firms. Their results indicated that M&A in property-liability insurance were primarily associated with value-maximization.

Acquiring firms achieved more revenue efficiency than non-acquiring firms, and target firms experienced greater cost and allocate efficiency growth than non-targets. They also found evidence that M&A were motivated by earnings diversification, but there was no evidence that scale economies played an important role in the insurance M&A merger wave. They concluded that the deals lead to a significant positive valuation effect for the acquiring insurers. Guest et al. (2010) examined the financial impact of 303 acquisitions of UK public companies, completed between January 1985 and December 1996. They wanted to address whether takeovers yield a positive net present value for the acquiring company.

They analyzed the sample using two methodologies- accounting returns and residual income approach. Their findings showed that while the accounting returns showed significant improvement in performance, the residual income approach finding was that acquisitions had a small and insignificant effect on fundamental value, relative to control firms.

Lole (2012) set out to investigate the effects of the merger of Apollo Insurance Company Ltd, and Pan Africa Insurance Company to form APA Insurance in 2004. Lole used accounting analysis regression models and found that the merger was effective on the financial performance of the insurance company. Lole (2012) further recommended that insurance companies should opt for mergers and acquisitions to enable the insurer to alleviate the challenges that face the Kenyan insurance industry.

Marengo (2012) set out to investigate the impact of mergers and acquisition on the financial performance of commercial banks in Kenya over the period 1994 to 2010. Marengo used accounting analysis regression models and found that the new financial institution formed after the merger was more financially sound. He further recommended that commercial banks with a weak and unstable capital base should seek to consolidate their establishments through mergers and acquisitions.

Corporate mergers and acquisitions (M&A) have long received a lot of attention from the corporate world, the public as well as the academic world. Many corporations across the world have been considering M&A strategies to realize competitive advantage, cost synergies against increased efficiency, pricing pressures, gaps in product mix and asset concentration (Hoang, Thuy Vu Nga Lapumnuaypon, Kamolrat, 2007).

Mergers and acquisitions (M&A) as an external growth strategy has gained spurt because of increased deregulation, privatization, globalization and liberalization adopted by several countries the world over. Mergers and acquisitions (M&A) have become an important medium to expand product portfolios, enter new markets, acquire new technology, gain access to research and development, and gain access to resources which would enable the company to compete on a global scale (Yadav, A. K. and B.R. Kumar, : 2005, pp. 51-63).



However, there have been instances where Mergers and acquisitions (M&A) enter into for non-value maximization reasons, i.e., to just build the company's profile and prestige (Malatesta, P. H.,:1983, pp. 155-181; Roll, R.,: 1986, pp. 197-216). Even though different companies have diverse reasons for engaging in mergers and acquisitions, the main purpose is to create shareholder's value over and above that of the sum of two companies (Sudarsanam, 2005).

Prakash and Balakrishna (2006) consider mergers and acquisitions as a strategic means for achieving sustainable competitive advantage in the corporate world but Prakash and Balakrishna (2006) investigate that the gains to be derived from M&A have increasingly become dependent upon the successful integration of cultures of the combining organizations and people, the role of human factors in determining merger outcomes has assumed greater relevance.

A comparative study of mergers and other forms of corporate investment at both industry and firm levels in US has been performed by Andrade and Stafford (2004) in order to investigate the economic role of mergers. Merilise Smit (2007) identifies that the success of a merger between two or more companies depends as much on cultural fit as it does on strategic fit and financial fit and the proper management of change and employee response thereto. Swami Prasad (2007) analyses the trends, direction and composition of cross border M&A in India and also throws light on certain issues in cross border M&A deals.

The researcher has gone through and critically analyzed the various previous studies on mergers and acquisitions and its various effects in its adoption as a strategy towards meeting the various corporate objectives. A key finding among most of the studies is that indeed mergers and acquisitions assists most organizations meet their goals. Also from the studies the merger strategy comes out as the most preferred corporate strategy compared to acquisitions this is because when companies merge it's on a voluntary basis and is on equal terms to form a new legal entity. For the acquisition, a company buys most if not all of the target company's stakes and assumes ownership. Acquisitions are mostly for companies that are underperforming thus seek to be salvaged by a bigger profitable company.

The findings from the studies confirm with researcher's results that indeed merger and acquisition are valuable strategies for a positive effect on a company's success. Mergers and acquisitions strategy provide a company with competitive advantage. Mergers and acquisitions if implemented well can lift a company to be well performing, meet customers' demands and needs, boots its products and service quality.

