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The Effect of Mergers and Acquisitions on Financial Performance of Banks (A Survey of Commercial Banks in Kenya)

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Abstract:

Mergers and Acquisitions perform a vital role in corporate finance in enabling firms achieve varied objectives and financial strategies. In Kenya, banks have been merging with the goal of improving their financial performance. Studies done on mergers and acquisitions have not conclusively established whether or not banks benefit from mergers. Most studies have observed that mergers did not lead to an improvement in financial performance as indicated by their profitability and earnings ratios. This study examined the banks that have merged or acquired in Kenya for the period between 2000 and 2014. The aim of the study was to analyze whether the merger had any effect on the banks' performance. The study was guided by the following specific objectives; to determine the effect of the mergers and acquisitions on the shareholders' value and to examine the implication of mergers and acquisitions on profitability. The study was a census of which all the 14 banks that have merged or acquired others in the period from 2000 to date were investigated. Data was collected by use of questionnaires with both open and closed ended questions. The collected data was analyzed using SPSS where the co-efficient of correlation obtained was used to determine the nature of the relationship between the independent and dependent variables. The study found out that the mergers and acquisitions raised the shareholders' value of the merged/acquiring banks in Kenya. The study further revealed that the main reason why most banks merged or acquired was to raise their profitability. The research questions were significant to the study and useful in arriving data conclusion. The researcher recommended that thorough feasibility studies should be carried out before the merger/acquisition process can be done. On areas of further research, it was recommended that effect of mergers/acquisitions in other sectors of the economy should be established with a view of drawing a parallel with the effects of the same processes in the banking sector.

1.1. Background of the Study

This section broadly discussed the concept of mergers and acquisitions highlighting how it has been done over the years by various sectors of the economy. The section also focused on the banking industry in Kenya and how mergers and acquisitions have been executed.

1.1.1. Mergers and Acquisitions

Mergers and acquisitions have hit headlines from the past as much as the present. They are being talked of and promoted the world over. Studies carried out have shown merger and acquisition activities on a wide range of sectors including banking & insurance, oil, gas, electricity among others. According to Brealey, 2006, Corporations from US incurred more than 1.7 trillion dollars on mergers and acquisition in 2000.

Sudarsanam (2003) found out that the main purpose of carrying out M&A is to increase the shareholders' value. Most firms seeking mergers and acquisitions seek to become the leading player in the product- market area of the strategic business unit. A lot has been happening on Mergers and acquisitions activities due to various factors. Samples of both corporate and financial buyers were able to achieve superior performance, Copeland (2005).

M&A are continuously occurring world over because they improve competition by gaining greater market share and reducing business risk (Kemal, 2011). The performance of two firms that have merged or acquired improves due to the increase of shareholders value (Sharma, 2009). The reasons that motivate M&A include economies of scale, revenue enhancement, tax reduction and others. Berger (1999) on the study on the role of capital in financial institutions asserts that mergers have become popular due to enhanced competition.

Many companies aim at improving their financial performance after merger and acquisition. Many of the studies show that mergers and acquisitions lead to better financial performance of companies. Contrary to this Ghosh, (2001), show results at odds with the view that mergers and acquisitions improve their performance.

M&A in Kenya in the banking sector have given out a dismal performance by some merged banking institutions and very positive performance by others. This has made stakeholders in the banking industry to wonder on whether M&A should be encouraged or not, (Muniu, 2012). The impact on local banks by the global financial crisis in 2008 can also facilitate mergers and acquisitions in the industry.

1.1.2. Banking Industry in Kenya

Banking is defined as the act of accepting money from members of the public on deposit repayable on demand or at the expiry of a fixed period or after notice (Banking Act, 2012). In Kenya, mortgage financial institutions and banks are regulated according to the provisions of the Banking Act. These banks are the players in the Kenyan banking industry and therefore a need to study them to ensure that they operate according to the law, (Gachanja, 2013). There are fourteen major M&A in Kenya since the year two thousand.

1.2. Statement of the Problem

Shareholders and managers of banks turn to mergers and acquisitions in the hope of improving financial performance in their banks but studies on this subject have produced mixed results. Some studies have suggested that merging banks perform better than the individual banks performed before the merger whereas other studies have not found any meaningful improvement in financial performance as a result of a merger. The study of Saple (2000) observed that mergers did not lead to an improvement in performance as measured by profitability adjusted for the industry average. Other than indicators with legal requirements by the central bank of Kenya merger restructuring has not improved the financial performance of the majority of merger institutions as indicated by the profitability and earnings ratios (Chesang, 2008). Shareholders contemplating mergers are at a loss due to the inconsistent findings by research studies on this subject. The conflicting findings have made it difficult for players in the banking sector to say with certainty whether merging two banks is a worthwhile undertaking (Athanasoglou&Brissimis, 2004 and Straub, 2007).

