GROWTH THROUGH ACQUISITION BY CFC BANK LIMITED

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DECLARATION

This management research project is my original work and has not been submitted for any degree award in any other university.

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This management research project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

I dedicate this work to my son Kyle who, despite being too young to know it, is a great source of inspiration in many of my endeavours.

I also dedicate it to my Mum and Dad for their priceless advice on life, and their unconditional love and support.

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ABSTRACT

The use of acquisition as a growth strategy has increased tremendously in the last decade. The main motivation for the use of acquisition as a corporate growth strategy is the speed with which it allows firms to enter new product or market areas. Acquisitions can be classified as either related or unrelated. Related acquisitions are where there is some level of product-market relatedness between the acquirer and the acquired firm. Unrelated acquisitions occur between firms that do not share any product or market relatedness.

This study examined the use of related acquisition as a growth strategy by a Kenyan firm. It studies the case of CFC Bank Limited which is structured both as a corporate with its core business in banking and also as a parent company for its insurance division. The study aimed to seek out the important factors that have contributed to CFC Bank's successful use of acquisition to grow its insurance division.

The research uses a case study design, and is conducted through in-depth interview sessions at CFC. The research data was qualitative in nature, and was analyzed by use of content analysis. The study glosses over CFC's acquisition history before zeroing in on an in-depth study of the company's latest acquisition. The acquisition under study was transacted in its insurance division and involved the acquisition of the life assurance business of ALICO Kenya Limited. The research also gives insight into both the process and the management of acquisitions. Few researches have ventured into understanding why some acquisitions fail and why others succeed. By understanding how CFC successfully manages its acquisition strategy, the study sought information that may help explain variations in post-acquisition performance.

The research findings show how if managed correctly, related acquisitions can help firms achieve synergy benefits that create value to their businesses. The value created can be in form of increased efficiencies that reduce cost, or in form of revenue enhancement mechanisms. Other benefits of acquisitions include access to new markets, and achieving geographical expansion. A well managed acquisition strategy can help a firm achieve growth without going through the long process of developing internally.

Lastly, the researcher suggests measures that CFC Bank can take to further the benefits of its latest acquisition. Recommendations on further researches that can help bridge the knowledge gap in this area are also made.

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1. INTRODUCTION

1.1 Background

1.1.1 Acquisition as a Business Strategy

Competitive strategy consists of all the moves and approaches a firm is taking to attract buyers, withstand competitive pressures, and improve its market position. It concerns what a firm is doing to gain competitive advantage. According to Thompson and Strickland (1992), *successful companies invest aggressively in* creating sustainable competitive advantage for it is the single most dependable contributor to above-average profitability. To succeed in building a competitive advantage, a firm must try to provide what buyers will perceive as "superior value"- either a good product at a low price or a "better" product that is worth paying more for. It is the provision of this superior value that enables a firm to successfully grow its business by increasing its market share, or increasing its profitability through higher prices or lower production costs.

Companies that are unable to develop resources and competences required to achieve superior value that can be sold to customers find it difficult to grow their businesses. The required resources and competences can be developed internally, but in today's highly competitive and fast changing business environment, it is sometimes necessary to develop them faster than the internal development process can allow. In other words, instead of developing the required resources, the business acquires them. The increasing use of acquisition as a growth strategy is hinged on this premise.

Acquisition is where an organization develops its resources and competences by taking over another organization. The need to keep up with a changing and competitive environment often dominates the thinking about acquisitions (Johnson & Scholes, 2002). As mentioned earlier, a compelling reason for the use of acquisitions as a corporate growth strategy is the speed with which it allows the firm to enter new product or market areas. In some cases, the product or market is changing so rapidly that acquisition becomes the only way of successfully entering the market, since the process of internal development is too slow.

Another motivation for acquisition is a lack of resources or competences to compete successfully, or the need to improve on the acquiring firm's resources and competences. Sometimes there are reasons of cost efficiency which make acquisition look favourable. The acquisition target may be a long way down the experience curve and have achieved efficiencies which would be difficult to match quickly by internal development.

Acquisition can also be driven by expectations of key stakeholders whose motives are speculative rather than strategic. They favour acquisition which might bring a short term boost to share value. However, strategy minded stakeholders are usually wary of the speculators since these short-term gains may be achieved at the expense of longer-term prospects. Indeed, mergers and acquisitions are more typically the result of organizations coming together because they are actively seeking synergistic benefits (Johnson & Scholes, 2002). This could be a result of the common impact of a changing environment in terms of either opportunities or threats, or the excessive cost of operations or innovations.

Growth through acquisition has increasingly become a common growth strategy in many industries. Globally, the number of completed acquisitions doubled between 1991 and 1997 to about 14,000 per annum (Schoenberg & Reeves, 1999). However, the research evidence on the financial consequences of acquisitions is largely inconclusive. Some research findings in this area indicate that acquisition is not an easy or guaranteed route to improving financial performance. It may take the acquiring company a considerable period of time to gain any financial benefits from acquisitions, if at all. The majority of acquisitions result in lower returns to shareholders (Johnson & Scholes, 2002).

Although the concept of mergers is not really new, comprehension of its antecedents and consequences is still far from complete (Lubatkin & Lane, 1996). Research in the area of mergers and acquisitions has yielded significant insights into the advantages and disadvantages associated with each of the components of this array of corporate strategy options (Ramaswamy, 1997). For example, several studies (e.g. Lubatkin, 1987; Singh & Montgomery, 1987) have shown that related acquisitions which involve some level of product-market relatedness between target and bidder firms is a desirable characteristic that can help post-merger performance. Others have demonstrated that compatibility in production technologies, organizational cultures, product functions, customer groups, etc has significant performance implications (Ramaswamy, 1997). These are only a few of the themes of a considerably larger body of work that has attempted to further the understanding of mergers and acquisitions. In this document, the terms *merger* and *acquisition* will be used interchangeably to refer to a similar strategy.

1.1.2 The Insurance Industry in Kenya

The Kenyan insurance industry operates under the umbrella of the Association of Kenya Insurers (AKI). Currently the membership of this association stands at 39 insurance companies, two of which are listed on the Nairobi Stock Exchange. The Kenyan insurance business environment has been characterized by increased competition with 39 companies fighting for a share of the Kshs. 20 billion industry.

An analysis of the gross direct premium incomes of insurers under long term insurance business reveals that out of a total of Kshs. 7.2 billion of premiums collected by all insurers, 53% was collected by only three firms i.e. ICEA (22.4%), Alico (16.34%), and British American (14.2%). A further 31.6%of the premiums were collected by only four firms namely Pan Africa Life Assurance (8.3%), Kenindia Insurance and Madison Insurance (8% each), and Jubilee Insurance (7.6%). In all, these seven firms collected almost 85% of the total premium in the life insurance category, leaving 32 companies with slightly less than 16% of the premium (Commissioner of insurance annual report, 2002).

An analysis of the industry's profitability paints a similar picture. 73 per cent of the industry's profitability can be attributed to only 5 companies, with the rest sharing only 27 per cent. An even more interesting analysis was the management expenses contribution of these companies relative to their profitability. The analysis revealed that the 7 companies collecting 85% of the industry's premiums spent only 42% of the industry's total management expenses. The 32 companies that collected the remaining 15 % of premiums spent 58% of the industry's management expenses! This analysis shows the great extent of to which economies of scale can be used to increase efficiency in this industry. Further, it paints a bleak picture for the future growth of the smaller insurance firms in the industry unless they can merge in order to achieve the required critical mass needed to improve efficiency. This reality seems to have dawned on the industry as evidenced by the merger between Apollo Insurance Company and Pan Africa General Insurance in 2005. In addition, these statistics attest to the highly competitive nature of the industry. Such an environment creates serious challenges for new entrants, and therefore favours new entry or growth by acquisition.

1.1.3 CFC Bank's profile

CFC Bank was incorporated in 1955 as Credit Finance Corporation Limited by two British businessmen, Mr. Harold Travis (Nairobi's last European mayor) and Mr. Bill May, as the first independent finance company in Kenya. In 1958 CFC became a public company with the majority shareholding being taken up by the James Finlay Group and Grindlays Bank. The year 1970 saw CFC's first issue of shares to the public on the Nairobi Stock Exchange. During its development CFC Bank has evolved from its initial status of a non banking finance company engaged in hire purchase to a fully fledged commercial bank in 1995. (CFC Information Memorandum, 2005)

The 1990s witnessed the acquisition of a majority interest by CFC Bank in Heritage A.I.I. Insurance Company Limited marking the company's entry into the insurance industry. In the year 2000, the bank activated CFC Financial Services Limited (CFCFS), its wholly owned subsidiary which became the first licensed Securities Dealer on the Nairobi Stock Exchange. CFCFS acquired Equity Stockbrokers Limited in November 2001, and became the first licensed investment bank in Kenya in June 2002. In December 2004, CFC Bank completed the acquisition of the life insurance business of ALICO Kenya Limited. CFC Group has a significant presence in the Tanzanian insurance industry through The Heritage A.I.I. Insurance Company (T) Limited. (CFC Information Memorandum, 2005)

CFC Bank has demonstrated the vision in identifying the necessity to diversify into other financial products. Indeed the company has evolved to be a financial services conglomerate providing commercial banking, asset finance, investment banking, general and life assurance products and services to its growing clientele. This research is a study of the company's latest acquisition - ALICO Kenya's insurance business.

1.2 Statement of the Problem

The advantage of acquisition as a competitive strategy lies in its ability to allow a firm to acquire new resources and competences that can create competitive advantage. The process of developing similar resources or competences internally may take too long and hinder the firm's competitiveness. In today's dynamic business environment, firm's seeking to grow their business often find themselves faced with an acquisition decision.

However, research findings indicate that acquisitions are risky transactions, and that indeed the majority of acquisitions result in lower returns to shareholders. Yet due to the increasingly more dynamic and global business environment, the use of acquisition as a growth strategy is on the increase. Despite the risk laden process and challenges of acquisitions, CFC Bank has opted to use this strategy to grow the company. So far, the company has pursued a related acquisition strategy with great success. CFC made its entry into the insurance industry in 1992. By 2004, in just over a decade, the company had grown this division tremendously through acquisitions. Between the years 2000 and 2004, the division's total assets grew from Kshs. 2.16 Billion to Kshs. 13.15 Billion. Today CFC boasts of being the second largest provider of life assurance products and services in Kenya. This research studied the case of CFC Bank and how it used acquisition to grow its insurance division. The study sought insight as to why CFC Bank's acquisition strategy is succeeding where others are failing.

1.3 Objective of the study

The study aimed to seek out the important factors that have contributed to CFC Bank's successful use of acquisition to grow its insurance division.

1.4 Importance of the study

The dynamic global business environment characterizing many Kenyan industries today will see an increasing use of mergers and acquisitions as a growth strategy in line with global trends. To enable successful acquisition transactions, management practitioners must understand the factors necessary to derive the strategic benefits of these acquisitions. This research study will provide insight on how an organization can successfully use acquisition as a growth strategy. This information is important to management, directors, and shareholders who need to appreciate issues pertinent to this strategy. The study also contributes to the existing strategic management literature on mergers and acquisitions, and provides a basis for further research.

