

**MERGER AND ACQUISITION STRATEGIES AND
PERFORMANCE OF COMMERCIAL BANKS IN KENYA**

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OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF
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DECLARATION

I declare that this is my original work and has not been presented for any award for a degree in any other university or college for examination or academic purposes.

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DEDICATION

This project is first and foremost dedicated to the almighty God, whose providence, grace and care I cherish. Secondly, to my father the late Lawrence Gachanja, my loving mother Teresia Wairimu Gachanja and the entire Gachanja family for their support, spiritual, financial, emotional, and the continuous encouragement throughout my studies, which has been my constant source of inspiration; has given me the drive and discipline to tackle any task with enthusiasm and determination. Without their love and support this project would not have been made possible. God bless them all.

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ABBREVIATIONS AND ACCRONYMS

CBK:	Central Bank of Kenya
CMA:	Capital Markets Authority
FCF:	Free Cash Flow
M&A:	Merger and acquisition
NSE:	Nairobi Securities Exchange
ROA:	Return on Assets
ROE:	Return on Equity
SPSS:	Statistical Package for Social Sciences
KPI:	Key Performance Indicators

ABSTRACT

Mergers and acquisitions (M&A) are being increasingly used world over for improving competitiveness of companies through gaining greater market share, broadening the portfolio to reduce business risk, for entering new markets and geographies, and capitalizing on economies of scale not forgetting strategic positioning. The main objective of this study was to establish whether M&A's have any effect on the profitability of commercial banks in Kenya. The following aspects were the specific objectives of the study; to examine the effect of capital base on profitability of mergers of commercial banks in Kenya, to determine how efficiency because of mergers and acquisition affects profitability of commercial banks in Kenya, to determine the relationship between competitiveness mergers and acquisitions and profitability of commercial banks in Kenya and to investigate the effect of expertise on profitability of mergers of commercial banks in Kenya. The study adopted a descriptive research design and the population of interest will comprised of all the 24 banks that merged or were acquired in Kenya during the study period of 2000 to 2010. The study used both primary and secondary sources of data from published and audited annual reports of accounts for the population of interest, C.B.K., N.S.E., C.M.A., and bank supervision annual reports from C.B.K. Primary data was obtained from the merged commercial banks through questionnaires. The data was analyzed using SPSS and computation of financial ratios from the financial statements like the balance sheet, cash flows, and profit and loss accounts and hence the interpretation of the study model. The results of the analysis were presented in tables, percentages, graphs and charts. Multiple regression analysis between variables was also done which showed that the variables under study were significant in explaining the relationship between the mergers and acquisitions on the profitability of commercial banks. the study recommends that institutions having weak capital base consolidate to create synergies so as to enjoy economies of scale as this will improve their profitability instead of going public by listing on the Nairobi Stock Exchange as this may be an expensive venture listing and that those firms facing constraints on the market should consolidate their energies by resorting to merger/acquisition so as to expand their performance not just for the best interest of the managers but also shareholders as it leads to an increase in shareholders' wealth as opposed to each financial institution operating separately on its own.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The reasoning behind mergers and acquisitions (M&A) is that two companies together are more valuable than two separate companies are (Pandey, 2001). There are various types of mergers as discussed hereafter: horizontal merger, which results when two or more firms in the same line of business are merged, leading to the expansion of a firm's operations and elimination of a competitor. The ultimate result is an increase in the performance of the two now combined firms; vertical merger which occurs between different stages in the production/distribution process within the same line of business or industry, leading to increased control; co-generic merger which is achieved by acquiring a firm in the same general industry but neither in the same line of business nor a supplier or customer and conglomerate merger involving the combination of firms in unrelated businesses (Hillier, Ross, Westerfield, Jaffe, & Jordan, 2004). Ultimately, the concept is that firms' performance improves when they come together riding on each other's strengths while eliminating weaknesses through perfect negative correlation which is achieved through strategic mergers.

The key principle is to create shareholder value over and above that of the sum of the two companies. The Resource Based View (RBV) of a firm school of thought recognizes that each firm has a bundle of valuable resources that it applies to give it a competitive advantage over its competitors. These resources are diverse in nature and require that a firm networks with other firms to develop complex solutions Wernerfelt, (1984, p172); Rumelt, (1984, p557-558; Penrose, 1959). Companies will act to buy other companies not only to create a more competitive and cost-efficient company but also with the hope of gaining a greater market share and enhanced performance.

The Dynamic capabilities theory examines how firms integrate, build, and reconfigure their internal and external firm-specific competencies into new competencies that match their turbulent environment (Teece, Pisano, & Shuen, 1997). The theory seeks to understand how firms use these capabilities to create and sustain a competitive advantage by responding to and creating environmental changes (Teece, 2007).

CBK and shareholders of banking institutions in Kenya have a positive inclination to M&A's. However, Kenya has witnessed a mix of dismal performance by some merged banking institutions and very positive performance by others. This has left stakeholders in the banking industry wondering whether M&A's should be encouraged in the industry.

M&As and their significance to commercial banks in Kenya can be evaluated in terms of the ability to exploit scale and scope of economies, gain market control, economize transaction costs, diversify risks, provide access to existing expertise, leveraging loans and deposit interest rates. Mergers and Acquisitions have become a prominent feature in Kenya's banking industry.

1.1.1 Concept of Strategy

Morris (2004) accentuate that the M&A's phenomenon that started out in the U.S. mushroomed throughout the world becoming one of the most important corporate level strategies in the new millennium. They noted that this led to the development of strategies where two or more organizations would share resources and activities to pursue a strategy. These strategic operations have therefore become the way businesses adapt to the ever-changing environment in an effort to survive.

The Great Merger Movement was a predominantly U.S. business phenomenon that happened from 1895 to 1905. During this, small firms with little market share consolidated with similar firms to form large, powerful institutions that dominated their markets. The mergers were not for large efficiency gains but that was the trend at the time. Wood (2005) adds that, development by mergers tends to go in waves and tends to be selective in terms of industry and sector.

Shimizu & Pisano (2004) argue that, the number and size of M&A's continue to grow exponentially. They found that throughout the 21st century, mergers went through five waves suffice to say that M&A's were a dominant strategy for the 21st century. The waves were merging for monopolies, merging for oligopolies, conglomerate mergers, merging for skills and lastly merging for expansion.

1.1.2 Merger and Acquisition Strategies

While the definition of success may vary, any activity that fails to maximize shareholders' wealth, interests and ultimately value cannot be termed to as a success(Hildebrandt, 2005). A long-term decline in shareholders' wealth after an M&A can term the combination process to be a failure(Joshua, 2011). The success of any mergers is defined by the core competences generated to create value or enhance value. It is measured using the parameters such as market attractiveness, competitive positioning because of cost leadership and product differentiation. This results in the long-term profit sustainability and the creation of shareholders wealth (Hildebrandt, 2005)

Olusola & Olusola (2012) stated that the classic expressed rationale for mergers have been to increase profits and shareholder value. In the series of studies carried out elsewhere, researchers had been unable to demonstrate that merger active firms were more profitable, or had higher stock prices following the merger activity. Kaviraj, Peirani, Khochfar, Silk, & Kay (2009) indicated that the financial performance of the company can be expressed in terms of income generated from its operation, after offsetting expenses when the performance of the firm is arrived at. Olusola & Olusola (2012), concluded that performance of some banks in Kenya improved, while that of others deteriorated. Another conclusion made in the study was that small and medium sized banking system institutions were forced to merge for survival since they are prone to liquidity problems due to their weak capital base, imprudent lending policies and inefficient management (CBK, 2011). The study also cited some strategies used by the bigger banks, such as Barclay's Bank merging with Barclays Merchant Finance Limited, due to dwindling business and its increase in capital base. Habib A.G. Zurich and Habib Africa Bank Limited merged resulting in an increase to capital base.

1.1.3 Organizational Performance

Organizational performance comprises the actual results of an organization as measured against its intended outputs (or goals and objectives). It involves the recurring activities to establish, monitor progress towards, and make adjustments to achieve organizational goals more effectively (Carter McNamara, MBA, PhD, Authenticity Consulting, LLC.)

According to Richard et al. (2009) organizational performance encompasses three specific areas of firm outcomes: financial performance (profits, return on assets, return on investment, etc.); product market performance (sales, market share, etc.); and shareholder return (total shareholder return, economic value added, etc.) Most organizations utilize mergers as one of the most frequently selected instruments for growth. A report by Botchway (2010) indicated that M&A is a critical vehicle in facilitating corporate growth, productivity and absolute organizational performance. Specialists in many fields are concerned with organizational performance including strategic planners, operations, finance, legal, and organizational development.

Organizations normally use key performance indicators (KPI) to evaluate success, or to evaluate the success of a particular activity in which they are engaged. These KPI must reflect an organization's goals and must be quantifiable. Sometimes success is defined in terms of making progress toward strategic goals, but often success is simply the repeated, periodic achievement of some level of operational goal (e.g. zero defects, 10/10 customer satisfaction, etc.). Accordingly, choosing the right KPIs relies upon a good understanding of what is important to the organization. 'What is important' often depends on the department measuring the performance - e.g. the KPIs useful to finance will be quite different from the KPIs assigned to sales. Since there is a need to understand well what is important (to an organization), various techniques to assess the present state of the business, and its key activities, are associated with the selection of performance indicators. These assessments often lead to the identification of potential improvements, so performance indicators are routinely associated with 'performance improvement' initiatives.