This study focused on mergers and acquisitions of banks in Kenya. The findings of the study provided bank managers and shareholders of similar banks with insights upon which they can base their decisions concerning mergers and acquisitions. The study therefore sought to determine the effect of mergers and acquisitions on financial performance of banks taking a survey of banking industry in Kenya.

1.3. Objectives of the Study

1.3.1 General Objective

The general objective of the study was to establish the effect of mergers and acquisitions on financial performance banks (a survey of banking industry in Kenya).

1.3.2 Specific Objectives

- (i). To determine the effect of the mergers and acquisitions on the shareholders' value in relation to financial performance
- (ii). To examine the implication of mergers and acquisitions on profitability of companies.

1.4 Research Questions

- (i). What was the effect of the mergers and acquisitions on shareholders' value in relation to financial performance?
- (ii). How did the mergers and acquisitions impact on profitability?

1.5 Significance of the Study

The study would have significance to a number of stakeholders. The study would be of value to investors and firms in NSE in having knowledge on the understanding of the importance of mergers and acquisitions in analyzing company performance. It would also benefit other firms in competitive industry and others not listed at NSE. The study would further provide more insight into the relationship between mergers and acquisitions and performance of commercial banks which would be of value to academicians and researchers in the same field. The environment is very dynamic making it a requirement for practitioners of management to update themselves and their respective industries on the best practices required. The study would also contribute to the bulk of knowledge and research at the University as it would be used as a basis of reference by students for any future study in the field of mergers and acquisitions.

1.6 Scope of the Study

The study covered all the 14 commercial banks in Kenya which had gone through merger/acquisition processes since year 2000 until the time of study. The study was based in Nairobi since the headquarters of the 14 commercial banks are based there.

1.7. Limitations of the Study

The researcher was not able to get information from the shareholders of the banks since it was difficult to get adequate sample frame of all the shareholders. The researcher, however, ensured that the questionnaires comprehensively obtained information from the bank managers regarding the opinion of shareholders on the issue of mergers and acquisitions.

2.1. Introduction

This chapter presented literature review on the effect of mergers and acquisitions on financial performance of companies. Both theoretical and empirical literature was reviewed. Theoretical review helped in getting an in-depth understanding of the current body of knowledge on the research topic. Empirical literature helped in understanding studies that have been done on the same area by other researchers and the recommendations therein. A conceptual framework, being a diagrammatic summary of the empirical review was drawn.

2.2. Theoretical Literature

Companies merge or acquire others in order to create value above the sum of the separate firms. This takes place when companies face problems and want to survive during hard times. The companies combine in order to compete favorably, reduce on costs and increase on the market share. This has made companies to give in to the pressure when they cannot stand alone (Murgia, 2000 & Myers, 2003).

2.2.1. The User Cost of Capital Theory

According to Romer (2006), this theory is from the concept that the capital used by firms is not rented but owned by the firms that use it. For the firms to acquire other firms or merge, a firm must consider the theory in making its decision. That is, to continue using its own capital, collaborate with another firm in using it or sell it. The limitations of this theory as pointed out by Romer is that it does not figure out any mechanism through which expectations affect the change in capital and it doesn't cater for the adjustment of cost of capital (Muniu, 2011).

2.2.2. Agency Theory

Shareholders may not have the necessary skills or expertise and time required to manage a company. Hence, they end up appointing other parties to run the company on their behalf. These parties are called management. When the managers want to increase their wealth at the expense of the shareholders this theory occurs. Even if the theory may reduce the value of the predator firm, management still prefers to seek a target and then the dependence of the firm so that their own competence can be enhanced (Jensen, 1986).

2.3. Empirical Literature

There are many studies carried on this area of mergers and acquisitions using stock prices. One of the weaknesses with these studies is that they depend on the already available information to investors and their anticipation that brings variance as compared to the actual value creation (Capron, 2002). The review of some of the studies is below.

Moeller (2005) on how shareholder control impacts merger payoffs determined that the total abnormal return of the firms acquiring others is 1.1 per cent in the same period. Few takeovers results in big losses leading to an experience of \$216 billion losses in the period from 1991 to 2001 to shareholders. Thus, it was not possible to incur the positive abnormal return.