Competitive advantage as deduced from the previous studies through mergers and acquisitions arises as a result of the various benefits accrued; Mergers and acquisitions often lead to an increased value generation for the company. It is expected that the shareholder value of a firm after mergers or acquisitions would be greater than the sum of the shareholder values of the parent companies. Mergers and acquisitions generally succeed in generating cost efficiency through the implementation of economies of scale.

Mergers and acquisitions also lead to tax gains and can even lead to a revenue enhancement through market share gain. Companies go for Mergers and Acquisition from the idea that, the joint company will be able to generate more value than the separate firms. When a company buys out another, it expects that the newly generated shareholder value will be higher than the value of the sum of the shares of the two separate companies.

Also mergers and acquisitions can prove to be really beneficial to the companies when they are weathering through the tough times. If the company is suffering from various problems in the market and is not able to overcome the difficulties, it can go for an acquisition deal. If a company, which has a strong market presence, buys out the weak firm, then a more competitive and cost efficient company can be generated. Here, the target company benefits as it gets out of the difficult situation and after being acquired by the large firm, the joint company accumulates larger market share. This is because of these benefits that the small and less powerful firms agree to be acquired by the large firms. When two companies come together by merger or acquisition, the joint company benefits in terms of cost efficiency. A merger or acquisition is able to create economies of scale which in turn generates cost efficiency.

As the two firms form a new and bigger company, the production is done on a much larger scale and when the output production increases, there are strong chances that the cost of production per unit of output gets reduced. An increase in cost efficiency is affected through the procedure of mergers and acquisitions. This is because mergers and acquisitions lead to economies of scale. This in turn promotes cost efficiency. As the parent firms amalgamate to form a bigger new firm the scale of operations of the new firm increases.

As output production rises there are chances that the cost per unit of production will come down. An increase in market share is one of the plausible benefits of mergers and acquisitions. In case a financially strong company acquires a relatively distressed one, the resultant organization can experience a substantial increase in market share. The new firm is usually more cost-efficient and competitive as compared to its financially weak parent organization. Mergers and acquisitions is one of the best strategic management practices companies can use to enable them achieve their corporate objectives. The researcher concludes on affirming that the merger and acquisition strategy has a positive impact on competitive advantage, this statement is backed up by the various previous studies covered.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents discussions on the effect of merger and acquisition strategy on competitive advantage of ICEA and LION Group from the key findings in chapter four. The chapter thus summarizes the findings, makes conclusions and recommendations, depicts limitations of the study and states the areas for further research.

#### **5.2 Summary**

The study aimed at establishing whether the merger and acquisition strategy created competitive advantage for ICEA and LION Group insurance company. The objective of the study was to establish the effect of mergers and acquisition strategy on competitive advantage by comparing and evaluating pre and post-merger performance within a four year time horizon using the Residual Income Valuation approach model. The researcher established that the companies undertook the merger strategy and not acquisition to achieve its corporate objectives. From the data analysis discussed in chapter four, the study established that following the merger the fundamental value of the combined entity was positive as the book value of the new entity increased implying that the company attained competitive advantage from this, value creation is linked to competitive advantage. Dividends were also higher for the merged entity whereas the residual income and terminal value decreased. These differences were not significant. The study found the merger and acquisition strategy in ICEA and LION Group Company had a statistically significant effect on its value and in turn on competitive advantage.

On the other hand findings from the interview guide were that majority of the respondents had worked in the company for more than 6 years and most respondents were in at least lower management level. This meant that the respondents were in a position to give knowledgeable, accurate and valuable information owing to the positions held and long interaction with the company. From the findings on the respondent place of work before the merger, the study found that majority of the employees in the company were drawn from the pre merged companies work force, a small percentage got their jobs after the merger. A larger competent and skilled work force was created as result of this, implying that the company attained competitive advantage.

According to the findings, economies of scale was created, the firms gained a higher competitive power, the business expanded were some of the reasons for the effects of the merger and acquisition strategy in relation to competitive advantage. As a result of increase in cost of running businesses and increased competition, companies look for strategies that will keep them afloat through strategic alliances such as the merger strategy. When two companies merge, economies of scale are created through use of same production plant, a cut down on distribution costs through use of one network and many others. All this implying that companies merge or are acquired in order to improve their competitive advantage thus marshaling together massive resources hence higher bargaining power.

On the different opinions of the respondents with regard to different statements about the merger strategy their companies undertook, it came out clearly that for the success of the merger objectives, employees need to be informed on the undertaking the company intends to do and the benefits that will accrue from such. The various shareholders also need to be informed and given the necessary updates. Achieving competitive advantage will only come about if everyone has the information in regards to the merger thus work towards attaining the firm's objectives.