In recent years, many organizations have attempted to manage organizational performance using the balanced scorecard methodology where performance is tracked and measured in multiple dimensions such as: financial performance (e.g. shareholder return), customer service, social responsibility (e.g. corporate citizenship, community outreach), employee stewardship among others. To organizations such as commercial banks, performance indicators include leverage ratios, non-performing assets, acid ratio, capital adequacy, operating efficiency as captured by cost to income ratio and major performance indicators, i.e., return on assets (RoA) and return on equity (RoE).

1.1.4 Commercial Banks in Kenya

Kenya has a reasonably sophisticated banking system. Commercial banks account for much of the total deposit in the country. Some of the banks that dominate the commercial banking system in Kenya include; Barclays Bank of Kenya, Kenya Commercial Bank and the Standard Chartered Bank. The National Bank of Kenya Ltd and Cooperative Bank of Kenya have also opened many branches in most areas of the country. The private banking sector too contributes much of the total deposits in commercial banks. These banks engage in the general banking system although some smaller banks tend to be rather specialized in domestic trade and others in import and export finance facilities offered by commercial banks in Kenya.

Commercial Banks and Mortgage Finance Institutions are licensed and regulated pursuant to the provisions of the Banking Act and the Regulations and Prudential Guidelines issued there under. They are the dominant players in the Kenyan Banking system and closer attention is paid to them while conducting off-site and on-site surveillance to ensure that they are in compliance with the laws and regulations.

Currently there are there are 43 licensed commercial banks and 1 mortgage finance company. Out of the 44 institutions, 31 are locally owned and 13 are foreign owned. The locally owned financial institutions comprise 3 banks with significant shareholding by the Government and State Corporations, 27 commercial banks and 1 mortgage finance institution CBK (2011).

Due to changes in the operating environment, several licensed institutions, mainly commercial banks, have had to merge and/or combine their operations in mutually agreed terms where one institution takes over another's operations (Brito, Pereira, Da Concorrência, & Ribeiro, 2008). Some of the reasons put forward for mergers and acquisitions are to meet the increasing market demand and competition, diversify to international markets, employ the emerging new and expensive modern technologies, or to meet the new threshold capital required by the regulators such as in the banking sector (Kithinji & Waweru, 2007).

Facilities offered by Kenya Commercial Banks include; money telegraphic transfer by mail, standing order payments, and Foreign exchange transactions services. They also offer financial advice to their customers. They advise their customers on the best business practices to engage in when asking for a loan to start a business, operation of safe deposits, operation of trust departments, dealing with confidential share purchases, offering business advisory services, acceptance of various deposits like fixed and regular deposits, provision of loans and advances Sashoo (April, 2012, Kenyaplex.com).

1.2 Research Problem

Mergers and acquisitions represent the ultimate in change for a business. No other event is more difficult, challenging, or chaotic as a merger and acquisition. It is imperative that everyone involved in the process has a clear understanding of how the process works.

Mergers and acquisitions are now a normal way of life within the business world. In today's global, competitive environment, mergers are sometimes the only means for long-term survival. In other cases, such as Cisco Systems, mergers are a strategic component for generating long-term growth. Additionally, many entrepreneurs no longer build companies for the long-term; they build companies for the short-term, hoping to sell the company for huge profits. A merger refers to the combining of two companies where one new company will continue to exist. The term "acquisition" refers to the acquisition of assets by one company from another company. In an acquisition, both companies may continue to exist.

Commercial banks everywhere and more so in Kenya are faced with many challenges ranging from uncertain government policies and regulations which may change anytime. The result of such challenges is commercial banks existing in an environment where they have to be both smart in strategy execution, resilient and creative in terms of survival tactics. These strategies and tactics include the involving of professional management consultants, business portfolio diversification to mitigate on risk and mergers and acquisitions. Many empirical studies have been done on the area of mergers and acquisitions regarding their effect on performance but have not been conclusive on the nature of the relationship.

However some studies have shown that not all mergers are profitable or performance enhancing due to poor management of the post-merger challenges and hence the question whether mergers improve performance or not? Some of these post merger challenges experienced in Kenya were issues of size, over-optimistic expectations of benefits and underestimation of post- integration difficulties like lack of market or technology relatedness and business culture clashes(Epstein, 2004). Still, various study findings have showed that there was general increase in the performance of commercial banks in Kenya after mergers and also increase in solvency and capital adequacy. However, others have also showed no significant improvement in performance of commercial banks in Kenya after the said mergers. The Kenyan corporations utilize mergers as one of the most frequently selected instruments for growth (Economic Mergers in Kenya have been on the increase, by multinational companies either acquiring local firms or local firms merging across industries).

As mentioned earlier herein, many empirical studies have been done on the area of mergers and acquisitions regarding their effect on performance but have not been conclusive on the nature of the relationship. Pasiouras and Kosmidou (2007) found a positive relationship between the size and the performance of a bank. Other researchers, such as Sufian(2010) found no correlation between the relative bank size and the Return on assets for banks, the coefficient is always positive but never statistically significant.

Javaid, Anwar, Zaman, and Gafoor (2011), who examined bank mergers in Portugal, Spain, France and Germany, found that the loans-to-assets ratio, as a proxy for risk, has a positive impact on the performance of banks contrary to (Athanasoglou, Brissimis, & Delis, 2008) among others who, find a negative and significant relationship between the level of risk and performance.

Kithinji and Waweru (2007) found that some of the reasons put forward for mergers and acquisitions are to meet the increasing market demand and competition, diversify to international markets, employ the emerging new and expensive modern technologies, or to meet the new threshold capital required by the regulators such as in the banking sector. However, not all the aspirations are achieved due to post-integration difficulties.

Ndung'u, Boniface Muita conducted a study to find out the effect M&A's on performance of commercial banks in Kenya. From his findings, the hypothesis that there was no improvement in financial performance after bank merger was therefore rejected. Thus the study found that there was improvement in financial performance after banks merger. The study also found that there was general increase in the performance of the banks after merger and also increase in solvency and capital adequacy.

In his study Marembo, (2012) established that following the merger or the acquisition, the Returns on Assets and Returns on equity both improved as the assets of the company improved. Adequate capitals requirements help lessen the chance that banks will become insolvent if sudden shocks occur therefore ensuring financial sector stability. With higher the risk-weighted capital adequacy ratios (CARs), the new financial institution formed after the merger is more financially sound as it carries with it lower is the probability that banks will be exposed to the risk of insolvency. His study recommended that commercial banks with a weak and unstable capital base seek to consolidate their establishments through mergers and acquisitions and that commercial banks need to deepen their services as statistics only indicate that less than 50% of the population have access to financial services.

The above evidence, to some extent succeeds and yet fails to undoubtedly show the relationship between capital base, efficiency, competition, expertise and the performance of commercial banks as a result of mergers and acquisitions. Therefore, since the importance of mergers and acquisitions cannot be over-emphasized, this prompted the researcher's interest to establish the relationship between bank mergers with performance on the commercial banks in Kenya.

The research problem would then prompt one to ask oneself; what is the effect of merger and acquisition strategies on the performance of commercial bank in Kenya?

1.3 Research objectives

The study was carried out to determine the effect of merger and acquisition strategies and performance of commercial banks in Kenya and whether banks adopt these strategies and if they do, to what extent?

1.4 Value of the Study

In the networked business environment of today, managers need to understand, anticipate and manage the business dynamics inherent in various alliances. Mergers and acquisitions have been empirically proven to be of great value in some instances. Others have shown contrary results but regardless of that, this study will be helpful to managers in predicting and managing these to ensure sustained business performance and in understanding at what point a firm considers engaging in a merger or acquisition and consequently at what point in the alliance relationship a firm considers exit.

Since investment decisions are made upon sufficient information about the companies concerned, this study will provide useful information to the investors on when to buy or sell stocks of companies that are in an alliance. Findings of this study shall make helpful contributions to governments and policy law makers in drafting monopoly and unfair competition laws to ensure a level playing field for businesses.

Scholars who are interested in advancing the theoretical studies discussed herein and engaging in further research in this field will be able to investigate any gaps in this study not researched or under researched in the course of providing the evidences supporting the research topic and research problems. Other findings herein shall also make great contributions to the already existing study theories either in critique or complement.

Great results already achieved show that indeed the Mergers and Acquisitions theories which are already in existence are of great relevance and positive results are inherent when the doctrines of the theories of M&As are put into practice and followed as per the book. However, the relevance of these theories also draws on heavy caution which must be exercised by managers, ranging from cropped ambition to prevent unrealistic expectations and ability to handle post merger challenges. Unless such caution is exercised, then the relevance of these theories will be relative and tethered on individual management behavior. All in all, the value brought herein and the potential held by these theories cannot go unnoticed or unmentioned and their relevance is seen in our everyday life through successful M&As executed in the corporate arena and also in failed Mergers and Acquisitions as a result of failure to pay attention to the guidelines outlined in the said theories.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This Chapter outlines the various theories and opinions propagated by various writers, authors and literally scholars of Strategic Management and Corporate Finance. It also outlines the various studies done in the discipline of mergers and acquisitions by different scholars or researchers leading to the conceptual framework of the study.