A study by Chesang (2008) to determine the implications of merger restructuring on performance of banks in Kenya observed that merger restructuring has not led to an improvement of financial performance of the majority of the institutions that have undergone merger and acquisition. Capital adequacy and solvency ratios indicate highly on the financial performance of the banks that have merged or acquired others. This is because the ratios have legal implication. There was a decline in financial performance as was shown by the profitability ratios.

2.3.1. Financial Performance

It refers to the measure on how companies carry out their activities to achieve the set financial goals. Financial performance measures on how well companies do in terms of financial returns. This is done by using various evaluation methods and the financial indicators (Weston, 2001).

Paul (2001) carried out a study on evidence on mergers and acquisitions and asserts that a second approach to measuring merger effects is by evaluating the data from financial statements. This is done before and after the merger or acquisition in order to know what happened after the merger or acquisition. The study focuses on profit margins, cash flow statements, accounting rate of return among others.

2.3.1.1. Return on Equity

Return on Equity shows on how the bank management effectively handles the shareholders' funds to generate profits. There is a preference to a high return on equity for it shows the management is efficient in managing the shareholders' funds to generate revenues. A study AL Khalayleh (2001) in the relationship between accounting performance indicators for Jordanian firms showed a positive relationship between the market power per share and the return on equity ratio.

2.3.2. The Relationship of Mergers and Acquisitions and the Shareholders Value

Shareholders value is affected by different reasons behind mergers and acquisitions which include; achievement of economies of scale and increasing of market share. According to Brealey (2006), reduction of average unit cost of production as a result of reduction increasing output is what is referred to as economies of scale. As the market share increases, the force of the suppliers and buyers reduces. Companies are able to overcome price wars as well as utilizing technological advancements (Pandey, 2006).

Agency problem leads some companies to undertake mergers and acquisitions as the managers decide to increase their benefits at the expense of those of the shareholders (Berkovitch, 1993). The agency problem increases competition but competition by itself cannot eliminate it. The motive of agency and free cash flow destroys the value of the shareholders (Jensen, 1998).

2.3.2.1. Earnings per Share

Malik (2004) evaluated the relationship between shareholders value and EPS as well as return on capital employed. He established that there was a positive correlation between EVA and EPS. EPS is used to predict future cash flows, for the comparison of companies' performance to establish the impact of issuing common stocks.

2.3.3. *Effects of Mergers and Acquisitions on Profitability*

Bank profitability is the net after-tax income or net earnings of a bank (usually divided by a measure of bank size). Financial ratios are found to be the most generally used methods to measure bank profitability (Mamatzakis, 2007). Financial ratios help in analyzing and interpreting the banks financial data and accounting information which gives an understanding on a bank performance.

Pandey (2008) on his book entitled financial management asserts that a combination of two or more firms may result into cost reduction due to operating economies. A combined firm may avoid or reduce overlapping functions and facilities. It can consolidate its management functions such as marketing, research and development and reduce operating costs. Other factors remaining constant, growth leads to higher profits and increase in shareholders' value. A company may expand and /or diversify its markets internally or externally. If the company cannot grow internally due to lack of physical or managerial resources, it can grow externally by combining its operations with other companies through mergers and acquisitions. Mergers and acquisitions may help to accelerate the pace of a company's growth in a convenient and inexpensive manner.

Internal growth requires that the company should develop its operating facilities-manufacturing, research and marketing. Mergers and acquisitions, however, involve cost. External growth could be expensive if the company pays an excessive price for merger. Benefit should exceed the cost of acquisition for realizing a growth which adds value to shareholders. In practice, it has been found that the management of a number of acquiring companies paid an excessive price for acquisition to satisfy their urge for high growth and large size of their companies (Luypaert, 2008).

The definition of success may vary, but any activity that fails to enhance shareholders interest and value cannot be deemed as a success (Straub, 2007). A long term decline in shareholder wealth of a merger and acquisition can term the combination process to be a failure (Pike & Neale, 2006). The success of any merger was measured by the core competences generated to create value or enhance value. It was measured using the parameters such as market attractiveness and competitive positioning as a result of cost leadership and product differentiation.

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

There were companies that had sound acquisition records. Their targets were carefully selected and they rarely got involved in competitive auctions. What these companies had in common was a strategic approach to acquisition (Pike & Neale, 2002). Successful acquisitions were part of a long term strategic process designed to contribute towards overall corporate development. Firms were attracted by the opportunity to fully utilize tax shields, increase leverage, and exploit other tax advantages.

2.3.3.1. Return on Investment

This ratio is calculated as net profit after tax divided by total paid in capital (Majid& Said, 2002). The ratio measures the firm's efficiency in utilizing the invested capital. It expresses company's ability to generate the required return (expected return) based in using and managing the invested resources by the shareholders (Matarneh, 2009).