2. LITERATURE REVIEW

2.1 Acquisition Motivations

Acquisition is where an organization develops its resources and competences by taking over another organization. A related acquisition is one which involves some level of product-market relatedness between the target and bidder firm. According to Johnson and Scholes (2002), the rationale behind acquisitions is often dominated by the need to keep up with a changing and competitive business environment.

The two traditional research streams in industrial organization economics emphasize market power and scale efficiencies as incentives for related acquisitions (Scherer & Ross, 1990). Strategy researchers, on the other hand, argue that firms often use acquisitions in order to reconfigure the acquiring or target businesses as part of the process of commercial change (Capron et al, 1998). Capron and colleagues suggest that acquisitions allow firms to exchange firm-specific resources that are subject to substantial market failure.

Economic discussions of related acquisitions traditionally contrast two schools of thought. Market power theories view related acquisitions (especially horizontal acquisitions) as a means for businesses to reduce the intensity of competition and increase their market power (Scherer & Ross, 1990). In contrast, traditional efficiency theories argue that related acquisitions lead to increased scale efficiencies (Dutz, 1989). Consequently, most economic research on acquisitions compares the revenue-side effects of market power to the cost-side effects of scale efficiencies.

Capron et al (1998) argue that the two traditional views have limited applicability in analyzing contemporary related acquisitions. This is because both the market power and scale efficiencies incentives for related acquisitions are most relevant in the context of stable industries (Dutz, 1989), where business combinations may help entrenched incumbents maintain their leadership positions. By contrast to this stable industry context, many modern businesses operate within dynamic and increasingly competitive environments. Consequently, any market power or scale efficiencies gained by attempting to concentrate a dynamic industry through horizontal and related acquisitions are likely to be eroded quickly as the environment changes (Hartman et al., 1994).

Given the above argument, a contemporary framework is necessary to better understand and analyze contemporary related acquisitions. The strategy literature provides elements of a contemporary framework, emphasizing that acquisitions play a dynamic role in increasing business efficiency and effectiveness. Strategy research suggests that acquisitions sometimes allow firms to restructure business organizations (Bowman and Singh, 1993). Restructuring supports business growth, allows changes in the mixes of goods and services that businesses offer, and helps businesses improve their technical and organizational systems (Seth, 1990).

Restructuring therefore provides a means by which firms can attempt to increase their efficiency and effectiveness by changing business operations, rather than simply seeking scale efficiencies for existing operations. This can be achieved through synergies resulting from the acquisition. Indeed, firms often restructure the target or acquiring firms after acquisitions. Acquisitions help firms to obtain resources that they need to reconfigure their businesses or apply their existing resources in new uses. Both offer the firm avenues for growing the business.

Corporate acquisitions fall under a category of infrequent, heterogeneous and complex events, which present a significant challenge for any organization undertaking such types of ventures (Singh and Zollo, 1998). Acquiring firms face a multiplicity of interdependent tasks throughout the acquisition process, from the necessary assessment of strategic and organizational fit among the two firms, to the technical and psychological hazards of evaluation and negotiation processes, to the complexities of planning, coordinating and executing the post-acquisition integration process.

2.1.1 The resource based view of Mergers & Acquisitions

The dominant view in financial economics literature is that acquisitions are transactions reflecting the workings of the market for corporate control (Jensen and Ruback, 1983). According to this view, management teams vie for the control of productive assets of firms. If a particular management team underperforms, then a more competent team takes its place. This view has however failed to advance explanations for the variance of post-acquisition performance of firms.

The strategic management field, on the other hand, is credited with having advanced a major body of theoretical and empirical literature focused on factors which provide a systematic discrimination between high and low performance of corporate acquisitions (Singh and Zollo, 1998). The most widely used perspective on acquisitions is the resource based view of the firm (Dierrickx & Cool, 1989). Empirical work in this area has used the resource perspective of the firm in order to test the impact of resource relatedness on the performance of acquisition transactions (Lubatkin, 1987; Seth, 1990). The findings suggest that the two constructs are related, and for acquirers to earn positive abnormal returns on their investments, they must create a uniquely valuable combination of their assets with those of the acquired firm. Simply put, they must create synergies with the acquired firm. The premiums paid to gain control of the target typically reflect the potential synergies that could be gained from relatedness (Barney, 1988).

Some relatively more recent studies produced findings that support those of the earlier ones. For example, Anand and Singh, (1997), compared consolidation-oriented acquisitions with diversification-oriented acquisitions in the U.S. defense industry. They found that consolidation-oriented acquisitions do result in positive abnormal returns, as well I significantly higher post-acquisition cash-flows, as compared to diversification-oriented acquisitions. This is because the latter cannot enjoy the value created from synergistic benefits. These results are consistent with the arguments made by Porter (1987) that acquisitions should be conducted in areas where the firm enjoys competitive advantage, and there are benefits from sharing critical resources between the acquiring and acquired firms.

2.2 Managing Acquisitions

The process of managing acquisitions is substantially more complex to study empirically, because of the lack of process level data in many observations. As a result, research on the process of managing acquisitions is still in the exploratory stage, relative to other acquisition literature, and empirical regularities are still being established (Singh & Zollo, 1998).

One of the earlier pieces of research on the management of acquisitions, by Jemison and Sitkin (1986), indicates that it is useful to think about acquisitions in terms of both their strategic fit and organizational fit. Organizational fit tends not to correspond neatly to strategic fit. Therefore, the complexity of an acquisition from an organizational standpoint can be quite different from what may be implied by the strategic considerations driving the acquisition transaction.

Haspeslagh and Jemison (1991) suggest that acquisitions should be classified based on the strategic role they would play in the acquired firm. They propose two dimensions along which the ongoing management of acquisitions can be classified. These are the need for strategic interdependence and the need for autonomy. Based on these two dimensions, they propose integration approaches to manage acquisitions, and further suggest that acquisition performance depends upon the congruence between the pre-acquisition conditions determined by the combination of the two dimensions and the integration approach adopted.

One important dimension in post-acquisition management is the choice of the level of integration of the acquired firm. As the acquired firm is integrated more extensively in the acquiring firm, a number of both positive and negative outcomes might be expected. Of these, Jemison and Sitkin, (1986) consider foremost that the complexity of the post-acquisition process increases substantially as acquirers face higher levels of uncertainty and take higher degrees of risk. For example, the integration process typically lasts longer than acquirers expect and can be highly disruptive to the established routines and the employees' morale of the acquired firm. At the same time, higher levels of integration among the two firms are necessary if the value creation potential of the acquisition is to be realized either through cost efficiency or through revenue enhancement mechanisms (Anand & Singh, 1997; Capron et al., 1998). Managing the tension between the positive and the negative implications of the integration process, i.e. maximizing cost efficiencies or revenue enhancement while minimizing organizational disruptions requires the development of ad hoc competencies. Higher levels of integration are, in fact, associated with higher levels of acquisition experience and with the development of support tools specific to the management of the integration process (Singh and Zollo, 1998).

Another important dimension of the post-acquisition process consists in the degree to which pre-existing resources within the two firms are replaced or dismissed after the completion of the transaction. Chief among the various types of firm resources is obviously the human and social capital embedded in the employees and, particularly, in the top management team. The degree to which post-acquisition turnover of human resources is actively pursued by acquirers eager to speedily implement the desired changes and obtain the expected performance improvements, has been researched in a small number of empirical studies. Contrary to the predictions of the "market for corporate control" approach, Canella and Hambrick (1993) find that managerial turnover was harmful to acquisition performance, and that the impact increased in magnitude the higher the degree of seniority of the replaced managers. More recently, Krishan, Miller, and Judge (1997) reach similar conclusions, adding that the degree of complementarity among the two top management teams positively influences performance and should therefore be protected, where possible.

2.3 The Acquisition Relatedness Hypothesis

2.3.1 Product-Market Relatedness

Mergers and acquisitions are arguably the diversification alternatives that have been the most widely researched in the corporate strategy literature. Ramaswamy (1997) observes that these studies have been rich and varied, often encompassing several distinct perspectives, including industrial organization economics, strategic management, and finance. The general consensus arising from these studies, with a few exceptions, is that "all things being equal, some product and market relatedness is better than none" (Lubatkin, 1987:39).

Many of the firms that fell victim to "merger mania" were once mistakenly convinced that the best way to achieve their objectives was to pursue unrelated diversification in the search for financial opportunity and synergy (Pearce & Robinson, 1997). That thinking has now been rejected, and many firms have been successful by pursuing a concentrated growth strategy that focuses on a specific product and market combination. Pearce and Robinson (1997) define concentrated growth as the strategy of the firm that directs its resources to the profitable growth of a single product, in a single market, with a single dominant technology. According to them, a firm employing this strategy grows by building on its competences, and it achieves a competitive edge by concentrating in the product-market segment it knows best.

Although not as conservative as a concentrated growth strategy, the relatively higher success rate of related acquisitions to unrelated ones is similarly tied to avoiding situations that require undeveloped skills, such as serving new customers and markets, acquiring new technology, building new channels, and facing new competition. Related acquisition modifies the concentrated growth strategy so as to avoid completely new product-markets, while at the same time not restricting the company to a single product and market combination. These transactions are hinged on concentric diversification which involves the acquisition of businesses that are related to the acquiring firm in terms of technology, markets, or products.

Despite the established evidence relating to the performance outcomes of different types of acquisition, such as related and unrelated ones, very little is known about within-type performance differences (Ramaswamy, 1997). This gap in the literature can be partly traced to the conceptualization and measurement of relatedness. Certain classifications of acquisitions into groups such as horizontal, vertical, product conglomerate, etc are limited in their ability to provide insights into the complex nature of relatedness (Lubatkin, 1987).

Although such classification might not necessarily be faulty, it is nevertheless suboptimal since it cannot indicate why these acquisitions might have varying degrees of success (Ramaswamy, 1997). According to Ramaswamy, these classification schemes provide a framework for detecting the potential for product-related synergies, but they do not take into account other possible sources of synergy e.g. organizational strategy, culture, or management philosophy.

2.3.2 Alternative views of Relatedness: Strategy, Managerial styles, and Resource Allocations

Research in strategic management has shown that organizations proactively design strategies to adapt themselves to the characteristics of their relevant external environments (Zajac & Shortell, 1989). Although these proactive strategies are firm specific, extensive empirical examinations have shown that common patterns of adaptive behaviour recur. These frequently occurring patterns of behaviour, referred to variously as generic strategies or strategic orientation provide a standard approach for studying firm-specific features such as market orientation, risk propensity, and relative emphasis on cost control or innovativeness.