2.2 Theoretical Foundation

Earlier, we mentioned the Resource Based View (RBV) of a firm school of thought which recognizes that each firm has a bundle of valuable resources that it applies to give it a competitive advantage over its competitors. The resource-based view (RBV) as a basis for a competitive advantage of a firm lies primarily in the application of the bundle of valuable interchangeable and intangible tangible resources at the firm's disposal (Mwailu& Mercer, 1983 p142, Wernerfelt, 1984, p172; Rumelt, 1984, p557-558; Penrose, 1959[1]). To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile (:[2] p105-106; Peteraf, 1993, p180). Effectively, this translates into valuable resources that are neither perfectly imitable nor substitutable without great effort (Barney, 1991;:[2] p117). These bundles of valuable resources that a firm applies to give it a competitive advantage over are diverse in nature and require a firm networks with other firm to develop complex solutions (Wernerfelt, 1984, p172; Rumelt, 1984, p557-558).

Complementing the RBV is the monopoly-market power theory which held the view that mergers execution was to achieve market power. The implication of this type of merger is that conglomerates use it to cross subsidize products, to limit competition in more than one market simultaneously and to deter the potential entrance of competitors into its market. These three advantages of the monopoly theory supported the idea of a collusive synergy (Trautwein, 2006) or competitor Interrelationships (Barros, 1998).

The dynamic-capabilities theory, introduced by David J. Teece as an extension of the resource-based view of the theory of the firm observed that in changing environmental conditions, like for example a technological disruption, companies will have to adapt their portfolio of resources. David J. Teece, Gary Pisano, and Amy Shuen define dynamic capability as "the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments. Teece's concept of dynamic capabilities essentially says that what matters for business is corporate agility: "the capacity to sense and shape opportunities and threats, to seize opportunities, and to maintain competitiveness through enhancing, combining, protecting, and, when necessary, reconfiguring the business enterprise's intangible and tangible assets.

According to the value increasing school also called synergies theory, mergers occur, broadly, because they generate 'synergies' between the acquirer and the target which, in turn, increases the value of the firm (Malatesta, 1983; Lubatkin, 1987). The efficiency theory suggests, in fact, that mergers will only occur when they are expected to generate enough realisable synergies to make the deal beneficial to both parties; it is the symmetric expectations of gains which results in a 'friendly' merger being proposed and accepted. If the gain in value to the target was not positive, it is suggested that the target firm's owners would not sell or submit to the acquisition, and if the gains were negative to the bidders' owners, the bidder would not complete the deal. Hence, if we observe a merger deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target.

The impact of mergers and acquisitions on the performance of the acquiring firm remains, however, at best, "inconclusive" and, at worst, "systematic[ally] detrimental" (Haynes & Thompson, 1999). Mergers fail to create value, it is suggested with somewhere between 60 and 80% classified and a number of value destroying theories have been put forward in explanation (Ghauri & Buckley, 2003).

Value-destroying theories assume that managers may have good intentions in increasing their firm's value but, being over-confident, they over-estimate their abilities to create synergies. Over-confidence increases the probability of overpaying, and may leave the winning bidder in the situation of a winner's-curse (Bollaert & Petit, 2009), which dramatically increases the chances of failure (Athanasoglou, Georgiou, & Staikouras, 2009).

Jensen's (1986) theory of managerial discretion claims that it is not overconfidence that drives unproductive acquisitions, but rather the presence of excess liquidity or free cash flow (FCF). Firms whose internal funds are in excess of the investments required to fund positive net present value projects, it is suggested, are more likely to make quick strategic decisions and are more likely to engage in large-scale strategic actions with less analysis than their cash-strapped peers. High levels of liquidity increase managerial discretion, making it increasingly possible for managers to choose poor acquisitions when they run out of good ones (Martynova and Renneboog, 2008).

2.3 Mergers and Acquisitions Linkage

When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. In an acquisition, one business buys a second and generally smaller company which may be absorbed into the parent organization or run as a subsidiary.

A merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. In a merger, two organizations join forces to become a new business, usually with a new name. Because the companies involved are typically of similar size and stature, the term "merger of equals" is sometimes used. A company under consideration by another organization for a merger or acquisition is sometimes referred to as the target.

Mergers and Acquisitions in the corporate and more so the banking world are achieving increasing importance and attention, especially with the advent of intense globalization. This is evident from the magnitude and growth of deal values and resultant mega-mergers transacted in recent times.

This research work attempts to assess the implication of merger and acquisition of commercial banks on their performance, performance and other associated measures of performance. It is evident that there is significant relationship between pre and post merger/acquisition capital base of commercial banks and level of performance, there is significant difference between pre and post-merger acquisition earnings per shares. Merger/acquisition have also, increased the capitalization of commercial banks with evidences of changes in company's share ownership, increase in the cost of services and changes in bank lending rates. Based on various research findings, it can be concluded that the merger and acquisition strategy has improved the overall performance of banks significantly and also has contributed immensely to the growth of the real sector for sustainable development.

2.4 Empirical Review

In this chapter, we reviewed the information and theories currently available concerning the concept of Mergers and Acquisitions Strategy and the historical background of the topic. In doing so, we also reviewed the information and theories currently available concerning the topic of Mergers and Acquisitions strategy and the historical background of the Mergers and Acquisitions.

Capital represents the accumulated wealth of a business, represented by its assets less liabilities and indicates the financial strength of a firm i.e.

$$A=L+OE \text{ Thus; } OE=A-L$$

Where; A=Assets

L=Liabilities

OE=Owner's Equity

When two or more firms come together, their capital base in terms of assets, cash and securities increases and hence a competitive advantage. This increased investment when well managed results in great profit. Pasiouras & Kosmidou (2007) indicate that the best performing banks are those who maintain a high level of equity relative to their assets. Highly capitalized banks are safer and remain profitable even during economically difficult times. Furthermore, a lower risk increases a bank's creditworthiness and reduces its funding cost. In addition, banks with high equity to assets ratios will normally have a lower need of external funding, which has a positive effect on their performance. From this point of view, a higher capital ratio has a positive effect on performance.

A study by Olalekan (2012) on implication of merger and acquisition of commercial banks in Nigeria on their performance and other associated measures of performance revealed that there is significant relationship between pre and post-merger/acquisition capital base of commercial banks and level of performance. Merger/acquisition have also increased the capitalization of commercial banks with evidences of changes in company's share ownership, increase in the cost of services and changes in bank lending rates. Based on these findings, he then concluded that the merger and acquisition programme has improved the overall performances of banks significantly and also has contributed immensely to the growth of the real sector for sustainable development.

(Javaid et al., 2011) observed that capital strength of a bank is of paramount importance in affecting its performance. A well-capitalised bank is perceived to be of lower risk and such advantage is converted to performance. He adds that a well-capitalised bank faces lower expected costs of financial distress and such advantage is translated into high performance. Merged firms have access to financial markets that were not available to one or both of the smaller firms. The cost of capital falls below premerger levels. For example, the combined firm may have a lower probability of bankruptcy than the two separate firms if the cash flows of the two firms are not perfectly positively correlated (Bruckner, 2005).

Beck et al., 2010) in his study on the impact of mergers on bank performance observed that mergers and acquisitions of commercial banks had consequently increased the capital base of banks and that increase in capital base of commercial banks does not only enhance revenue generation but acts as a hedge against future losses, economic slow-down and to secure the capital of shareholders.

It is the expectation of all the stakeholders involved in the process of M&A that the organization to emerge from the combination operates in a more efficient manner than the two organizations did separately. The reason behind this assumption is due to the fact that the new firm benefits from economies of scale and synergies drawn from the combination should reduce operating costs and/or capital investments, thus improving cash flow (Gakure, Keraro, Okari, & Kiambati, 2010). The cost-to-income ratio is the operating costs (such as the administrative costs, staff salaries and property costs, excluding losses due to bad and nonperforming loans) over total generated revenues. It is used to measure the effect of efficiency on bank performance. Mergers or acquisition is a corporate strategy for growth and survival of firms. Mergers are expected to reduce these costs hence when incomes are higher than costs then performance is expected to be high.

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Merriam-Webster defines competition in business as "the effort of two or more parties acting independently to secure the business of a third party by offering the most favourable terms in effort to gain profits. Profit is a function of revenues and costs, when revenues are higher than costs then profits are attained. A combined firm generates greater revenues than two separate firms(Hillier et al., 2010).

Villalonga & McGahan (2005) affirms that when firms combine operations they become more competitive than an individual firm does. A more competitive firm is able to amass more profits through the following ways: marketing gains, when firms combine their marketing efforts and strategies there will be improvement in advertising efforts, strengthening of weak existing distribution networks and a balanced product mix hence increased operating revenues at lower costs resulting greater profits.

Hillier et al., 2010 argues that strategic benefits are realised in terms of technological integration. This is one of the key reasons for mergers of employing unique, new and expensive technologies, which can meet the unique needs of customers at lower costs and also gain increased market share which is converted to performance. They add that a firm with weak technological structures merging with another which has good technological framework and these combinations may provide an opportunity to take advantage of the competitive environment if certain situations materialize and hence increased revenues.

Marketing power is also achieved through competitive strength of a firm, depending on the market power of the bank in input and output markets respectively, it may be able to increase output prices or decrease input prices. Bank management can select the combination of inputs and outputs at which profits are maximized, monopoly prices are higher generating monopoly profits (Hillier et al., 2010).

Competitiveness is also achieved through cost leadership, differentiation, product mix and focus (Libra, Borchert, & Banit, 2003). Merging of firms leads to reduced competition hence price leadership as a result of monopoly pricing and economies of scale. Well-differentiated product to meet the customer needs and a well-balanced product mix to meet the customers unique needs because of the synergies are strategies for effective competition.