### **5.3 Conclusion**

The mergers and acquisitions are arguably the most popular strategy among firms who seek to establish a competitive advantage over their rivals due to their changing operating environment brought by the forces of globalization and fast technological changes and as a consequence firms are facing intense competition. However, based on the findings it can also be concluded that merger strategy is a common and preferred method of business combination compared to acquisition which can be explained by the fact that merger involves joining of the companies involved as equals or in slight difference without loss of identity of individual companies involved. Acquisition can be said to be less attractive as it result in loss of identity of the acquired. ICEA and LION Group undertook the merger strategy to attain their corporate objective which was having a competitive advantage.

The study concludes that based on the data presented in chapter four and the summary of the findings above, the merger and acquisition strategy had a positive impact on the company's competitive advantage. This is because the merger and acquisition strategy brings about higher capital which is an important factor for a firm's positive performance. This is evidenced from the increase in book value following the merger. Thus from the study, the merger and acquisition strategy indeed created competitive advantage for ICEA and LION Group company.

The study also concludes that the merger and acquisition strategy is a common method of corporate business practice combination, which is the voluntary amalgamation of two firms on roughly equal terms into one new legal entity. The study concludes that despite the process of mergers being smooth, uncertainty and confusion among the employees persist. Creation of economies of scale, gaining a higher competitive power and business expansions were some of the effects that accrue from mergers in relation to competitive advantage. Palia's (1993) findings that equity of both the two firms conducting merger and acquisition changes positively thus affecting their economies of scale and bargaining power, which consequently leads to business expansion is in line with the findings that mergers and acquisition in the ICEA and LION Group which are driven by the need to create economies of scale, gain a higher bargaining power and business expansions.

In mergers and acquisitions, only synergistic combination and integration of sets of resources form competitive advantage. According to this view, a company's competitive advantage is derived from its ability to assemble and exploit an appropriate combination of resources by developing existing and creating new resources in response to rapidly changing market conditions. Therefore mergers and acquisitions are justifiable as it leads to economies of scale which is achieved by selling more of the same product, economies of scope resulting from sharing resources common to different products, better control of costs and thereby improve profit margin, increased entry barriers to potential competitors, if the firm can gain sole access to a scarce resource, increased dependability of the supply or quality of raw materials used as production inputs and improve the predictability of demand for its output through forward vertical integration.

## **5.4 Recommendations**

The study recommends that more insurance companies in Kenya and beyond should seek to attain positive competitive advantage through consolidating their firms through the merger and acquisition strategy. Improving customer service, enhancing internal efficiencies and creating greater competitiveness in the market place are some of the benefits that accrue from mergers and acquisition strategy. The study further recommends that for effective M&A, companies should have similar approach to rewards and promotions of its employees.

The study also recommends that for successful mergers it should be voluntary and on roughly equal terms thus form a new legal entity. Owners of each pre-merger firm continue as owners, and the resources of the merging entities are pooled for the benefit of the new entity. Successfully implemented strategies will lift a firm to superior performance by facilitating the firm with competitive advantage to outperform current or potential players. To gain competitive advantage, a business strategy of a firm manipulates the various resources over which it has direct control and these resources have the ability to generate competitive advantage. Superior performance outcomes and superiority in production resources reflects competitive advantage. The study established that mergers and acquisitions are great business strategies for gaining competitive advantage but only after thorough planning and execution have been with great diligence so that the integration delivers the benefits sought.

It is therefore recommended that the management of the company should ensure that their company does not join the list of the mergers and acquisitions which have failed due to poor execution of the strategy. In this study, by carrying out regression tests, evidence obtained supported and confirmed the relationship between mergers and competitive advantage where it was found out that the two have a strong relationship. The resulting merged entity performed better financially after the merger. The fundamental aim of mergers and acquisitions (M&A) is the generation of synergies that can, in turn, foster corporate growth, increase market power, improve production efficiencies, boost profitability, and improve shareholders' wealth. Accordingly, M&A should constitute positive net present value projects. The synergies that come by as a result of the merger and acquisitions will alleviate the above mentioned challenges facing the insurer or reinsurer.

## **5.5 Limitations of the study**

The main limitations of this study were the use of secondary data which the organization provided in limitation. The data provided in the websites was scanty; this forced the researcher to use incomplete records for their analysis. The use of the residual income model was cumbersome to use as it meant the researcher had to make many assumptions. The use of scanty data makes inferences for the total population of mergers impossible.

Finally, there are some potential concerns about the estimated cost of equity. The researcher noted the betas estimated could be downward biased because of thin trading. The interview guide data collection method used was costly, time wasting and tedious as the respondents had to find time in between their work schedule to be interviewed hence some were unavailable necessitating repeated visits. The use of the regression model made the analysis complex due to interdependence of variables involved. Also the estimation error may be within the expected limit or unreasonable depending on the information used. The model therefore can be subjective depending on researcher.