Strategy researchers have used resource allocation patterns as indicators of the underlying strategies that organizations pursue (Zajac & Shortell, 1989). For example, firms pursuing low cost strategies typically exhibit relatively lower levels of operational expenditure than other firms. Similarly, firms following strategies based on product innovation reflect higher levels of R&D spending. In essence, the core aspects of an organization's strategic direction are visible in the resource allocation decisions that top management makes. Consequently, if two firms exhibit very similar resource allocation patterns as measured across a variety of strategically relevant characteristics (e.g. risk propensity, marketing, efficiency), they can be considered to be strategically similar (Ramaswamy, 1997). This concept of strategic similarity can be particularly useful in studying the consequences of acquisitions. Its appeal lies in its ability to encompass a wide variety of organizational and managerial factors that go beyond the confines of product-market attributes.

Very few studies have attempted to recast the notion of relatedness to include factors of organizational, strategic, and managerial importance (Chatterjee et al., 1992; Datta et al., 1991) Chatterjee and colleagues (1992) examined the impact of "cultural fit" between the target and acquirer in a sample of acquisitions. Their results showed that acquisitions in which there was a match between the target and the bidder on dimensions such as risk-taking attitude, reward orientation, innovation orientation, and autonomy orientation resulted in superior stockholder gains, and that those that involved cultural mismatches did not perform as well. In a study conducted along similar lines, Datta et al (1991) examined the performance impact of incompatibility in the management styles of acquirer and target firms. They found that inconsistency between the management teams of acquirer and target firms on factors such as decision-making approach, risk propensity, and time orientation was negatively related to post-merger performance. They reasoned that when acquisitions require an amalgamation of dissimilar management styles, a firm loses its ability to act in unison to realize the potential synergies arising from the acquisition, leading to poor performance. These two studies therefore provide evidence that consistency in key elements of the managerial or subjective culture of merging organizations is an important driver of post-acquisition outcomes.

Building on these studies, one can argue that mergers between firms emphasizing similar strategic characteristics will result in positive performance outcomes. For instance, if a firm competing on the basis of low cost and efficiency in operations were to merge with another one with a set of similar competencies, the resultant firm would be better positioned to fully exploit the synergistic benefits of combining similar skills (Prahalad & Bettis, 1986). The cost control emphasis would become more prominent and lead to greater efficiencies, derived from better economies of scale and scope. Minimization of conflicts arising from disparities in core competencies would contribute to better performance (Chatterjee & Wernefelt, 1988). Such performance outcomes would be difficult to achieve in mergers involving firms with widely divergent strategies.

Since divergence in strategic direction could indicate differences in the approaches that managements use to achieve competitive advantage, such variations might not be optimal (Ramaswamy, 1997). It is more likely that the post-acquisition phase of such mergers will be characterized by conflicts and dissent regarding future courses of action. For example, management incompatibility might lead to opposing views on critical decisions such as eliminating redundancies arising form the merger or rationalizing product lines (Datta et al., 1991). Given their distinctly different strategic approaches, the management teams of the target and bidder would find it difficult to reach consensus on critical aspects of operations that are crucial for the realization of synergies. Although this could be equally true in horizontal mergers between strategically similar firms, the potential for conflict is relatively low in such instances.

However, the impact of strategic dissimilarities and attendant cultural differences on post-acquisition performance might vary across merger types. For example, horizontal mergers involve a much closer and intensive interaction between the bidder and target organizations than do conglomerate mergers (Nahavandi &

Malekzadeh, 1993). Therefore, cultural mismatches might have greater consequences in horizontal mergers.

Prahalad and Bettis (1986) used the concept of "dominant logic" to reach similar conclusions. They suggested that members of the top management team of an organization share a dominant logic that arises through shared experience and organizational learning. This dominant logic is defined by them as "the way in which managers conceptualize the business and make critical resource allocation decisions..." (1986: p.490) Building on this concept, they argued that the dominant logic plays a critical role in the manner in which an organization utilizes its resources and achieves competitive advantage since it constantly filters managerial action and influences all top management decisions.

Therefore, the ability of top management to manage its acquisitions is viewed as a function of the extent to which the logics of a target and a bidder are similar. Since strategic similarity presupposes the existence of similar dominant logics, mergers between strategically similar firms are likely to provide greater benefits than those involving firms pursuing dissimilar strategies. Further, such mergers limit the need to develop and maintain multiple logics, change existing logics, or resolve cognitive conflicts that could arise from merging strategically dissimilar firms – all of which are processes that are long drawn and difficult to implement (Prahalad & Bettis, 1986). Hence the dominant logic approach also favours strategic similarity as a precondition for achieving better post-merger performance.

2.4 Challenges of the acquisition strategy

The use of acquisition as a growth strategy presents some challenges that have to be managed if positive post-acquisition performance is to be achieved. Tanner (1991) aptly describes these challenges as "the seven deadly sins of strategy acquisition". Perhaps the most serious of these is the choice of a wrong acquisition target. This error becomes apparent when the acquirer realizes that anticipated synergies just do not exist, the expanded market just isn't there, or that the acquirer's and target's technologies simply were not complimentary. The first step in avoiding this mistake is for the acquirer to carry out a strategic review to determine the strategic goals and identify the mission. The product of this review will be specifically identified criteria for selecting the target. The second step is to design and carry out an effective due diligence process to ascertain whether the target indeed has the identified set of qualities selected in the strategic review.

The second challenge is paying the wrong price. Even in a strategic acquisition, paying too much may lead to failure. Overpaying may divert needed acquirer resources and adversely affect the firm's borrowing capacity. In the extreme case, it can lead to business failure. This problem can be avoided by using the right valuation model. The model should incorporate assumptions concerning industry trends and patterns developed in the strategic review.

A third significant challenge is the use of the wrong structure in an acquisition. The legal structure chosen for the entities, the geographic jurisdiction chosen for newly created entities, and the post-acquisition capitalization structure selected for business are important success determinants. The wrong structure may lead to an inability to repatriate earnings (in the case of a foreign acquisition), tax disadvantages, or regulatory problems that delay or prevent realization of synergies. The two principal aspects of the acquisition process that can prevent this problem are a comprehensive regulatory compliance review and tax and legal analysis.

Fourth, poorly managed acquisition transactions can result in lost deals. Lost deals can usually be traced to poor communication. A successful strategic acquisition requires agreement upon the strategic vision, both with the acquiring company and between the acquirer and the continuing elements of the target. This should be established in the preliminary negotiations that lead to the letter of intent. Although the acquirer may justifiably focus on expenses, indemnification, and other logical concerns in the letter of intent, relationship and operational concerns are also important.

A fifth challenge of acquisitions is management difficulties. Lack of attention to *management issues may lead to a failed acquisition. These problems can range* from a failure to provide management continuity or clear lines of authority after a merger to incentives that cause management to steer the company in the wrong direction. Issues of management compensation structure must be designed to achieve goals identified in the strategic review. Financial rewards to management must depend upon the financial and strategic success of the combined entity.

Tanner (1991) refers to the sixth challenge as *the closing crisis*. The closing crisis may stem *from unavoidable changed conditions*, *but most often* they result from poor communication. Negotiators sometimes believe that problems swept under the carpet maintain a deal's momentum. These problems need to be addressed openly when they arise, or they may resurface and prevent the deal's consummation.

The last of the challenges is referred to as *the operating transition crisis*. Even the best conceived and executed acquisition will prevent significant transition and post-closing operation issues. Management time and energy must therefore be spent to assure that the benefits identified in the strategic review are achieved. The principal constraints on smooth implementation are usually human. The most common are *poor interaction between the two pre-existing management* structures and resistance to new systems. Problems may also arise from paying too much attention to the strategic vision and too little attention to the nuts and bolts of continuing business operations.

3. RESEARCH METHODOLOGY

3.1 Research design

The research was conducted using a case study design. The appropriateness of this design lies in the heterogeneous nature of the strategy under study. The experience of each acquisition is largely unique to the firm undertaking the venture. This called for an in-depth study to enable a greater understanding of the dynamics involved. The ability of the case study design to probe deeper into the issues therefore made it appropriate.

3.2 Data collection

The study utilized multiple sources of data. Primary data was collected from an in-depth interview with the Associate Director at CFC who acted as the lead acquisition transaction advisor. The interview was conducted using a semi-structured interview questionnaire. The unstructured portion of the questionnaire sought elaborations of the structured answers and helped to capture information that was not explicitly asked for. The researcher also used the interview session to clarify and elaborate on information gathered from secondary sources. Secondary data showing the company's financial performance was solicited from the firm's library and other external sources.

3.3 Data Analysis

The data was analyzed by use of content analysis. The data collected was qualitative in nature, and any quantitative data is only important in corroborating the findings existing in qualitative form. Since the objective of the study is restrictive to the nature of information, content analysis was the most appropriate tool for analyzing the data. Thuo (2003) and Bansal (2005) used similar approaches to qualitative analyses in their respective related studies.

4. RESEARCH FINDINGS AND DISCUSSION

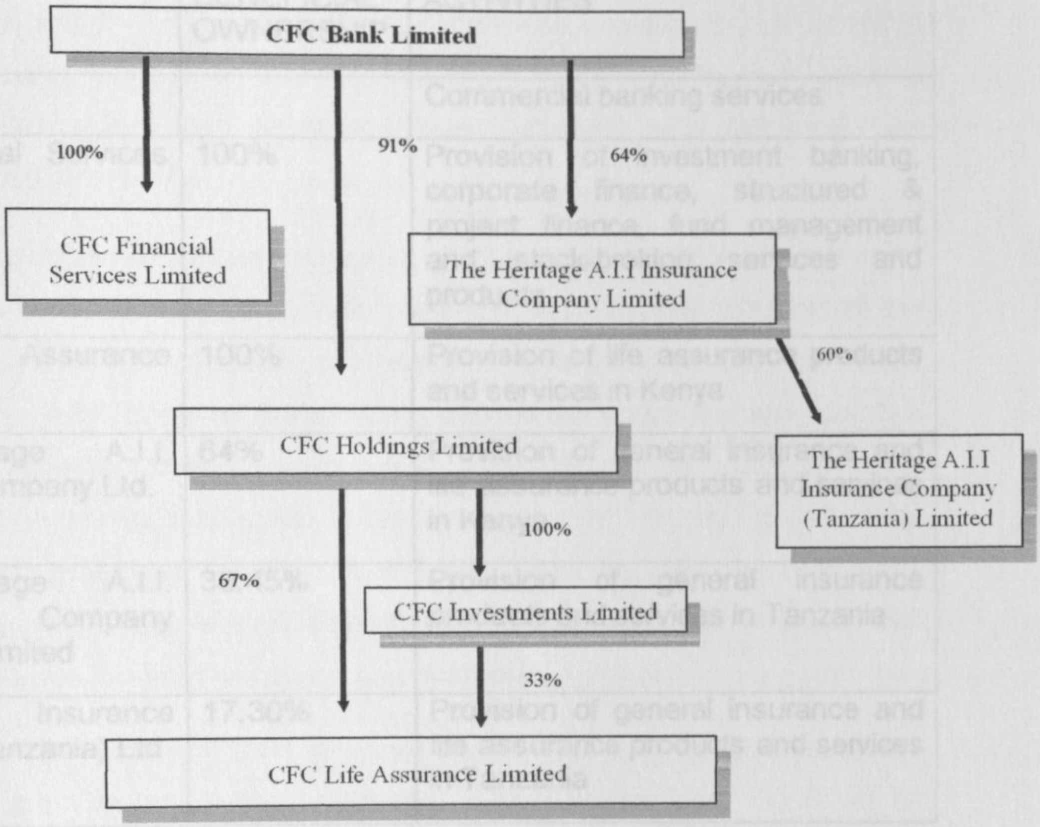
4.1 The Organization's acquisitions profile

The key milestones in CFC Bank's growth history include five successful acquisitions/merger transactions. The first acquisition was in 1992 when the company embarked upon a diversification programme and acquired a substantial interest in The Heritage Insurance Company Limited. The second acquisition was in 1995 when CFC Bank acquired a controlling interest in African International Insurances Limited. In 1997, The Heritage Insurance Company Limited merged with African International Insurances Limited to form The Heritage A.I.I. Insurance Company Limited ("Heritage A.I.I. Insurance").