Sathye, 2005 adds that technological integration through merging has enhanced competitiveness of commercial banks through innovations like internet banking, online bank transactions and convenient money transacting through the mobile technology. This has increased attractiveness of bank services and products and hence winning the market, which has led to increased revenues at reduced costs, hence profits.

Expertise is the ability to execute a function or activity effectively by employing productive skills and experiences and competencies. When banks come together there is increased pool of expertise as different employees with great experiences, skills and competencies come together and share ideas. The pool of professionals bring about creativity and innovation which is converted to better products and services for customers at reduced costs hence performance (Panagiotakopoulos, 2012). He adds that productivity and performance improvements and innovation can be achieved only if firms employ high-skilled workers.

Coleman's, 2011 examined the relationship between human and financial capital and firm performance for women- and men-owned small firms in the service and retail sectors. Results indicated that human capital variables, including education and experience, had a positive impact on the performance of women-owned firms, whereas measures of financial capital had a greater impact of the performance of men-owned firms. The ability to secure financial capital also had a positive impact on the growth rate of men-owned firms, but did not appear to affect the growth rate of women-owned firms. These findings suggest that the growth aspiration for women-owned firms is by factors other than human capital or the ability to secure external capital.

Dwyer, Richard and Chadwick (2012) found that management decisions, especially regarding loan portfolio concentration, were an important contributing factor in bank performance. Researchers frequently attribute good bank performance to quality management. Management quality is assessed in terms of senior officers “awareness and control of the bank’s policies and performance. In essence, mergers and acquisitions lead to a complete blend of skills and competencies hence ability to provide competitive services. Performance measurement enables stakeholders to hold organizations accountable and to introduce consequences for performance (Ross, Westerfield, Jafee, & Jordan, 2008). It helps citizens, customers judge the value that company creates for them, and it provides managers with the data they need to improve performance.

Mergers and acquisitions has emerged as a strategic approach to achieving higher efficiency, control of operations and reduction of cost leading to higher productivity and performance due to synergies. Several financial performance measures have been adopted between the financial statements analysis and long term planning (Ross, Westerfield, Jafee, & Jordan, 2008). In this study several financial ratios have been adopted Return on Equity (ROA), a measure of bank performance that, which divides the net income of the bank by the amount of its assets. ROA measures how well a bank manager is doing the job because it indicates how well a bank’s assets are being used to generate profits.

Kosmidou, Pasiouras, & Tsaklanganos (2007) points out; the ROA has emerged as key ratio for the evaluation of bank performance and has become the most common measure of bank performance in the literature.

$$\text{ROA} = \frac{\text{Net income}}{\text{Total assets}}$$

ROA provides useful information about bank performance, however the bank’s owners (equity holders) care more about how much the bank is earning on their equity investment, an amount that is measured by the return on equity (ROE), the net income per dollar of equity capital.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Capital}}$$

Willie and Hopkins (1997) indicated that the ultimate measure of the strength of any financial institution is not its asset size, the number of branches, or the pervasiveness of its electronics rather the true measure is its return on shareholder equity (ROE). Hence ROE is the preferred method of measuring banks performance.

Thus, on review of the financial performance measures of banks, ROA and ROE will be considered as a general measure of banks' performance.

Other ratios to be used in the study to indicate efficiency and capitalization are as shown below;

$$\text{Return on Capital Employed} = \frac{\text{Operating Profit} \times 100\%}{\text{Capital Employed}}$$

$$\text{Debt Equity Ratio} = \frac{\text{Total Debts}}{\text{Shareholders Fund}}$$

$$\text{Cost Income Ratio} = \frac{\text{Operating Ratio}}{\text{Revenues}}$$

From the studies conducted, there is mixed evidence about the effect of mergers and acquisitions on the performance of commercial banks. It is therefore, important for bankers, bank regulators, supervisors, investors and researchers to understand how mergers and acquisitions affect the performance of banks. Hence, the researchers' main purpose in this proposal will be to fill this significant gap by providing systematic analysis of the effect of mergers and acquisitions on performance of commercial banks. To achieve this goal, the researcher will analyze the financial statements of the selected commercial bank mergers and acquisitions and annual supervision reports from regulators like central bank, Nairobi securities exchange and capital market authority.

Few researches have been conducted on the area of mergers and acquisitions especially on performance of commercial banks in Kenya and mostly have failed to show that there is a relationship between capital base and the performance of commercial banks as a result of mergers and acquisitions and thus this has motivated the researcher to fill this gap in the literature.

2.4.1 Capital base and profitability

Capital represents the accumulated wealth of a business, represented by its assets less liabilities and indicates the financial strength of a firm. When two or more firms come together their capital base in terms of assets, cash and securities increases and hence a competitive advantage. This increased investment when well managed results in great profit. Pasiouras & Kosmidou(2007) indicate that the best performing banks are those who maintain a high level of equity relative to their assets. Highly capitalized banks are safer and remain profitable even during economically difficult times. Furthermore, a lower risk increases a bank's creditworthiness and reduces its funding cost. In addition, banks with higher equity to assets ratios will normally have a lower need of external funding, which has a positive effect on their profitability. From this point of view, a higher capital ratio has a positive effect on profitability.

A study by Olalekan (2012) on implication of merger and acquisition of commercial banks in Nigeria on their profitability and other associated measures of performance revealed that there is significant relationship between pre and post-merger/acquisition capital base of commercial banks and level of profitability. Merger/acquisition have also increased the capitalization of commercial banks with evidences of changes in company's share ownership, increase in the cost of services and changes in bank lending rates. Based on these findings, he then concluded that the merger and acquisition programme has improved the overall performances of banks significantly and also has contributed immensely to the growth of the real sector for sustainable development.

(Javaid et al., 2011) observed that capital strength of a bank is of paramount importance in affecting its profitability. A well-capitalised bank is perceived to be of lower risk and such advantage is converted to profitability. He adds that a well-capitalised bank faces lower expected costs of financial distress and such advantage is translated into high profitability. Merged firms have access to financial markets that were not available to one or both of the smaller firms. The cost of capital falls below premerger levels. For example, the combined firm may have a lower probability of bankruptcy than the two separate firms if the cash flows of the two firms are not perfectly positively correlated (Bruckner, 2005).

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2.4.6 Research Gaps

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To achieve this goal, the researcher will analyze the financial statements of the selected commercial bank mergers and acquisitions and annual supervision reports from regulators like central bank, Nairobi securities exchange and capital market authority. Few researches have been conducted on the area of mergers and acquisitions especially on profitability of commercial banks in Kenya and mostly have failed to show that there is a relationship between capital base, efficiency, competition and expertise and the profitability of commercial banks as a result of mergers and acquisitions and thus this has motivated the researcher to fill this gap in the literature.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter describes the procedure used to conduct the empirical research. This includes how the data was collected, the determination of the sample used and how the data was analysed, interpreted and presented.

In this chapter, we entail the chronological events undertaken herein, durations, processes, procedures and any other undertaking gone through in the process of collecting, analyzing and preparing data. We also entail data analysis techniques used to arrive to logical discussions, summary and conclusion thereafter.

3.2 Research Design

Research design is the ultimate blue print for the collection, measurement and analysis of data (Kothari, Ramanna, & Skinner, 2010). The study used Cross-sectional survey. This design was opted since the study sought to investigate associations between risk factors and the outcome of interest in mergers and acquisitions to performance of commercial banks.

Cross-sectional survey involves observation of all of a population, or a representative subset, at one specific point in time. Since cross-sectional survey uses randomly collected data, the use of routinely collected data allows large cross-sectional studies to be made at little or no expense. This is a major advantage over other forms of epidemiological study. It differs from case-control studies in that cross-sectional surveys aim to provide data on the entire population under study, whereas case-control studies typically include only individuals with a specific characteristic, with a sample, often a tiny minority of the rest of the population. Cross-sectional studies are descriptive studies (neither longitudinal nor experimental). Unlike case-control studies, they can be used to describe, not only the Odds ratio, but also absolute risks and relative risks from prevalence (sometimes called prevalence risk ratio, or PRR).

In some cases, it is useful for other researchers to adapt or replicate your methodology, so often sufficient information is given to allow others to use the work. This is particularly the case when a new method had been developed, or an innovative adaptation used. That was also another factor that necessitated the use of a cross-sectional survey as our research design as the research findings resultant thereof are meant to benefit not just the researcher but also other scholars and varied interest parties.

Longitudinal studies differ from both in making a series of observations more than once on members of the study population over a period of time. Secondary historical unbiased data available to the public was retrieved from the financial statements of the commercial banks and the central bank while primary data was collected through administering of questionnaires to the banks' employees.

3.3 Population of the Study

Mbwesa (2006) defines population as an entire group of individuals, events or objects having common observable characteristics. The population of interest in this study comprised of 10 banks that merged or were acquired in Kenya and the regulatory authority the central Bank of Kenya. The banks considered in this study are those that either merged or acquired during the study period of 2000 to 2010 (Appendix 2). The period selected provided insightful and relevant information on the performance of mergers and acquisition in Kenyan Banking industry.

The size of the target population was dictated by regulation and licensing by the Central Bank of Kenya (CBK), a factor which limited the size of the target population to only those officially licensed by the Central Authority. Further, our target population measurement was also more bracketed by the fact that only a certain number out of those licensed by the Central Bank have actually undergone either a merger or an acquisition or pursued such strategy.