The study took a casual design framework to establish the effect of ICEA LION Group merger strategy on competitive advantage, causal research designs are used to determine the causal relationship between one variable and another. On the flip side, it may be difficult to reach appropriate conclusions on the basis of casual research findings due to the impact of a wide range of factors and variables in social environment hence a challenge to the researcher.

## **5.7 Implication of the study**

Corporate mergers and acquisitions are aimed at amplifying efficiency, enhancing competitive advantage, achieving synergy and improving firm value. Mergers and Acquisitions pursue the profitability, liquidity and solvency objectives of an organization. The study was carried out to determine whether competitive advantage occur after the merger and acquisition are undertaken. The analysis and results show that company performed better in the post- merger or acquisition era as compared to the pre-merger or acquisition era. This is supported by the fact that merging and acquisition had a significant impact on its fundamental value, which is the overall standard measure of financial performance due to the statistical significance.



The implications from the study was that as a result of the merger and acquisition strategy, the company was able to achieve competitive advantage through attaining a globalized outlook, improved efficiency, improved quality of service, better deployment of idle resources, acquisition of synergies and economies of scale. The company achieved competitive advantage from the mergers and acquisition strategy through economies of scale which was achieved by selling more of the same product, economies of scope resulting from resources sharing, better control of costs and thereby improve profit margin, increased entry barriers to potential competitors. The firm gained access to an increased human capital resource, increased in quality of services offered to customers and improve the predictability of demand for its output through forward vertical integration. The study found that mergers have a statistically significant effect on fundamental value of the merged or acquired entity hence competitive advantage.

## **5.6 Suggestion for further research**

The researcher suggests that further research should be carried out for longer event periods to determine whether there is significant impact of mergers on value creation in the long term for shareholders and in turn competitive advantage. Further research could examine whether the Residual Income Valuation methodology stands the test of further exploration of this or more recent data. One worthwhile approach would be to use analyst forecasts (rather than historical earnings) to predict future (post-merger) earnings per share, which would avoid any problems of dirty surplus accounting in the pre-merger period.

Future research could extend the analysis to a more recent sample of merger to ensure that our results are robust across different time periods. IRA are in the process of implementing a new regime known as the risk based supervision regime which will require insurance companies to calculate the capital requirements based on their risk profile and size. This change in regulation may result in increased mergers. Research could be extended to the effect of value creation following implementation of the new regime. The study should be conducted using different research design in order to offer different approach towards the same problem thus enhancing the clarity of the findings by eliminating the influence of other forces affecting financial performance.

To cut on time and the costs spent and to make it less tedious the researcher suggest the research to be done through telephone interview or any other suitable method that can improve the quality of the data through respondents' control. The study should incorporate analyses of various variables independently to avoid complexity that limits the clarity of results when all are lumped together. The study confined itself to the use of mergers and acquisitions as a strategy for competitive advantage. There are however other challenges which affect performance of the mergers and acquisitions and therefore further studies should be done on the challenges affecting performance of the mergers and acquisitions. Finally the study should focus primarily on secondary data to eliminate the possibility of personal opinion as a result of collection of data through questionnaires and interview method.

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DATE... 27/05/2016

**TO WHOM IT MAY CONCERN**

The bearer of this letter Mark Omondi Onyang'o

Registration No. BA/72723/2014

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

**PATRICK NYABUTO**  
**MBA ADMINISTRATOR**  
**SCHOOL OF BUSINESS**

So

## **APPENDIX 2: INTERVIEW GUIDE**

1. For how many years have you worked for the company?
  - i) 1-5 years
  - ii) 6-10 years
  - iii) 11-15 years
  - iv) 16-20 years
  - v) Over 20 years
  
2. What is your Management Level?
  - i) Lower level management
  - ii) Middle level
  - iii) Senior management
  
3. What was the nature of the corporate strategy action ? Was is a Merger or an Acquisition?
  - i) Merger
  - ii) Acquisition
  
4. Which company did you work for prior to the merger or acquisition?
  - i) ICEA LION Limited
  - ii) LION of Kenya Insurance company
  - iii) Neither
  
5. How true are the following in regards to attaining competitive advantage from merger and acquisition strategy?
  - i) Monopolies and higher competition power was created
  - ii) The business expanded as a result of the M&A strategy