In 2002, CFC Financial Services acquired Equity Stock Brokers Limited and subsequently became the first non deposit taking investment bank to be licensed by the Capital Markets Authority. The year 2004 saw a fourth acquisition transaction with The Heritage A.I.I. Insurance Company (Tanzania) Limited acquiring 45% of the shares of Alliance Insurance Corporation of Tanzania Limited. In the same year, CFC Holdings and CFC Investments, both wholly owned subsidiaries of CFC Bank, acquired the life assurance business of American Life Insurance Company Kenya Limited (then a subsidiary of American Life Insurance Company Inc. and now known as CFC Life). Pursuant to the acquisition, CFC Group became the second largest provider of life assurance products and services in Kenya.

Today, CFC is a financial services group with a comprehensive range of products and services with total assets of approximately Ksh 30 billion. The CFC Group structure and CFC Bank's direct and indirect equity interests in subsidiary companies, is set out in figure1 below:-

Figure 1: Corporate structure



Source: CFC Shareholders Circular (2004)

4.2 CFC Corporate Structure

CFC Bank is both an operating company providing commercial banking services and products as well as a holding company with substantial direct and indirect equity interests in companies involved in investment banking, general insurance, life assurance and other investments.

CFC Bank is commonly referred to in the market place as "CFC group" as a reflection of its diverse business activities. The table below sets out the subsidiaries under CFC Bank, and the activities they are involved in.

Table 1: CFC Bank's ownership in subsidiary companies

COMPANY	BENEFICIAL OWNERSHIP	ACTIVITIES
CFC Bank		Commercial banking services
CFC Financial Services Limited	100%	Provision of investment banking, corporate finance, structured & project finance, fund management and stock-broking services and products
CFC Life Assurance Limited	100%	Provision of life assurance products and services in Kenya
The Heritage A.I.I. Insurance Company Ltd.	64%	Provision of general insurance and life assurance products and services in Kenya
The Heritage A.I.I. Insurance Company (Tanzania) Limited	38.45%	Provision of general insurance products and services in Tanzania
Alliance Insurance Company (Tanzania) Ltd	17.30%	Provision of general insurance and life assurance products and services in Tanzania

Source: CFC Bank Shareholder's Information Memorandum (2005)

4.3 Motivations for CFC's previous acquisitions

As mentioned above, CFC has been involved in five acquisitions since its establishment more than 50 years ago. That all these transactions occurred between 1992 and 2005 is consistent with the global popularity of acquisitions as a growth strategy during this period. Prior to 1992, the company's development was organic.

The motivations for these acquisitions were varied but related. The acquisition of Heritage Insurance in 1992 was a result of a diversification programme the company had embarked on. During this period, the banking industry in Kenya was going through rough times that saw several bank and non bank financial institutions close their doors. The large proportions of bad quality assets, mainly in the form of non-performing debts and unsecured / under secured loans, came biting on the industry. CFC, whose strategy then was centered on conservative but steady growth, decided to diversify into the insurance business in order to protect its shareholders from what was then perceived as a relatively risky banking industry.

Its second acquisition of African International Insurances Limited was driven by the need to consolidate the gains made following CFC's successful entry into the insurance business. This acquisition enabled CFC to increase both its market coverage and market share in the industry, without the rigors and long duration that internal growth would have required. However, as is expected when operating two horizontal businesses in the same industry, the need to streamline operations in order to realize synergistic benefits became apparent. Consequently, in 1997, African International Insurances was merged with Heritage Insurance to form Heritage A.I.I. Insurance.

CFC Financial Services (CFCFS), a wholly owned subsidiary of CFC Bank was licensed by the Capital Markets Authority (CMA) in the year 2000 as an investment advisor and dealer in the Nairobi Stock Exchange. However, being a heavily regulated industry, the activities that CFCFS could undertake as an investment advisor were limited. To become a one – stop financial services provider, the company needed to achieve investment bank status. The acquisition of Equity Stockbrokers Limited in 2002 was to enable CFCFS achieve this. CFCFS became the first non-deposit taking investment bank to be licensed by the CMA. The company widened its activities to include investment banking, corporate finance, structured and project finance, and fund management, in addition to stock broking services and products. This positioned CFCFS to appropriately take advantage of the growing demand for these services by corporate clients and high net worth individuals.

CFC has substantial interests in Heritage A.I.I. Insurance (Tanzania) through Heritage A.I.I. which owns 60 percent of the Tanzania operations. In 2004, The

Heritage A.I.I. Insurance Company (Tanzania) Limited acquired a significant stake in Alliance Insurance Corporation (45%) with resultant market share increase in the insurance market for small and medium sized businesses in Tanzania. Currently, Heritage A.I.I. Insurance Company (Tanzania) Limited is the leading general insurer in Tanzania and has consistently posted satisfactory profits. This acquisition was meant to enhance the group's presence in insurance in the East African region.

Heritage A.I.I. ranks amongst the top ten composite insurance companies in East Africa. Although it ranks amongst the top five general insurers in Kenya, the company has a small but rapidly growing long term insurance business. The existing management team in Heritage A.I.I. comprises largely of general insurance experts with a relatively low life assurance staff count. It is this lack of expertise on life assurance business that informed the CFC Group's largest acquisition yet, which is discussed in more detail below.

4.4 The ALICO Kenya acquisition

In 2004, CFC made its boldest and biggest acquisition. By this time, the group's interests in the insurance industry had grown significantly through Heritage A.I.I. However, Heritage's insurance business is largely general insurance comprising motor, domestic packages, professional indemnity, etc. The company wished to grow its small life assurance business but lacked the in-house competencies to do so. The proposed divestment by ALICO from life assurance business in Kenya therefore presented CFC with an opportunity to enhance earnings emanating from life assurance business on an immediate basis, in comparison to the organic growth option via Heritage A.I.I. which would be time consuming. It is worth noting that the life assurance industry in Kenya offers significant growth opportunities, specifically individual life business class, which remains a largely untapped market. CFC's acquisition of ALICO has made them the envy of many industry players. In order to appreciate the magnitude of this particular acquisition, it is necessary to give a brief background of the acquired business.

4.4.1 Background of ALICO Kenya

ALICO Kenya, a composite insurance company, was incorporated in 1962 initially as a branch office of American Life Insurance Company, State of Delaware, USA. As at the time of the acquisition, ALICO Kenya was ranked amongst the top three largest general insurance and life assurance underwriters in Kenya with a geographical operating presence in 9 cities and towns, with approximately *550 agents and 200 staff members*.

ALICO Kenya serviced over 200 corporate clients spread across different economic sectors *from small to large domestic businesses*, diplomatic missions, subsidiaries of multinationals, non-governmental institutions, and state owned enterprises. In addition, the company had approximately 100,000 individual clients. ALICO Kenya had over the years consistently posted a surplus on an annual basis.

The company was jointly owned by ALICO of Delaware USA which had 67% shareholding in ALICO Kenya, and Trans-National Group Limited (TNG) which had 33% shareholding. ALICO USA was extending technical and managerial support to ALICO Kenya. TNG was a wholly owned subsidiary of Trans-National Bank.

4.4.2 Rationale for the ALICO Kenya acquisition

The directors and management of CFC Bank believed several benefits would be derived from the *acquisition of ALICO Kenya's* life assurance business. Foremost, it resulted in the creation of a premier financial services group. The acquisition presented a unique opportunity for CFC Group to significantly advance its position as a leading financial services company in East Africa rendering a comprehensive range of financial services and products (i.e. commercial banking, custodial services, general insurance, long-term insurance, corporate and structured finance, stock broking, and fund management) to institutional, corporate, and individual clients.

The acquisition was in line with CFC Bank's initiatives that are designed to *delivering substantial value to shareholders by pursuing attractive growth* opportunities. The life assurance industry in Kenya offers a great deal of potential due to low penetration levels. In this context, the acquisition resulted in CFC Group becoming a leading provider of insurance products and services (both general and life assurance) in East Africa combining ALICO Kenya's leading position in the life assurance market with Heritage A.I.I's small but rapidly growing life assurance business, in addition to the latter's competitive advantage in the general insurance market. It was perceived that the limited overlap across Heritage A.I.I. and ALICO Kenya *business lines and the resultant* expanded customer base would in turn have a positive influence on underwriting profits emanating from insurance business lines, in addition to potentially advancing CFC Bank's foothold in the consumer/personal banking market.

In addition, the directors believed that the acquisition would result in synergy benefits and increased *management capacity. Synergies would be achieved in* terms of products and services offered by both Heritage A.I.I. and ALICO Kenya, specifically in life assurance business with resultant economies of scale in areas such as information technology, investment management and other support functions. This would result in favourable terms of trade with key stakeholders (i.e. reinsurance partners, insurance brokers/agents, etc.), and competitive advantage in terms of service delivery and premium pricing. The enlarged life business would therefore be well positioned to pursue further growth opportunities.

It was believed that there would be no overlap in management as ALICO staff comprised of *personnel with vast working experience in the* life assurance business whilst the management team at Heritage comprises largely of general insurance experts. Accordingly, the strategic vision was to extract client and capability synergies of both ALICO Kenya and Heritage A.I.I. The increased management capacity would facilitate rapid growth.

4.5 Key issues in the ALICO Kenya acquisition

A strong case for the use of acquisition is that it can enable a company grow faster than if it relied on organic growth. However, it should be noted that this strategy is not a guarantee for successful growth. As mentioned earlier, most acquisitions do actually result in lower returns to the shareholders. If not properly crafted, mergers and acquisitions can have disastrous consequences to both the acquiring and the acquired firms. Below, the research delves a little deeper into the process of acquisitions to enable appreciation of the hard work that goes into successfully completing an acquisition transaction. The researcher singled out the ALICO Kenya acquisition for detailed discussion for two reasons. First, it is the biggest acquisition the group has made, and secondly, it is the most recent so the facts were still fresh in the minds of the current management.