3.4 Data collection

The researcher used self-administered questionnaires for primary data through drop and pick method to top management team which includes the branch manager, human resource manager, operation manager, marketing manager and the head of the IT department. The study also used secondary sources of data from published audited annual reports of accounts for the population of interest, central bank of Kenya(CBK), Nairobi securities exchange(NSE), Capital market authorities(CMA) and the selected bank Mergers. The method of data collection opted and used herein allows the scholar to be able to keenly undertake a systematic review of the data collected as well as derivatives of already advanced Mergers and Acquisitions theories (which is a comprehensive survey of a topic that takes great care to find all relevant studies of the highest level of evidence, published and unpublished, assess each study, synthesize the findings from individual studies in an unbiased, explicit and reproducible way and present a balanced and impartial summary of the findings with due consideration of any flaws in the evidence). In this way it can be used for the evaluation of both existing or new theories and practices.

In using self administered questionnaires for primary data in tandem with cross-sectional survey and secondary data from existing publications, one of the problems anticipated was that routinely collected data does not normally describe which variable is the cause and which the effect. Cross-sectional studies using data originally collected for other purposes are often unable to include data on confounding factors, other variables that affect the relationship between the putative cause and effect. Most case-control studies collect specifically designed data on all participants, including data fields designed to allow the hypothesis of interest to be tested. However, in issues where strong personal feelings may be involved, specific questions may be a source of bias. This was mitigated by way of designing the research questions in a manner that did not invite bias or the indulgence of deep personal feelings.

3.5 Data analysis

The study used both qualitative and quantitative data. Qualitative data was analyzed using interpretive approach which includes sorting and coding raw data and use of Statistical Package for Social Sciences (SPSS).

Quantitative data was analyzed using regression technique as shown in the regression model below. A linear regression model will be used to indicate the extent to which each independent variable affected performance of commercial banks in Kenya.

The model is as below

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Where Y presented performance the depended variable, β_0 is a constant term, X_1 -Capital base, X_2 -Efficiency, X_3 -Competitiveness and X_4 - expertise are the independent variables and ε is the disturbance term.

The above model can be used to test the viability of any merger or acquisition with absolute results. The data collected and discussed herein can be used to test the validity of this model as it indeed is the core generator of our findings, through the statistical data analysis tool SPSS.

A commercial bank willing to undertake a merger, should or can consider testing its data here and using the findings or results therefore to gauge whether in its current state, the intended merger or acquisition would be a viable strategy to pursue or abandon.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter entails analysis and findings of the study as set in the research objectives and methodology. The study findings are presented on the effect of mergers and acquisitions strategy on performance of commercial banks in Kenya.

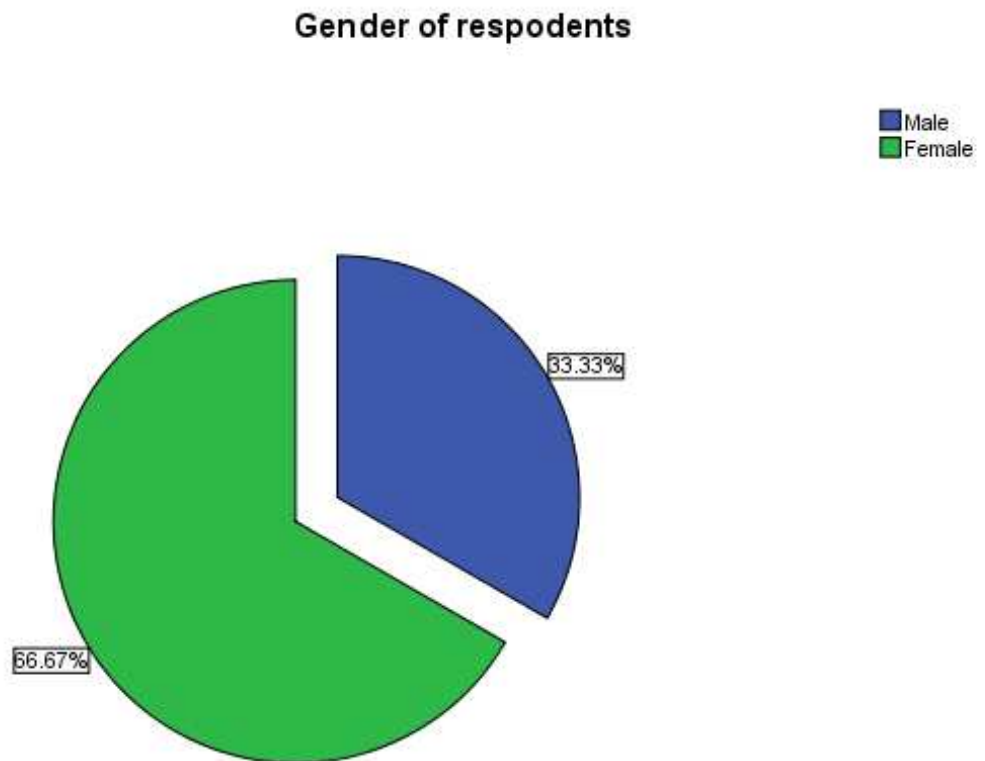
4.2 Demographic Information

Demographics are the quantifiable statistics of a given population. Demographics are also used to identify the study of quantifiable subsets within a given population which characterize that population at a specific point in time. *Demographic trends* describe the historical changes in demographics in a population over time (for example, the average age of a population may increase or decrease over time). Both distributions and trends of values within a demographic variable are of interest.

4.2.1 Gender of the respondents

The study sought to establish the gender distribution of respondents. From the findings in figure 4.2.1 below (33.33%) of the respondents was male while (66.67%) were female. This was because most of the respondents were human resource managers and operations managers who in most organizations were women.

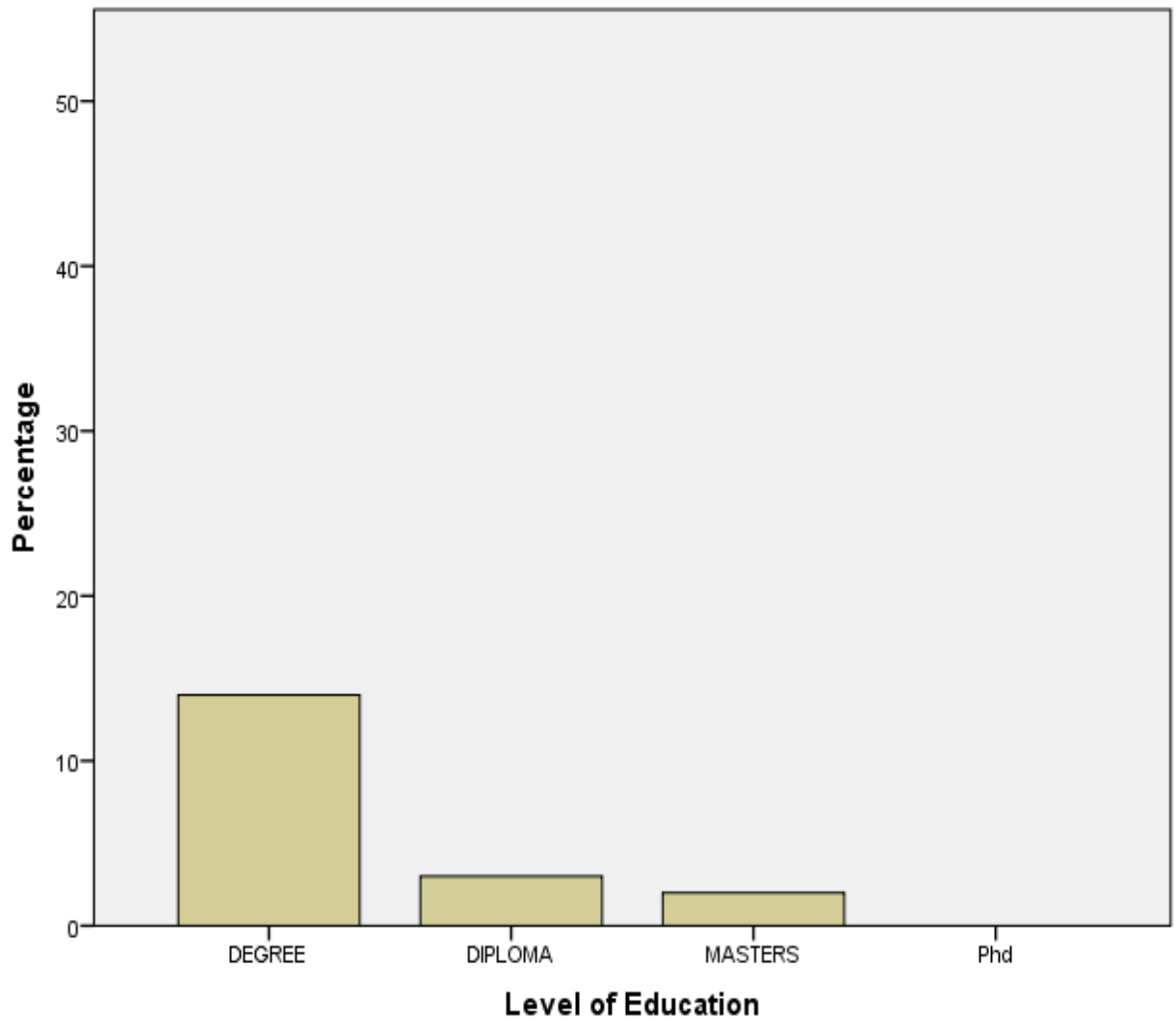
Figure 4.1 Gender of the respondents



4.2.2 Level of education

The study had further sought to determine the respondent's level of education. According to the findings, 50% of the respondents had undergraduate degrees, 33.33% had masters' degrees and 16.67% had PHD's as shown in figure 4.2.3 below.