- iii) The firm had a globalized outlook from the M&A strategy
- iv) Economies of scale was created from the M&A strategy
- v) M&A strategy created more efficiency was created
- vi) M&A created quality of service
- vii) Idle resources was redeployed because of M&A strategy
- viii) Priority was given to employees during mergers
- ix) The company's profitability increased upon a merger

6. During the merger or acquisition process of the company you worked for:

- i) Did you receive adequate information on what was going to happen?
- ii) Did you clearly understand the implications of the merger process?
- iii) Did you receive regular updates on what was happening?
- iv) As far as you are concerned was the process smooth ?
- v) Did you feel uncertain and confused ?
- vi) Did you experience no difference on your work?
- vii) Were the values of the organization the same?
- viii) Did the work procedures and processes remain the same?
- ix) Did the behavioral tendencies remain the same?
- x) Did the management orientation remain the same?

## APPENDIX 3: FINANCIAL STATEMENTS

### **Financial Statements ICEA Insurance Company Ltd**

Shs '000

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Common Stockholders' Equity	1,086,045	1,171,323	1,304,875	1,620,569
Profit/Loss from Revenue	175,000	86,723	160,950	461,710
Investment Income	189,481	226,186	236,165	318,232
Management Expenses	-	-	8,326	132,686
Other Expense	120,281	12,796	3,666	16,774
Profit or loss before tax	243,361	300,113	386,123	630,482
Provision after Taxation	79,962	94,835	124,090	192,278
Profit or Loss after Tax	163,399	205,278	261,033	438,204
Profit available for Distribution	923,545	991,323	982,356	1,293,059
Dividends	137,500	120,000	127,500	122,500

### **Financial Statements Lion of Kenya Insurance Company Ltd**

Shs '000

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Common Stockholders' Equity	1,314,705	1,499,536	1,924,240	2,329,872
Profit/Loss from Revenue	(776)	(7,542)	146,652	96,633
Investment Income	-	369,290	455,869	631,023
Other Income	573,327	-	-	-
Management Express	-	-	-	-
Other Expense	-	-	-	-
Profit or Loss before tax	572,461	361,748	602,621	727,656
Provision after Taxation	181,259	107,092	164,176	197,139
Profit or Loss after Tax	391,202	254,656	438,345	530,517
Profit available for Distribution	965,731	1,114,706	1,322,371	1,710,841
Dividends	107,500	132,500	145,000	157,500

**Financial Statements ICEA Lion Insurance Company Ltd****Shs '000**

	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Common Stockholders' Equity	3,950,441	5,391,795	9,958,824	
Profit/Loss from Revenue		668,732	582,853	
Investment Income		1,251,600	800,747	
Other Income		-	88,545	
Management Expenses		297,585	178,268	
Other Expenses		77,024	32,254	
Profit or Loss before tax		1,545,723	1,261,622	
Provision after Taxation		292,735	240,348	
Profit or Loss after Tax	968,721	1,252,989	1,021,274	
Profit available for Distribution		3,980,185	4,562,095	
Dividends	280,000	142,500	860,000	

Source: IRA Statistics 2016

Table 4.8 Statements on attaining competitive advantage from the merger and acquisition strategy

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean	STD DEV
Monopolies and high bargaining power was created	4	12	13	1	0	3.63	0.752
Business expanded	17	13	0	0	0	4.57	0.496
Company had a globalized outlook	8	16	6	0	0	4.07	0.680
Economies of scale was created	18	12	0	0	0	4.60	0.490
Efficiency was created	5	15	9	1	0	3.80	0.748
Quality of service was created	6	18	6	0	0	4.00	0.632
Idle resources were deployed	0	8	13	9	0	2.97	0.752
Employees were given top priority during the merger or acquisition	0	3	17	9	1	2.73	0.680
Company profitability increased upon the merger or acquisition	12	13	5	0	0	4.23	0.716
Merger or acquisition was driven by cost of the project	11	11	5	3	0	4.00	0.966
Higher competitive power was attained	18	12	0	0	0	4.60	0.490

Table 4.9 Respondents opinion about the merger.

	No	Yes	Mean	STD DEV
I received adequate information on what was going to happen	20	10	1.333	0.471
I Clearly understood implications of merger process	23	7	1.233	0.423
I received regular updates on what was happening	21	9	1.300	0.458
I felt uncertain and confused	7	23	1.767	0.423
As far as I am concerned, the process is smooth	3	27	1.900	0.300
I experienced no difference on my work	12	18	1.600	0.490
The values of the organization remained the same	13	17	1.567	0.496
Work procedures and processes remained the same	15	15	1.500	0.500
Behavioral tendencies have remained the same	11	19	1.633	0.482
Management orientation remained the same	10	20	1.677	0.471