The acquisition was crafted under specific negotiated terms and conditions. First, was that CFC Bank, through its wholly owned subsidiary CFC Holdings Ltd, would acquire from ALICO USA its 67% shareholding in ALICO Kenya for a purchase consideration of Kshs 1.23 Billion. Simultaneously, CFC Bank, through its wholly owned subsidiary CFC Investments Ltd, would acquire TNG from Trans-National Bank for a purchase consideration of Kshs 613.7 Million, consequently becoming the beneficial owner of 33% of ALICO Kenya.

Secondly, in terms of the definitive agreement, ALICO, AIG Kenya and Trans-National Bank were restrained for a period of three years from carrying on or engaging in any aspect of life assurance business in Kenya. The purpose of this clause in the agreement was to protect CFC against a scenario where the former owners of ALICO used their expertise to set up a competing business, thereby eroding the value of the goodwill of the acquired business.

Third, to avoid confusion in the market place, it was also agreed that the name ALICO Kenya be changed to CFC Life Assurance Company as the ALICO brand name belongs to ALICO USA. The definitive agreement and the disposition agreements included warranties and indemnities, which are usual in an acquisition of this nature.

4.6 Stages in the acquisition process

4.6.1 Preliminary discussions

The acquisition of ALICO Kenya was a single bidder transaction, meaning that there were no competing bidders for the life assurance business. CFC therefore did not have to engage in a bidding contest, and only had to make a satisfactory offer to ALICO Kenya's shareholders. The process began with several preliminary discussions after ALICO Kenya made it known to CFC Bank that it was seeking a strategic investor to take over its life assurance business.

Following these preliminary discussions and after CFC Bank showed a willingness to discuss the proposed acquisition, a memorandum of understanding (MOU) was prepared and executed by both parties. Because some of the information that was to be exchanged at this stage was confidential, a confidentiality agreement was prepared and executed by both parties. This agreement served to bind the parties involved not to disclose information furnished during the transaction to outsiders. This was necessary to avoid leaking of information, especially to competitors of both CFC and ALICO Kenya. Pending tentative agreement on the key issues discussed in section 4.5 above, the acquisition negotiations were generally very secretive in nature. It is for this reason that the negotiating teams of both CFC and ALICO Kenya consisted of only a handful of senior management and directors from both sides. It was at this stage that formal negotiations began.

The negotiators on both sides comprised of the respective Managing Directors and their respective transaction advisers, whom for CFC was the Associate Director at CFC Financial Services. Other members of the negotiating team included the due diligence partners charged with giving expert advice on both sides. For CFC, these included senior representatives from the audit firm KPMG and the law firm of Kaplan and Stratton Advocates. The negotiations were deliberately handled by top most managed to facilitate quick decision making. The idea was to minimize reporting and decision making time that would be necessary if the negotiators were from lower levels of management.

The Managing Director of CFC led the team and was mandated by the board of directors to make certain decisions upon consultation with his team of experts, provided the decisions were within financial and structural parameters given by the directors. Decisions outside the given parameters would have to be referred back to the board of directors for discussion. Negotiations were intense and conducted through face to face as well as telephone conference meetings. The negotiations involved meetings in Nairobi with representatives of both parties attending from Kenya, the USA, and South Africa. The USA representatives were from ALICO's parent company, while the South African ones represented American Insurance Group, who would be the new headquarters for ALICO's general insurance business after the acquisition. Some meetings required CFC representatives to travel to the USA. These meetings were usually extremely lengthy, going on for hours at a time as concerned parties tried to agree on the parameters of the transaction. Several of these were held over a period of approximately 18 months before an agreement was reached.

4.6.2 Due diligence

Due diligence involves engaging of experts to extract and thoroughly examine relevant material information pertaining to a company's assets, liabilities, and business operations. CFC Bank was acquiring ALICO Kenya as a going concern. The implication of this is that the acquirer takes over all assets and liabilities, both seen and unforeseen. In order to protect shareholders, CFC had to do a due diligence on ALICO Kenya to ensure that there was full disclosure of any material information that may affect the business' operations in future, or erode the value of the business. To this end, due diligence was conducted in three areas, legal, tax, and finance. A law firm – Kaplan and Stratton Advocates conducted the legal due diligence, while KPMG, an audit firm carried out the tax and financial due diligence. Findings were discussed and clarifications were sort on all pertinent matters to uncover any information that may have affected CFC's decision or had implications on the offer price.

The legal due diligence involved a verification of the ownership of ALICO Kenya's assets. ALICO had to provide relevant ownership documents e.g. the title document to their office building. The law firm then conducted searches with relevant government departments to authenticate ownership, and establish if any land rent or rates were outstanding. The law firm also studied material contracts between ALICO and various parties. For example, contracts with the reinsurance companies and major insurance policy contracts were checked to see if they would be nullified by the acquisition. Statutory issues e.g. filing of annual company returns and relevant board minutes with the registrar of companies were also analyzed to ensure that there were no skeletons in the closet that CFC did not know about. Pending court cases and their subsequent liabilities if lost were also scrutinized. This enabled CFC to carry out an assessment of contingent liabilities and get an expert legal opinion of the exposure to be indemnified by ALICO Kenya. Contingent liabilities are those resulting from pending cases that have not yet been determined, but have to be provided for.

The financial due diligence involved studying ALICO Kenya's audited financial accounts, with a focus on the last three years. In addition, KPMG was given access to all management accounts and reports. All supporting documents had to be availed for the auditor's perusal. The detailed audit was meant to ascertain ALICO's financial position as reported in the company's balance sheets, income statements, cash flow statements, and statement of changes in equity. An integral part of the financial due diligence was claims provisioning. An important part of this was determining the amount of outstanding accounts receivable. The statutory requirement for remitting insurance premiums is 60 days. Therefore any monies that had not been remitted after this period had to be provided for as outstanding receivables. The taxation due diligence involved ensuring that ALICO's various tax obligations to the government had been met. This required an analysis of the company's tax position as far as Corporate Income tax, Pay As You Earn (P.A.Y.E.) tax, Value Added Tax (V.A.T.), and any stamp duty taxes payable.

The due diligence uncovered important information especially in regards to contingent liability claims. For some of these, ALICO Kenya had to indemnify CFC from possible losses; for others, provisions had to be made to cover possible losses. Where provisions had to be made, the effect was a downward renegotiation of the price to reflect this. However, most of the findings were considered regular for a transaction of this magnitude and no major issue stood out as a deal breaker. The main issue of negotiation was agreeing on the purchase price.

4.6.3 Valuation

CFC contracted the services of external accountants (KPMG) to value the total net assets (including goodwill) of ALICO Kenya. The valuation process was critical as it determined the price that CFC eventually offered for the business. The purchase consideration was largely informed by this independent valuation. One can appreciate the amount of work that was needed to value a company the size of ALICO Kenya which had an operational presence in 9 cities and towns.

The product of the valuation process was the valuation report. The purchase consideration was the most negotiated of all issues during the transaction and it was therefore important that the valuation report was accurate. The valuation report gave a feel of the indicative business value and was used by CFC to support the financial negotiations.

The valuation process was done using three different methods – the discounted cash flow method, the price-earnings (P.E.) method, and the embedded value method. The discounted cash flow method focused on ALICO's cash inflows and outflows while taking into account the timing of the cash flows. In other words, it considered the time value of the cash flows by using a rate that discounted them to calculate their present value. The price-earnings method was calculated by dividing the value per share of ALICO's ordinary shares by the earnings per share. The embedded value method used an insurance valuation of assets. Under this method, assets were carried at market or cash value, and long term liabilities not in default of interest or principal payments were carried at their amortized value. Long term liabilities in default were carried at market value.

4.6.4 Technical advice

In addition to the independent financial valuation, the acquisition transaction was guided by technical advisers who were well versed on the inner workings of insurance businesses. The role of the technical adviser was played by an insurance actuarial expert from Alexander Forbes who conducted an independent actuarial valuation. This was necessary to ascertain the value and risk measure of the various life fund components of ALICO Kenya, which include ordinary life assurance, group life assurance, pension schemes, and group medical insurance. The actuarial valuation also served to ensure the integrity of the valuation reports previously prepared. The risk expert accessed the composition of the life fund visa vis the composition of the long-term assets used to back them. Though long-term, assets used to underwrite life insurance must be liquid assets.

The most relevant information during this process was whether the ALICO life assurance fund had a surplus or a deficit. A surplus meant that the amount available was more than the liabilities needed to meet obligations to the company's policyholders. On the other hand, a deficit meant that the fund did not have enough money to meet obligations to policyholders. Also of importance was whether any surplus had been paid out of the fund to shareholders and, if so, whether this was done in accordance with the regulations of the insurance act which limits the amounts payable. The actuarial valuation reported that the fund had a surplus of approximately Kshs. 820 Million.

4.6.5 Negotiation of purchase consideration and terms of acquisition

Armed with its due diligence findings, the actuarian's technical advice, and the independent valuation, CFC Bank made their offer to purchase ALICO Kenya, and terms under which this offer was made. The two parties then negotiated on the offer and terms of the acquisition until they both reached agreement. In making its offer, CFC had to make provisions for claims outstanding. The bank also had to make some provision for unforeseen liabilities, because it is possible that the due diligence could have missed some information, or that the liability claim erupts soon after acquisition.

The fair value of the assets of ALICO's life business was assessed at Kshs. 6.8 billion. The fair value of liabilities and contingent liabilities provided for was Kshs. 3.8 billion. The actuarial value of the life fund was assessed at Kshs. 2.2 billion, leaving a net fair value of assets at Kshs. 819.7 million. After lengthy negotiations, the parties agreed on a goodwill value of the ALICO life assurance business. Goodwill is the amount in excess of the fair net asset value paid for an acquired company. The goodwill was negotiated at Kshs. 1.08 billion. The purchase price for ALICO's life business was therefore the sum of the fair net asset value plus the goodwill, which was Kshs. 1.9 billion.

The Implications of the acquisition on the ALICO business' working relationships were also discussed. For example, it was important for the CFC to know how the acquisition was going to affect relationships with brokers and suppliers, especially where those relationships were on favourable terms to ALICO. After agreeing on the purchase consideration and the terms of the acquisition, the parties then entered into a Definitive Agreement spelling out these details in September 2004. This agreement was however subject to certain precedent conditions.

The first condition was that the acquisition was subject to the approval of CFC Bank shareholders. Secondly, ALICO had to apply for registration by the Minister for Finance (through the Commissioner of Insurance) to carry on its general insurance business as AIG Kenya Limited. Third, the Minister for Finance had to approve the transfer of certain assets and liabilities of ALICO Kenya's general insurance business to AIG Kenya. Fourth, the Minister for Finance had to approve the transfer by ALICO and TNG and the acquisition by CFC of the entire paid-up share capital of ALICO Kenya. Finally, an unconditional authorizing order from the Minister for Finance, this time through the Monopolies and Prices

Commissioner, had to be given to CFC. The purpose of this condition was to ensure compliance with the Restrictive Trade Practices, Monopolies and Price Control Act which was meant to ensure that the acquisition would not create a monopoly advantage for CFC in the insurance industry.