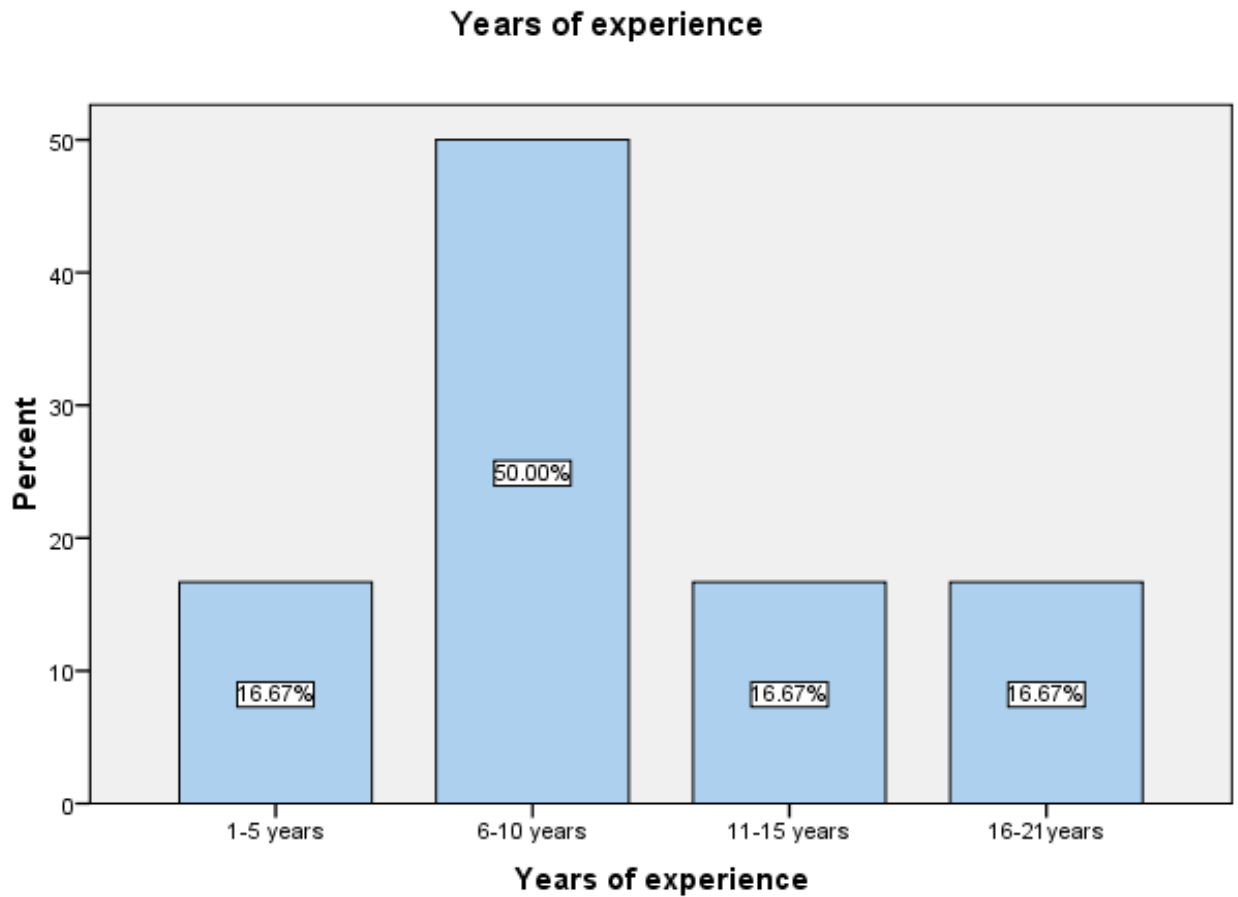
Figure 4.2 level of education



4.2.3 Years of experience

From the findings, 16.67% had 1-5years experience, 50%had 6-10 years, 16.67% had 11-15 years and lastly 16.67% had 16-21years of experience. Thus majority of the respondents had 6-10 years which is an average years for a competent worker.

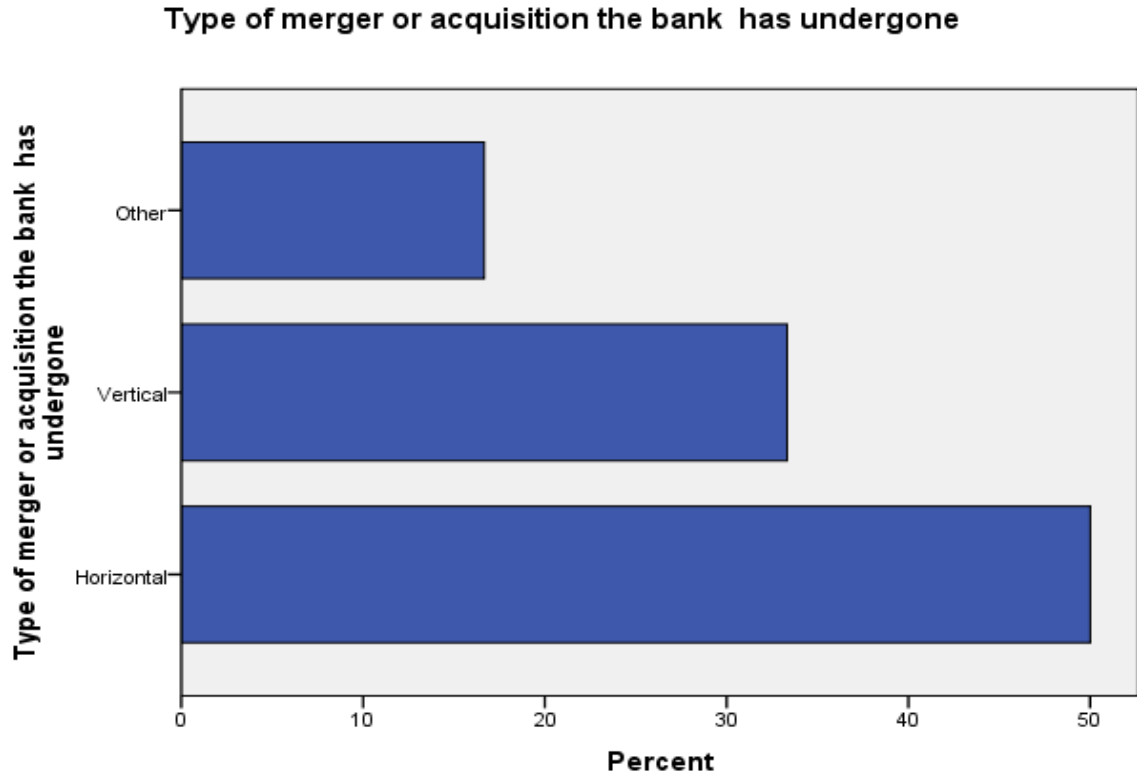
Figure 4.3: Years of experience



4.2.4 The type of merger the banks has undergone

On the type of merger or acquisition that each commercial bank had undergone, the study established that 50% of the commercial banks had undergone a horizontal type of merger, 35% had undergone vertical merger and the remaining 15% was other types of mergers including the conglomerates and co-generic as shown in figure 4.3 below.

Figure 4.4 Type of Merger Undergone by the Bank.



4.3 Capital structure

To understand the effect of merger or acquisition strategy on capital base of the different commercial banks, the respondents were to indicate the extent to which they agreed with the various statements. The findings according to the respondents agreed that the capital base of the bank increased after the merger or acquisition as shown by a mean of 4.667 and standard deviation of 0.5164; the capital increment helped the bank in expansion evident in a mean of 4.1667 and a standard deviation of 0.75277; the merger or acquisition afforded more assets seeing growth and performance as indicated by a mean of 4 and standard deviation of 0.63246 and lastly they testified that commercial banks met the core capital requirement by the central bank of Kenya(CBK) as shown in table 4.3 below with a mean of 4.3333 and a standard deviation of 0.5164.

Table 4.1: Aspects of capital base

Aspects of capital structure	Mean	Std. Deviation
The capital base of the bank increased after acquisition?	4.6667	.51640
The capital increment from acquisition helped in expansion?	4.1667	.75277
The merger or acquisition has afforded more assets for the company seeing its growth and performance?	4.0000	.63246
The bank met core capital requirement by CBK?	4.3333	.51640

4.4 Efficiency

Efficiency was another independent variable in the study to determine whether the merger or acquisition strategy had an effect on performance of commercial banks. The findings showed the different extents to which the respondents agreed with different statements about the efficiency of the merger or acquisition. The respondents agreed that the merger or acquisition reduced the commercial banks running costs as shown by a mean of 4.5 and a standard deviation of 0.54772; the service costs reduced as indicated by a mean of 4 with no standard deviation; marketing costs reduced also at a mean of 4.3333 and a standard deviation of 0.5164; salaries and operating costs reduced also as shown in the table at a mean of 4.5 and a standard deviation of 0.54772; Improved technology which was a core result of the M&As strategy increased innovation and invention enhancing probability of meeting customers' unique needs as shown by a mean of 4 and a standard deviation of 0.63246; lastly Improved technology has reduced customer service time and related costs as shown below with a mean of 4.8333 and a standard deviation of 0.40825.

Table 4.2: Aspects of efficiency

Aspects of efficiency	Mean	Std. Deviation
The merger or acquisition reduced running costs?	4.5000	.54772
Service costs have reduced?	4.0000	.00000
Marketing costs have reduced?	4.3333	.51640
Salaries and operating costs have reduced?	4.5000	.54772
Improved technology has increased innovation and invention enhancing probability of meeting customer's unique needs?	4.0000	.63246
Improved technology has reduced customer service time and related costs?	4.8333	.40825

4.5 Competitiveness

Competitiveness is the ability to outperform others and win the minds of many. On the differentiated products and services that the mergers and acquisitions were able to provide include SME loans, business loans, asset loans, corporate banking, mortgage, insurance, personal loans, online banking and online money transfer services. In addition the respondents were required to evaluate the different aspects of competitiveness; the findings indicated that the number of the product lines had increased over the years as indicated by a mean of 3.6667 and standard deviation of 0.5164; the number of branches also increased at a mean of 4.5 and a standard deviation of 0.54772; the merger or acquisition was able to capture a great number of different customer groups as shown by a mean of 4.000 and standard deviation of 0.63246; The merger or acquisition afforded the bank more loan products to the different clients shown by a mean of 4.333 and a standard deviation of 0.5164; The attractiveness of the bank merger has increased customer deposits reducing the lending rates shown by a mean of 3.1667 and a standard deviation of 0.40825.

Table 4.3: Aspects of competitiveness

Aspects of competitiveness	Mean	Std. Deviation
The number of product lines has increased over the years after the merger	3.6667	.51640
The merger or acquisition has increased the number of branches making the services accessible to the customers	4.5000	.54772
The merger has been able to capture a great number of customer groups	4.0000	.63246
The merger or acquisition afforded the bank more loan products to the different clients	4.3333	.51640
The attractiveness of the bank merger has increased customer deposits reducing the lending rates	3.1667	.40825

4.6 Expertise

Expertise refers to the acquired experience and skills over time. It was used in the study to test whether the mergers or acquisitions strategy had any effect on the performance of commercial banks. The respondents observed that the banks attracted a rich pool of skilled and efficient professionals as shown by a mean of 4.6667 and a standard deviation of 0.5164; Inefficient management was eliminated through reviewing of job descriptions and specifications as shown by a mean of 4.1667 and a standard deviation of 0.40825; specialization enhanced invention and innovation hence meeting the customers emerging needs shown by a mean of 4.3333 and a standard deviation of .51640 ; the bank mergers consequently improved work culture and ethics through frequent trainings, workshops and seminars indicated by a mean of 4.0000 and a standard deviation of 0.63246 as shown in the table below.

Table 4.4: Aspects of Expertise

Aspects indicating efficiency	Mean	Std. Deviation
The bank has attracted a rich pool of skilled and efficient professionals	4.6667	.51640
Inefficient management has been eliminated through reviewing of job descriptions and specifications	4.1667	.40825
specialization has enhanced invention and innovation hence meeting the customers emerging needs	4.3333	.51640
The bank has improved work culture and ethics through frequent trainings, workshops and seminars	4.0000	.63246

4.7 Regression Analysis

The researcher conducted a multiple regression analysis so as to test relationship among variables. The research applied the statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions for the study.

4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.937	0.878	0.865	0.65244

Coefficient of determination explains the extent to which changes in dependent variable can be explained by the change in the independent variables or the percentage of the variation in the dependent variable (performance of commercial banks) that is explained by all the four independent variables (capital base, efficiency, competitiveness, and expertise)

The independent variables studied explain only (87.8%) of the effects of mergers and acquisitions on the performance of commercial banks in Kenya as represented by R^2 . This means that the other variables not studied in this research contributed (12.2%) and thus further research should be conducted to investigate these other effects of mergers and acquisitions on the performance of commercial banks in Kenya.

Table 4.6: Coefficient of determination

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.843	.175		4.847	.000
The capital base	.642	.082	.586	7.835	.000
Expertise	-.212	.083	-.246	-2.806	.006
Efficiency	.167	.063	.223	2.583	.011
Competitive	.143	.082	.132	1.739	.034

As per the SPSS generated table above, the equation ($Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$) becomes $Y = 0.843 + 0.642X_1 - 0.232X_2 + 0.167X_3 + 0.143X_4$. This regression equation shows that taking all the factors into account (capital base, efficiency, expertise and competitiveness at constant zero then performance is 0.843. However taking all the independent variables at zero, then a unit increase in capital base will lead to 0.642 increase in performance, the same way a unit increase in efficiency will lead to 0.167 increase in performance. Again a unit increase efficiency will decrease performance by 0.212 and finally a unit increase in competitiveness will lead to 0.143 increase in performance respectively.

This depicts that capital base continues to have the leading effect on commercial banks performance followed by efficiency then competitiveness and expertise which shows a negative relationship between merger or acquisition strategy and the performance of commercial banks. At 5% level of significance and 95% level of confidence, then efficiency, capital base and competitiveness are significant in explaining the relationship between mergers and acquisitions strategy and the performance of commercial banks in Kenya since their levels of significance are below 0.05 which is the significance level.

Indeed, evident from an earlier discussion in chapter two of this project, When two or more firms come together, their capital base in terms of assets, cash and securities increases and hence a competitive advantage. This increased investment when well managed results in great profit. Pasiouras & Kosmidou (2007) indicate that the best performing banks are those who maintain a high level of equity relative to their assets. The dynamic merger analysis indicates that the cost efficiency of merging banks is positively affected by merger while the relative degree of profit efficiency improves only marginally (christopoulos, lolos & Tsionas,2008) Highly capitalized banks are safer and remain profitable even during economically difficult times. Furthermore, a lower risk increases a bank's creditworthiness and reduces its funding cost. In addition, banks with high equity to assets ratios will normally have a lower need of external funding, which has a positive effect on their performance. From this point of view, a higher capital ratio has a positive effect on performance .Javaid et al.,(2011) observes that capital strength of a bank is of paramount importance in affecting its performance.

Again on more scrutiny of the above data, unit increase efficiency will decrease performance by 0.212 and finally a unit increase in competitiveness will lead to a 0.143 increase in performance respectively. This depicts that capital base continues to have the leading effect on commercial banks performance followed by efficiency then competitiveness and expertise which shows a negative relationship between merger or acquisition strategy and the performance of commercial banks. Competitiveness is also achieved through cost leadership, differentiation, product mix and focus(Libra, Borchert & Banit, 2003).

At 5% level of significance and 95% level of confidence, then efficiency, capital base and competitiveness are significant in explaining the relationship between mergers and acquisitions strategy according to Back et al.,(2010) in his study on the impact of commercial banks indicates that it increased the capital base of the banks and that this increase does not only enhance revenue generation but also acts as a hedge against future losses, economic slow down and to secure capital of shareholders and the performance of commercial banks in Kenya since their levels of significance are below 0.05 which is the significance level. A study by Olalekan (2012) on implication of merger and acquisition of commercial banks in Nigeria on their performance revealed that there is a significant relationship between pre and post merger acquisition capital base of commercial banks and level of performance.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter discusses the overall findings with the aim of answering the research questions. The chapter also presents the conclusions and recommendations from the current study based on the effect of mergers and acquisitions strategy on the performance of commercial banks in Kenya. The specific objectives were to determine the effect of mergers and acquisitions strategy on performance of commercial banks in Kenya and whether banks adopt these strategies and if they do, to what extent?

5.2 Summary

The findings showed that, most of the commercial banks had undergone a horizontal type of merger as shown by 50% on the graph. The respondents had undergraduate degrees followed by masters' degrees then PHDs had the least percentage. However, most of the respondents pertaining to the area of management were branch, human resource and operation managers and had 6-10 years of experience which is the average years for a competent worker.

Regarding the capital base of the commercial banks, the respondents agreed that the capital base of majority of the banks increased after acquisition or merging and thus the commercial banks were able to meet the core capital requirement by the central bank. Statistics from central bank supervision reports also indicated that some commercial bank mergers also remerged in efforts to meet this core capital requirement as per the bill in 2008, where the then Finance Minister Amos Kimunya proposed to raise the minimum core capital for banks to 1 billion shillings from 250 million shillings, giving 2012 as the deadline for all banks to comply (Beck et al., 2010).

Efficiency was also used to ascertain whether mergers or acquisitions had any effect on performance of commercial banks, the findings as per the different aspects showed that most of the respondents agreed that post merger operation costs reduced as a result of synergies and economies of scale.

Technology was also an aspect of efficiency and from the responses, one can construe that it led to reduced customer service time and increased inventions and innovations through research and development. These findings on efficiency are in line with (Gakure, Keraro, Okari, & Kiambati, 2010) who argue that the new firm benefits from economies of scale and synergies drawn from the combination, reducing operating costs and/or capital investments, thus improving cash flow and hence performance.

As regards competitiveness, it is evident that the mergers and acquisitions are able to offer differentiated products to their customers. The respondents were neutral on the number of product lines as indicated by a mean of three since most of the banks offered similar product lines thus the increment was minimal, however, on the number of branches it was a great achievement for mergers and acquisitions as result of increased customer base and the deposits and different customer groups led to expansion of services to clients which converted to great profits.