4.6.6 The final stages

In October 2004, a circular was issued to shareholders of CFC Bank giving them information on the proposed acquisition, and giving them notice of an Extra-Ordinary General Meeting (EGM) convened on 22nd November 2004 for the purpose of approving this acquisition. The issuing of the circular complied with the requirements of the Capital Markets Authority regulations for publicly listed companies.

The EGM approved the acquisition and on 15th December 2004, the Group acquired ALICO's and TNG's respective shareholdings in ALICO Kenya. There was no noteworthy resistance, and the shareholders of CFC voted by landslide majority in favour of the acquisition. It is worthy of note that TNG was involved at all stages of the negotiations. Though TNG was the minority shareholder, it had preemptive rights over the purchase of ALICO's shares in ALICO Kenya. Preemptive rights required that TNG was given the right to purchase any shares being sold before they are offered to outsiders. Therefore, for the transaction to materialize, they had to waive this right. As a result of the acquisition, the CFC Group became the second largest provider of life assurance products and services in Kenya.

4.6.7 Integrating the business

The integration process took place at four levels. The first level was ensuring the employees of ALICO had faith in CFC. The idea was to make the employees confident that they had strong shareholders. The second level was ensuring business as usual. This was done through maintenance of the same or better standards of service delivery. This was necessitated by the need to minimize disruption to business operations. The most important tool at these two levels of integration was communication to clients, employees, suppliers, brokers, and agents to keep them informed on the goings-on and the effect of the acquisition to their continued relationships. Arrangements were made to have material contracts continue during the integration phase.

The third integration level dealt with the business systems and processes. A key integration activity here was the system of reporting which had to be changed from international to local, as the parent company was no longer based in the USA. The fourth integration level involved looking at ALICO's human resource policy and remuneration to ensure compliance with the other CFC Group companies. Qualified employees had to be retained and promoted where necessary.

CFC maintained most of the middle and lower level staff, but made a number of changes at top management level. The Managing Director who was an ALICO parent company appointee was replaced by a CFC appointee. Other changes included the promotion of the financial controller at ALICO to Director of Finance in charge of CFC Life, Heritage A.I.I., and CFC Bank. The Human Resource Manager and the Group Medical Manager were also replaced. The only top managers untouched by the changes were the Marketing Manager and the Customer Service Manager. This was beacuse CFC did not want to make changes that may affect relationships with key clients. The other staff changes were to enable parental control despite CFC Life's semi-autonomous operations. The challenge for CFC during this process was to make changes needed for more efficient management and control, while at the same time trying not to disrupt business operations. This explained why the top managers charged with managing client relationships were left unchanged.

The structure of ALICO facilitated a smoother integration phase. The life assurance business was run autonomously from the general insurance business, and so each had its own structures. CFC inherited these structures and continued to run the business as an autonomous operation. Their insurance firm, Heritage A.I.I., continued to have its own structures and operations as it specializes in general insurance. The limited overlap between the two companies enabled them to operate independently and therefore minimized the challenges that would have come with a full integration exercise requiring a union of structures, systems, and processes. The level of integration for ALICO was therefore not high. This reduced the complexity of the post-acquisition process.

As can be expected of an acquisition transaction of this magnitude, all was not smooth sailing. CFC experienced some resistance to this integration process. This resistance was mainly from employees who were not happy with the changes being made. A few of the employees even resigned in the process. Resistance was also experienced from certain clients who decided not to renew their insurance contracts, citing uncertainty in the business following the acquisition. Overall, however, the integration phase was smooth and devoid of any major disruptions.

4.7 The effect of the acquisition on CFC Group's performance

The last 5 years has seen a tremendous growth in the assets and profitability of CFC Group. Most of this growth can however be attributed to the acquisition of ALICO Kenya. This acquisition alone accounted for an increase of almost Kshs. 7 billion in the group's balance sheet.

The group has also recorded significant growth in its banking & financial services division mainly due to increased loans and advances resulting in higher interest income, and an increase in income from financial services. So far, the Group's strategy of aggressive acquisitive growth in its insurance division coupled with a more conservative but focused and mainly organic growth from the banking side seems to be paying dividends. Tables 2 and 3 below summarize the performance of the insurance division and the Groups consolidated performance respectively.

As can be seen from Table 2, the insurance division's assets grew by 345%, and profits more than doubled at the end of 2004. The growth in assets was mainly due to the acquisition of ALICO by CFC Bank, and that of 45% of Alliance Insurance Corporation (TZ) in the same year. The 2004 post ALICO acquisition financial performance of CFC in terms of assets and income growth attest to the success of this acquisition to CFC's growth strategy in its insurance division.

Table 2: CFC Insurance Division Performance (Amounts in '000s)

Year	Assets (Kshs 000s)	Income	Profit	**Assets Growth**	**Profits Growth**
2000	2,163,430	824,792	218,704		
2001	2,112,290	927,502	231,623	**-2%**	**6%**
2002	2,620,335	1,033,764	272,317	**24%**	**18%**
2003	2,956,060	1,382,630	249,958	**13%**	**-8%**
2004	13,148,851	2,404,277	549,096	**345%**	**120%**

Source: Information Memorandum to CFC Shareholders (2005)

Table 3: CFC Group's Consolidated Performance (Amounts in Kshs '000s)

Year	Assets	Income	Profit	**Assets Growth**	**Profits Growth**
2000	9,886,378	1,895,588	403,065		
2001	10,412,367	2,177,102	342,919	**5%**	**-15%**
2002	11,865,387	2,125,955	429,540	**14%**	**25%**
2003	16,430,346	2,731,595	529,966	**38%**	**23%**
2004	29,815,562	3,895,295	880,896	**81%**	**66%**

Source: Information Memorandum to CFC shareholders (2005)

4.8 Relatedness of CFC's acquisitions

CFC group is currently organized into two major divisions – banking and related services, and insurance. The principal activities of the banking and related services division include taking deposits, lending to customers, and provision of financial, advisory, and stock broking services. The principal activity of the insurance division includes insuring risks for all classes of insurance business.

CFC's first acquisition of Heritage Insurance was motivated by the need to seek diversification from the banking industry. As a result, the direct relatedness of the acquisition to CFC's core business was not a major consideration. Nonetheless, though the acquisition diversified CFC into a new industry, there was some market relatedness in terms of the bank's and the insurance company's clientele. There are also some shared threads in the banking and insurance, as financial investments play a pivotal role in both industries.

All subsequent acquisitions have been insurance related acquisitions which were all aimed at increasing market share, entering new geographical markets (to either take advantage of new clients or enable regional service delivery to existing clients), or to attain critical mass so as to enhance efficiencies and enjoy economies of scale.

CFC Group can therefore be said to be pursuing a related acquisition strategy to grow its insurance businesses. Indeed some of these related acquisitions have been horizontal acquisitions merging two competing businesses. The banking division of the business has however been developed organically.

4.9 Synergistic benefits of CFC's businesses

Apart from shareholder pressure for incremental earnings, CFC's robust acquisition strategy in the last decade has been driven by a vision to become a premier financial services group which positions itself as a leading financial services provider in the East African region. To achieve this, the company had to grow its businesses to enable it render a comprehensive range of financial services and products.

Because of the relatedness of its businesses, CFC is enjoying synergies with resultant economies of scale in areas such as information technology, investment management, and other support functions. The company is laying structures intended to derive other potential synergies in terms of cross selling its products and services. For example, a typical life insurance client from its latest acquisition – ALICO Kenya – has needs that span the entire spectrum of services and products provided by the group. This client needs banking services and most likely has a bank account. This offers an opportunity for CFC Bank which is currently strategizing to make an entry into the retail banking business,

The same client may have property e.g. a car that requires insurance against various risks. The general insurance can therefore be offered by Heritage A.I.I. Insurance. At the same time, the insurance premium financing requirements for their insurance can be met by CFC Bank. The client's investment needs at the Nairobi Stock Exchange can be met through CFC Financial Services. Business clients may require asset financing which is also available from CFC Bank, and life insurance products can be provided by CFC Life Insurance Company.

With the possibility of cross selling all these services, CFC can gain significant competitive advantage by marketing itself as a one-stop shop in financial products and services. CFC can therefore tailor packaged products to meet individual customer needs. The convenience and enhanced service delivery of such a product can attract premium pricing.

5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The increasing popularity of acquisition as a growth strategy is driven by the need to keep up with a changing and competitive business environment. A compelling reason for the use of acquisition as a corporate growth strategy is the speed with which it allows a firm to enter new product or market areas. In rapidly changing market situations, the internal development process is too slow. Acquisition allows a company to acquire or improve resources and competences needed to compete successfully. However, acquisitions are risky transactions, and most of them result in lower returns to shareholders.

There are certain key success factors that influence post-acquisition performance. One of these is the *relatedness of the acquisition*. Related acquisitions where there is some level of product-market relatedness between target and bidder firms is a desirable characteristic that can help post-acquisition performance. Related acquisitions help firms avoid situations that require undeveloped skills, such as serving new customers and markets, acquiring new technology, or facing new competition. The relatedness of the target and bidder firms also makes it easier to harness synergies between the two.

Another important success factor is the management of the various acquisition stages in the *acquisition process. The due diligence must* be detailed and accurate so as to uncover any material information that may affect the value of the target firm, or expose the bidder firm to risk of loss. Similarly, the valuation and technical advice stages must involve experts who can apply appropriate valuation and technical knowledge tools to arrive at the correct value of the firm.

A critical factor is the management of the integration phase of the acquired business. Appropriate communication tools must be used at this stage to ensure that the employees of the acquired firm feel secure and have confidence in the new shareholders. The transition to new systems and processes must be carefully managed. Human resource management is important here as the new owners must make changes needed for more efficient management and control, while at the same time trying not to disrupt business operations.

Growth through acquisition presents some challenges that can result in a failed transaction if not appropriately addressed. Perhaps the worst of these is the choice of a wrong acquisition target, which is realized when anticipated synergies do not materialize. Another challenge is ensuring that the right price is paid for the acquisition. Overpaying may divert needed resources and adversely affect the firm's borrowing capacity. This can lead to operating losses and even business failure. Other challenges involve the use of the wrong structures to handle the post –acquisition integration of the businesses. Wrong organizational structures can lead to management difficulties that may create a transition crisis, with devastating effects to business operations. Similarly, the wrong legal structure may lead to an inability to repatriate earnings (in the case of a foreign acquisition), and to regulatory problems that delay or prevent realization of synergies. Issues of cultural and strategic fit also pose great challenges to a company during the integration phase of the acquisition. The effect of a cultural misfit amongst the target and the acquirer is even more prominent in a horizontal merger where the businesses need to merge operations under one roof.

5.2 Conclusions

Until now, CFC Bank has managed to achieve tremendous growth in its insurance division by using an acquisition strategy. The success of its acquisitions can be partly attributed to the company's choice to ensure that it engages only in related acquisitions. This strategy enables the company to use its core competencies and capabilities to grow its businesses, while at the same time avoiding acquisitions that require undeveloped skills or expose them to new product-markets and new competition.