Further findings indicated that the growth and expansion attracted qualified professionals and elimination of inefficient management through job descriptions and specification reviews, trainings, seminars and workshops. On performance of commercial bank after employment of the mergers and acquisitions strategy, measured using return on assets and return on equity, it was evident from the commercial bank reports that the rates increased marginally and others had mixed indications thus performance is observed to have increased more proportionately as a result of the merger. ROE and ROA, increased in the preceding years, but a slower rate as shown in appendix 5.

5.3 Conclusion

From the findings conducted as described herein, one concludes that performance of commercial banks' as a result of mergers and acquisitions strategy is affected by the capital base, efficiency, competitiveness and expertise as indicated by the regression equation;

$$[Y=0.843+ 0.642X_1-0.232X_2 +0.167X_3+ 0.143X_4]$$

Showing that taking all the factors into account (capital base, efficiency, expertise and competitiveness at constant zero then performance is 0.843. However taking all the independent variables at zero, then a unit increase in capital base will lead to 0.642 increase in performance, the same way a unit increase in efficiency will lead to 0.167 increase in performance, similarly, a unit increase expertise will decrease performance by 0.212 and finally a unit increase in competitiveness will lead to 0.143 increase in performance respectively. This depicts that capital base continues to have the leading effect on commercial banks performance followed by efficiency then competitiveness and expertise which shows a negative relationship between merger or acquisition and the performance of commercial banks. The negative relationship between expertise and performance is an indication that the hiring of more professionals calls for an extra expense in the firm which negatively affects performance according to value destroying theories by (Ghauri & Buckley, 2003). At 5% level of significance and 95% level of confidence, then efficiency, capital base and competitiveness are significant in explaining the relationship between mergers and acquisitions and the performance of commercial banks in Kenya since their levels of significance are below 0.05 (which is the base significance level).

As pertains performance which was measured using ROE and ROA, the theory of mergers that $A + B = AB + SYNERGY$ is evident from Appendix 5. Some banks experienced negative ratios as a result of some factors which affect ROA and ROE like leverage which affects a company's ROE for example if interest rates, or the net cost of borrowing, decreases, ROE will improve. If the return on the company's assets (net income divided by total assets) goes down, the company will have a worse ROE.

Taking on more debt does not necessarily decrease ROE, as leverage can work in a company's favor and improve ROE if used wisely. *ROE* is more than a measure of profit; it's a measure of efficiency. A rising ROE suggests that a company is increasing its ability to generate profit without needing as much capital. It also indicates how well a company's management is deploying the shareholders' capital. In other words, the higher the ROE the better falling ROE is usually a problem according to Willie and Hopkins (1997).

Return on Assets (ROA) is an indicator of how profitable company's assets are in generating profit. Return on Assets shows how many dollars of earnings result from each dollar of assets the company controls. Return on Assets ratio gives an idea of how efficient management is at using its assets to generate profit. The only common rule is that the higher return on assets is, the better, because the company is earning more money on its assets. A low return on assets compared with the industry average indicates inefficient use of company's assets. Return on equity is an important measure of the performance of a company. Higher values are generally favorable meaning that the company is efficient in generating income on new investment. Investors should compare the ROE of different companies and also check the trend in ROE over time. In conclusion, industries have high return on equity because they require less capital investment. Other industries require large infrastructure build before generating any revenue. It is not a fair conclusion that the industries with a higher Return on Equity ratio are better investment than the lower ones. Generally, the industries which are capital-intensive and with a low return on equity have a limited competition. But, the industries with high return on equity and small assets bases have a much higher competition because it is a lot easier to start a business within those industries.

5.4 Recommendation

Following the findings from the analysis of the selected ratios of the financial institutions that have undergone mergers/acquisition in Kenya, the study recommends that institutions having weak capital base consolidate to create synergies so as to enjoy economies of scale as this will improve their performance instead of going public by listing on the Nairobi Stock Exchange as this may be an expensive venture as it requires much funds for listing.

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

Further, it is important to note that if the value of the shareholders' equity goes down, ROE goes up. Thus, write-downs and share buybacks can artificially boost ROE. Likewise, a high level of debt can artificially boost ROE; after all, the more debt a company has, the less shareholders' equity it has (as a percentage of total assets), and the higher its ROE is and thus the study recommends that for companies to remain profitable they must maintain lesser values of shareholders equity

5.5 Limitations and Areas for Further Research

The same study should be carried out in other firms in different industries to find out if the same results would be obtained. This study focused primarily on the commercial banking sector. There are many challenges facing the formation of mergers and the executions of acquisitions. A study should be carried to find out the challenges on formation of mergers and why many firms have not formed or considered forming mergers despite the advantages got from engagement in the same. Further study should also be done on other factors of mergers and acquisitions strategy on that could affect performance of commercial banks since the study only covered 87.8% of the factors.

5.6 Implication on Theory, Policy and Practice

The evidence from event studies on the efficiency of mergers is so extensive and consistent that a brief summary suffices. Acquisitions always entail a large gain for the target firm's shareholders over the market value of the freestanding entity. The proportional gain if anything has been rising over time and amounts to a premium of 30 percent for the change in corporate control via takeover, 20 percent via merger (Jensen and Ruback 1983). The average return to the bidding firm's shareholders is less clear.

Some studies have found small but statistically significant gains, others small losses. It seems safe to conclude that the bidder's shareholders approximately breakeven. A bundle for the target's shareholders plus zero for the bidder's still sums to a bundle, supporting the conclusion that mergers create value and accordingly are economically efficient and with tangible results in practice.

These results evidently invite the conclusion that mergers are profit- able and therefore socially desirable. If we accept the positive inference from event studies, the conclusion that mergers are productive may require no more theoretical foundation than the widely assumed disinclination of purposive individuals to leave currency on the footpath. The findings of this study in tandem with other correlated studies will be of major implications to all aspects of the economy both in policy, theory and practice. Among those who are likely to feel these implications more include; The Corporate Managers: In the networked business environment of today, managers need to understand, anticipate and manage the business dynamics inherent in various alliances.

This study will be helpful to managers in predicting and managing these to ensure sustained business profitability and in understanding at what point in the alliance relationship should a firm exit. The Government: In drafting monopoly and unfair competition laws to ensure a level playing field for both small and large businesses. Investors: Since investment decisions are made upon sufficient information about the companies concerned, this study will provide useful information to the investors on when to buy or sell stocks of companies that are in an alliance.

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APPENDICES

Appendix 1: Questionnaire

Instructions: Please tick where appropriate [/]

Section A: Demographic information

•Gender

Male [] Female []

•What type of a merger has the bank undergone

Horizontal [] Vertical [] Co generic [] Conglomerate []

•Highest level of qualification achieved

Diploma [] Degree [] Masters [] PhD []

Others (Please specify) _____

•What is your area management in the organization?

Finance [] operations [] Information technology Human resource []

Others (Please specify) _____

• For how long have you worked for the firm?

1-5 years [] 6-10 years [] 11-15years [] 16-21 years []

Others (please Specify) _____

Section B: Capital base

Rank the following statements with the following labels

5. Strongly agree 4. Agree 3. Neutral 2. Disagree 1.Strongly Disagree

		5	4	3	2	1
6.	The capital base of the bank has increased as a result of merger or acquisition.					
7.	The capital increment resulting from merging has helped in expansion?					
8.	The bank been able to meet the core capital requirement as per the Central bank					

	requirement?					
9.	The M&A has afforded more assets for the company seeing its growth and performance?					

Section C: Efficiency

Please Rank the following statements with the following labels

5. Strongly agree [] 4. Agree [] 3. Neutral [] 2. Disagree [] 1.Strongly Disagree []

		5	4	3	2	1
•.	The number of product lines has increased over the years after the merger or acquisition?					
•.	The merger or acquisition has increased the number of branches all across the country making services easily accessible to the customers?					
•.	The merger has been able to capture a great number of customer groups?					
•.	The merger or acquisition has been afforded the bank more loan products to different clients.					
•.	The attractiveness of the bank merger has increased customer deposits reducing the lending rates?					

Appendix 2: List of mergers and acquisitions

No.	Institution	Merged with	Current Name	Date approved
1	Universal Bank Ltd.	Paramount Bank Ltd.	Paramount Universal Bank	11.01.2000
2	Kenya Commercial Bank	Kenya Commercial Finance Co.	Kenya Commercial Bank Ltd.	21.03.2001
3	Co-operative Merchant Bank Ltd	Co-operative Bank ltd	Co-operative Bank of Kenya ltd	28.05.2002
4	First American Bank ltd	Commercial Bank of Africa ltd	Commercial Bank of Africa ltd	01.07.2005
5	Prime Capital &Credit Ltd.	Prime Bank Ltd.	Prime Bank Ltd.	01.01.2008
6	CFC Bank Ltd.	Stanbic Bank Ltd.	CFC Stanbic Bank Ltd.	01.06.2008
7	Savings and Loan (K) Limited	Kenya Commercial Bank Limited	Kenya Commercial Bank Limited	01.02.2010
8	City Finance Bank Ltd.	Jamii Bora Kenya Ltd.	Jamii Bora Bank Ltd.	11.02.2010
9	Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010

Acquisitions

No.	Institution	Acquired by	Current Name	Date approved
10	Mashreq Bank Ltd.	Dubai Kenya Ltd.	Dubai Bank Ltd.	01.04.2000

Author: Source CBK (2011)