Equally important to CFC's successful acquisitions was the effective management of the acquisition process. Each stage of the acquisition from the preliminary discussions, to due diligence, to the technical advice and valuation stages was carefully and professionally managed and experts engaged to ensure that the right price was paid and CFC's risk exposure minimized. Of critical importance was the management of the integration of the acquired business into CFC's operations to ensure a strategic fit which resulted in synergistic benefits to the group's businesses.

The study shows that if well undertaken, an acquisition strategy can be used successfully in the Kenyan insurance industry. Related acquisitions can result in synergies that enhance operating efficiency through economies of scale. Additionally, mergers and acquisitions can accelerate entry into new markets, increase market share, and enable firms achieve a wider geographical presence. Through the acquisition of ALICO Kenya, CFC has managed to create an almost instant dominating presence in Kenya's insurance industry becoming the second largest provider of life assurance products. It has been able to grow its market share significantly in the Tanzanian insurance industry through the acquisitions of Alliance Insurance Corporation and Strategis Insurance Company by Heritage A.I.I. Tanzania.

5.3 Recommendations

As has been mentioned above, wrong structures can lead to an inability to realize the synergies that motivated the acquisition in the first place. In addition, issues of cultural and strategic fit should be addressed to ensure that these do not impede or unnecessarily delay synergy realization. Post-merger integration should therefore seriously consider the impact of these factors to successful performance.

To reduce both employee and systemic resistance during integration, change management must be practiced at every stage. After an acquisition, it is important to ensure business as usual first, and to make the employees of the acquired firm feel like they are still part of the team, rather than assets of a new owner to do with them as they please. To ensure normal operations that do not affect customers, it is important not to rock the boat too hard.

Nevertheless, management must set out to derive the anticipated benefits of the acquisition. Key to CFC's five year strategic plan is the exploitation of CFC Group's synergies in cross selling of products and services. As the acquisition dust settles, I would recommend that CFC does a research profiling its clientele base across its various businesses, and to ascertain the potential of realizing significant cross selling benefits. If the results of the profiling suggest significant similarities across businesses, then the group may want to consider centralizing its marketing operations. Not only will this save marketing operations costs, but it will enable better co-ordination (e.g. in training of staff) to facilitate cross selling of the Group's insurance and financial services and products.

I would also recommend that CFC undertakes an evaluation to establish the need to retain the life assurance department of Heritage A.I.I. in Kenya. By their own admission, Heritage staff comprises largely of general insurance experts with a low life insurance staff count. Heritage's life assurance portfolio is also said to be small. CFC should therefore consider the benefits and consequences of transferring Heritage's life business in Kenya to its newly acquired CFC Life Assurance. This will allow Heritage to focus only on general insurance which is its area of expertise.

Finally, I would recommend to CFC to manage the Group's pace and type of growth. The Group has been aggressive on the acquisition path in the last decade, and so far with an impressive measure of success. However, it is important that they manage this growth at a pace that does not over stretch their capacities. An equally important consideration should be to ensure that strategic growth and not short-term financial gain is at the heart of their continued acquisition strategy.

5.4 Limitations of the study

Acquisition transactions are by nature very confidential. Consequently, there is a limit to the nature of information that was availed to the researcher. Only a handful of senior management formed the team that negotiated the ALICO Kenya acquisition. Of these, the managing director of CFC Bank during whose tenure the acquisitions took place had already left the bank at the time of this study. Unfortunately, the chairman of the company during the same period passed away in December of 2005. Their personal experiences with the company's acquisitions could therefore not be documented. However, the depth of the interview and the respondent's experience provided a lot of valuable information, having been the lead transaction adviser on the ALICO acquisition. In addition, some of the information was provided in secondary data format, which does not allow deeper probing into specific issues.

5.5 Recommendations for further research

In trying to explain the post-acquisition performance differences in varying types of acquisitions, this study emphasizes that an acquisition strategy does not guarantee successful growth. On the contrary, research shows that most acquisitions result in lower returns to shareholders. Strategic management researches in the area of failed acquisitions are still sparse in comparison to other topics. More studies need to be carried out in order to better understand the use or misuse of this strategy.

For example, at the University of Nairobi, this research and a previous one by Bansal (2005) have studied mergers and acquisitions with (so far) successful outcomes. Bansal however points out correctly in his research into the merger of Pan Africa Insurance and Apollo Insurance that his study was carried out too soon after the merger to properly gauge its success. Previous studies related to acquisition were done by Thuo (2003), and Musembi (2005) on the use a diversification strategy by the Nation Media Group and East African Building Society respectively. Again, these were cases on the successful use of these strategies. To foster a better understanding of mergers and acquisition, it will be interesting to read the results of a research into a highly problematic or failed merger.

It would also be interesting to read a research on the use of acquisition in a manufacturing sector as opposed to the service sector. The on-going merger between Carbarcid Investments Ltd. and B.O.C. Kenya Ltd could be a good candidate for a merger and acquisitions research.

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APPENDIX 1:

QUESTIONNAIRE / INTERVIEW GUIDE

INTERVIEW GUIDE

Company Name ……..CFC BANK LIMITED …………………………………………

Name of respondent ………………………………………...... Tel: ……………………

Department …………………..………… Designation ………………………………

Brief Organization Profile

1. When was the organization established? ....
2. What was / is the size of the business in terms of staff numbers and total net assets 10 yrs ago ..../… …….; 5 yrs ago ………/…………; Current ……./………
3. The growth of the company has mainly been through internal development □, or through acquisitions / mergers □.

Scope of acquisitions / mergers

1. How many acquisitions has the company made since it was established? ………
2. Were these acquisitions in related business(es) □, unrelated business(es) □ Specify the acquired business(es) and respective industries:

   ………………………………………………………………………………

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3. What was the motivation of the acquisition (e.g. increased market coverage), and why that particular company?

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   ………………………………………………………………………………

   ………………………………………………………………………………

4. Do you consider the motivation to have been: strategic to the company □, or only financial/profit considerations and no strategic impact to the acquiring company□

   ………………………………………………………………………………

5. Did the new acquisition improve the company's competitiveness in its core business? Yes□ No□. If yes, how?

....

6. Were there any synergy benefits as a result of the acquisition(s) Yes □ No □. If yes, state which one(s)..

....

7. If the motivation was strategic, did the company consider similarities in the business strategies of the company and the target business? Yes □, No □..

....

8. Was the cultural-fit between the acquiring company and the target company considered? Yes □, No □. If no, was it assumed that the target business would automatically adopt the culture of its new owner? Yes □, No □. Other

....

....

9. Did the company adopt a hands-off approach to the acquired business(es) □, or were the operations of the acquired business(es) intergrated completely into the company's operations □? ....

....

10. Did the company change the management of the acquired business(es) □; retained the management of the acquired business(es)? □..

....

11. Did the change in management result from the need to streamline operations due to synergy benefits □, or the need to entrench the parent company corporate culture □, or reason (s) ....

....

12. Was there resistance from the employees of the acquired company? a) No resistance □, b) little resistance□, c) average resistance□, d) a lot of resistance□ If answer is (c) or (d), briefly state measures taken to reduce resistance.

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………………………………………………………………………………………

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13. What is the experience of your company with previous acquisitions? a) Parent company performance improved □, b) performance worsened□, c) no change in performance □.

14. Was the experience gained from previous acquisitions beneficial in subsequent acquisitions, or was each experience unique? a) Beneficial □, b) not beneficial. Comment

……………………………………………………………………………………

……………………………………………………………………………………

APPENDIX 2:

CFC GROUP FINANCIAL PEFORMANCE

Notes to the Financial Statements (Continued)

for the year ended 31 December 2005

(a) Primary reporting format - Business segments

	BANKING AND RELATED SERVICES		INSURANCE		GROUP	
	2005	2004	2005	2004	2005	2004
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Income	2,162,103	1,491,018	3,612,754	2,404,277	5,774,857	3,895,295
Expenditure	1,768,386	1,159,218	3,140,592	1,997,918	4,908,978	3,157,136
Segment result	393,717	331,800	472,162	406,359	865,879	738,159
Taxation					313,388	215,442
Profit after taxation					552,491	522,717
Assets	21,145,708	16,666,711	11,966,486	13,161,959	33,112,194	29,828,670
Goodwill	-	-	1,084,647	1,084,647	1,084,647	1,084,647
Liabilities	18,230,218	14,575,906	10,905,518	12,215,630	29,135,736	26,791,536
Capital expenditure	215,046	61,918	52,340	33,238	267,386	95,156
Depreciation and amortisation	79,151	69,367	45,023	23,795	124,174	93,162

(b) Secondary reporting format – Geographical segments

The Group's operations are located in Kenya and Tanzania. The Tanzanian subsidiary contributes over 10% of the Group's consolidated income.

	KENYA		TANZANIA		GROUP	
	2005	2004	2005	2004	2005	2004
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Income	5,127,818	3,488,397	647,039	406,898	5,774,857	3,895,295
Expenditure	4,345,197	2,835,629	563,781	321,507	4,908,978	3,157,136
Segment result	782,621	652,768	83,258	85,391	865,879	738,159
Taxation					313,388	215,442
Profit after taxation					552,491	522,717
Assets	31,242,529	27,264,416	1,869,665	2,564,254	33,112,194	29,828,670
Goodwill	1,084,647	1,084,647		-	1,084,647	1,084,647
Liabilities	27,549,978	24,499,747	1,585,758	2,291,789	29,135,736	26,791,536
Capital expenditure	256,864	92,072	10,522	3,084	267,386	95,156
Depreciation and amortisation	114,385	82,861	9,789	10,301	124,174	93,162

CFC BANK LIMITED

J NOTES TO THE FINANCIAL STATEMENTS FOR THE FIVE YEARS ENDED 31 DECEMBER 2004

1 SEGMENTAL REPORTING

The group is currently organised into two major divisions – banking and related services and insurance. These divisions are the basis on which the group reports its primary segment information.

Principal activities are as follows:

Banking and related services - taking deposits, lending to customers and provision of financial, advisory and stock broking services.

Insurance - insuring risks for all classes of insurance business.

(a) Primary reporting format - business segments

TWO YEARS TO 31 DECEMBER 2004

	BANKING AND RELATED SERVICES		INSURANCE		GROUP	
	2004 Sh'000	2003 Sh'000	2004 Sh'000	2003 Sh'000	2004 Sh'000	2003 Sh'000
Income	1,491,018	1,348,965	2,404,277	1,382,630	3,895,295	2,731,595
Expenditure	1,159,218	1,068,957	1,855,181	1,132,672	3,014,399	2,201,629
Segment result	331,800	280,008	549,096	249,958	880,896	529,966
Taxation					215,442	114,858
Profit after taxation					665,454	415,108
Assets	16,666,711	13,474,286	13,148,851	2,956,060	29,815,562	16,430,346
Goodwill	-	-	1,084,647	-	1,084,647	-
Liabilities	14,575,906	11,026,008	9,428,173	2,265,490	24,004,079	13,291,498
Capital expenditure	61,918	66,511	33,238	34,689	95,156	101,200
Depreciation and amortisation	69,367	65,991	23,795	30,439	93,162	96,430

J NOTES TO THE FINANCIAL STATEMENTS FOR THE FIVE YEARS ENDED 31 DECEMBER 2004

TWO YEARS TO 31 DECEMBER 2002

1 SEGMENTAL REPORTING

(a) Primary reporting format – Business segments

	BANKING AND RELATED SERVICES		INSURANCE		GROUP	
	2002 Sh'000	2001 Sh'000	2002 Sh'000	2001 Sh'000	2002 Sh'000	2001 Sh'000
Income	1,092,191	1,249,600	1,033,764	927,502	2,125,955	2,177,102
Expenditure	934,968	1,138,304	761,447	695,879	1,696,415	1,834,183
Segment result	157,223	111,296	272,317	231,623	429,540	342,919
Taxation					98,368	68,643
Profit after taxation					331,172	274,276
Assets	9,245,052	8,300,077	2,620,335	2,112,290	11,865,387	10,412,367
Liabilities	7,046,430	6,310,363	1,969,192	1,434,001	9,015,622	7,744,364
Capital expenditure	46,891	67,825	15,627	22,133	62,518	89,958
Depreciation and amortisation	56,892	47,901	32,164	29,552	89,056	77,453

(b) Secondary reporting format – Geographical segments

In 2001 and 2002, over 90% of the group's consolidated income and assets were contributed by the Kenyan businesses.

CfC bank LIMITED

CFC BANK LIMITED

J NOTES TO THE FINANCIAL STATEMENTS
FOR THE FIVE YEARS ENDED 31 DECEMBER 2004

ONE YEAR TO 31 DECEMBER 2000

1 SEGMENTAL REPORTING

(a) Primary reporting format – Business segments

	BANKING 2000 Sh'000	INSURANCE 2000 Sh'000	GROUP 2000 Sh'000
Income	1,070,796	824,792	1,895,588
Expenditure	886,435	606,088	1,492,523
Segment result	184,361	218,704	403,065
Unallocated expenses			-
Profit before taxation			403,065
Taxation			125,712
Profit after taxation			277,353
Assets	7,722,948	2,163,430	9,886,378
Liabilities	6,414,138	1,002,906	7,417,044
Capital expenditure	86,275	25,370	111,645
Depreciation and amortisation	44,349	27,360	71,709

(b) Secondary reporting format – Geographical segments

In 2000, over 90% of the group's consolidated income and assets were contributed by the Kenyan businesses.

Consolidated Balance Sheet

for the year ended 31 December 2005

	Note	2005 Sh'000	2004 Sh'000 (restated)
ASSETS			
Cash and balances with Central Bank of Kenya	12	1,389,193	967,113
Government securities	13	9,548,033	9,124,433
Deposits and balances due from banking institutions	14	2,708,513	1,264,614
Loans and advances to customers	15	11,661,714	10,969,365
Investment in associates	17	109,533	107,095
Other assets	18	3,029,567	3,444,842
Taxation recoverable		48,463	5,185
Investment properties	20	293,981	152,250
Other investments	21	2,162,734	1,776,474
Property and equipment	22(a)	958,111	823,240
Operating lease prepayment	23	31,953	36,109
Goodwill	24	1,084,647	1,084,647
Intangible assets	25	16,505	18,946
Deferred tax asset	26(a)	69,247	54,357
Total assets		33,112,194	29,828,670
LIABILITIES			
Customer deposits	27	14,794,042	12,673,291
Deposits due to banking institutions	28	1,398,575	1,464,202
Line of credit	29	443,756	393,250
Borrowings	30	952,412	623,000
Other liabilities	31	11,356,939	11,508,084
Taxation payable		58,589	50,489
Deferred tax liability	26(b)	125,917	74,382
Unclaimed dividends		5,506	4,838
Total liabilities		29,135,736	26,791,536
CAPITAL RESOURCES			
Share capital	32	780,000	720,000
Share premium		669,420	-
Capital reserve		233,496	231,172
Revaluation reserve		40,962	-
Fair value reserve		(192,823)	20,961
Revenue reserve		1,894,027	1,442,786
Proposed dividend		-	120,800
Equity attributable to equity holders of the parent		3,425,082	2,535,719
Minority interest		551,376	501,415
Total equity		3,976,458	3,037,134
Total equity and liabilities		33,112,194	29,828,670

The financial statements on pages 18 to 67 were approved by the Board of Directors on 15 March 2006 and were signed on its behalf by:

C Njonjo)
J G Kiereini) Directors
M. Soundararajan)
R R Vora) Company Secretary

CFC BANK LIMITED

G CONSOLIDATED BALANCE SHEETS FOR THE FIVE YEARS ENDED 31 DECEMBER 2004

	Note	2004 Sh'000	2003 Sh'000	2002 Sh'000	2001 Sh'000	2000 Sh'000
ASSETS						
Cash and balances with Central Bank of Kenya	11	967,113	768,867	506,151	454,404	456,433
Government securities	12	9,124,433	4,517,398	1,906,475	1,330,472	1,326,600
Deposits and balances due from banking institutions		1,264,614	780,111	1,098,497	1,400,400	878,531
Loans and advances to customers	13	10,969,365	7,831,494	6,174,234	5,299,368	5,260,599
Investment in associates	14	107,095	10,043	-	-	-
Other assets	15	3,431,734	711,163	589,201	565,125	535,028
Taxation recoverable		5,185	21,476	19,373	17,422	17,308
Investment properties	16	152,250	138,264	132,990	132,900	133,612
Other investments	17	1,776,474	1,067,900	857,237	622,491	710,781
Property and equipment	18	823,240	486,475	501,909	534,598	522,401
Operating lease prepayment	19	36,109	31,950	32,300	32,650	33,000
Goodwill	20	1,084,647	-	2,281	3,421	-
Intangible assets	21	18,946	26,173	8,568	7,003	10,410
Deferred tax asset	22	54,357	39,032	36,171	12,113	1,675
Total assets		**29,815,562**	**16,430,346**	**11,865,387**	**10,412,367**	**9,886,378**
LIABILITIES						
Customer deposits	23	12,673,291	9,868,243	6,702,875	5,555,503	5,003,746
Deposits due to banking institutions		1,464,202	1,221,528	476,956	-	132,075
Line of credit	24	393,250	-	-	786,000	780,500
Term loan	25	623,000	-	-	-	-
Other liabilities	26	8,720,627	2,154,162	1,779,183	1,408,283	1,498,947
Taxation payable		50,489	25,235	33,534	38	1,776
Deferred tax liability	22	74,382	18,118	19,262	-	-
Unclaimed dividends		4,838	4,212	3,812	-	-
Total liabilities		**24,004,079**	**13,291,498**	**9,015,622**	**7,744,364**	**7,417,044**
CAPITAL RESOURCES						
Share capital	27	720,000	600,000	600,000	600,000	600,000
Capital reserve		231,172	196,841	163,186	135,240	107,052
Revaluation reserve		20,961	47,942	37,737	25,719	17,347
Revenue reserve		1,429,678	1,270,105	1,126,073	1,063,085	1,033,438
Proposed dividend		120,800	100,800	80,400	80,400	80,400
Shareholders' funds		**2,522,611**	**2,215,688**	**2,007,396**	**1,904,444**	**1,838,237**
Minority interest	8	501,415	444,130	369,902	327,724	277,714
Life fund	9	2,787,457	479,030	472,467	435,835	353,383
Total liabilities, shareholders' funds and life fund		29,815,562	16,430,346	11,865,387	10,412,367	9,886,378

Consolidated Income Statement

for the year ended 31 December 2005

	Note	2005 Sh'000	2004 Sh'000 (restated)
INTEREST INCOME	3	2,401,525	1,450,494
INTEREST EXPENSE	4	(881,876)	(337,076)
NET INTEREST INCOME		1,519,649	1,113,418
Fees and commission income		516,171	350,702
Foreign exchange trading income		125,127	90,324
Other operating income	5	2,702,531	1,985,863
OPERATING INCOME		4,863,478	3,540,307
Operating expenses	6	(3,935,838)	(2,744,917)
Impairment losses on loans and advances	16	(91,264)	(75,143)
OPERATING PROFIT		836,376	720,247
SHARE OF PROFIT IN ASSOCIATES	17	29,503	17,912
PROFIT BEFORE TAXATION		865,879	738,159
TAXATION	8	(313,388)	(215,442)
PROFIT AFTER TAXATION	9	552,491	522,717
ATTRIBUTABLE TO:			
MINORITY INTEREST		88,296	89,669
EQUITY HOLDERS OF THE PARENT		464,195	433,048
		552,491	522,717
		Shs	Shs
EARNINGS PER SHARE			
Basic	10	3.17	2.97
Diluted	10	3.17	2.97
DIVIDEND PER SHARE - Proposed	11	0.84	0.84

CFC BANK LIMITED

F CONSOLIDATED INCOME STATEMENTS FOR THE FIVE YEARS ENDED 31 DECEMBER 2004

	Note	2004 Sh'000	2003 Sh'000	2002 Sh'000	2001 Sh'000	2000 Sh'000
INTEREST INCOME	2	1,450,494	1,103,918	953,860	1,153,167	1,039,944
INTEREST EXPENSE	3	(337,076)	(311,687)	(358,883)	(511,333)	(402,553)
NET INTEREST INCOME		1,113,418	792,231	594,977	641,834	637,391
Fees and commission income		350,702	251,380	176,995	150,814	108,428
Foreign exchange trading income		90,324	27,111	20,226	19,114	11,746
Other operating income	4	1,985,863	1,361,484	974,874	854,007	735,470
OPERATING INCOME		3,540,307	2,432,206	1,767,072	1,665,769	1,493,035
Operating expenses	5	(2,602,180)	(1,779,197)	(1,270,289)	(1,152,753)	(1,026,428)
Bad and doubtful debts expense		(75,143)	(115,248)	(67,243)	(170,097)	(63,542)
OPERATING PROFIT		862,984	537,761	429,540	342,919	403,065
SHARE OF PROFIT/(LOSS) IN ASSOCIATES		17,912	(7,795)	-	-	-
PROFIT BEFORE TAXATION		880,896	529,966	429,540	342,919	403,065
TAXATION	6	(215,442)	(114,858)	(98,368)	(68,643)	(125,712)
PROFIT AFTER TAXATION	7	665,454	415,108	331,172	274,276	277,353
MINORITY INTEREST	8	(89,669)	(82,693)	(51,036)	(50,432)	(41,268)
PROFIT ATTRIBUTABLE TO LONG TERM BUSINESS	9	(142,737)	(33,058)	(106,447)	(82,452)	(42,443)
NET PROFIT FOR THE YEAR ATTRIBUTABLE TO SHAREHOLDERS		**433,048**	**299,357**	**173,689**	**141,392**	**193,642**
EARNINGS PER SHARE –Basic/Diluted	**10**	**3.01**	**2.08**	**1.21**	**0.98**	**1.34**
DIVIDEND PER SHARE	**10**	**0.84**	**0.84**	**0.67**	**0.67**	**0.67**