2.4. Summary of Literature Review and Gaps

Many studies have been done on mergers and acquisitions. Most of these studies have examined the effects of the mergers or acquisitions in several companies in a single study. For instance Kithiku's study examined the role of mergers and acquisitions on various commercial banks in Kenya (Kithitu, 2012). Studies of this kind have produced mixed results; some have found that merging companies benefited from the merger whereas others found that the mergers had no positive impact on the companies' performance. The inconsistent findings could be attributed to the fact that companies differ in many respects. Previous studies have similarly failed to examine the characteristics of particular banks before and after they merged. Consequently, all the literature available on this subject is conflicting and too general. It is difficult to make concrete conclusions on the basis of the existing literature. Therefore, there is a need for studies to be done on particular banks and the findings could be generalized to other banks with comparable characteristics.

2.5. Conceptual Framework

The conceptual framework contained, independent variables, intervening variables and a dependent variable. Independent variables were the variables which affect other variables to change and the researcher had control over them. The variables included shareholders’ value, profitability, synergy and operational efficiency. The dependent variable showed the effect of manipulating the independent variables. From the framework, the dependent variable was financial performance. Moderating variables stood between the independent and dependent variables and they moderated the implication of the independent variable on the dependent variable.

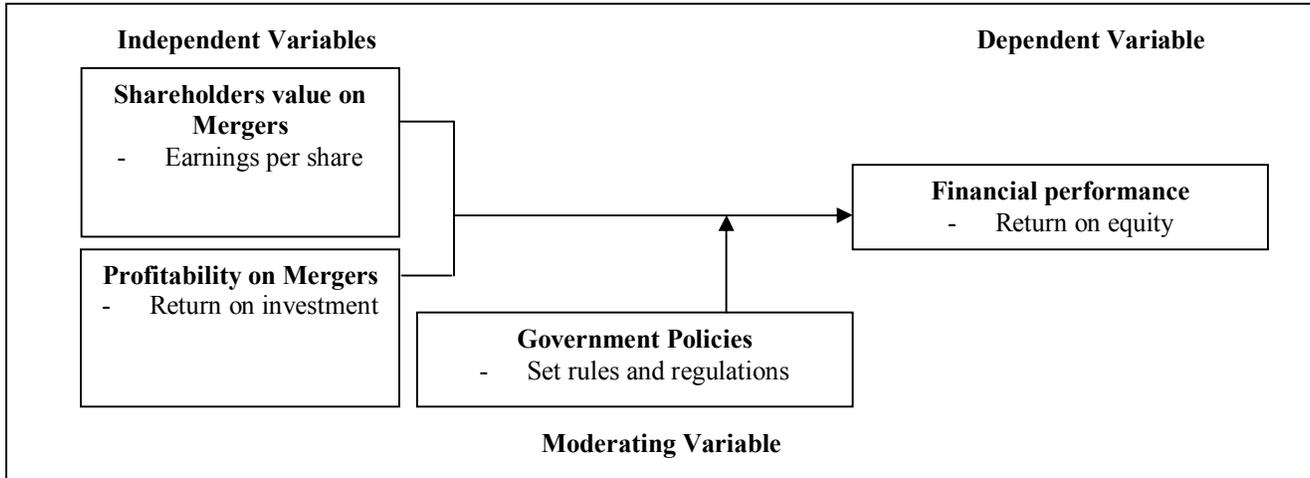


Figure 1: Conceptual Framework
Source: Author, 2014

3.1. Introduction

This chapter focused on the research methodology. It covered the research design, the study population, data collection, and data analysis.

3.2. Research Design

The study used descriptive survey design. This design serves best in studies that collect descriptive data. The study was largely descriptive in nature and that’s why this design was preferred. The design is used when describing the characteristics of a phenomenon in a particular situation (Kothari, 2008). The design helps in obtaining information on the current status of the merged banks.

3.3. Study Population

According to CBK report, there were 14 major mergers and acquisitions that had taken place in the banking industry in Kenya since 2000 to the time of study. The population of this study was comprised of all the 14 banks that had merged or acquired in Kenya since year 2000 to the time of study.

3.4. Sample Size

This study was a census and therefore, there was no need to sample given that all the elements in the population targeted were studied. A census was preferred due to the low number of elements in the targeted population besides the high level of accuracy that it provides.

| Number of Banks that have Merged/Acquired since Year 2000 | Number of Banks to be Studied | Percentage covered in the Study |
|---|-------------------------------|---------------------------------|
| 14 | 14 | 100% |

Table 1: Sample Size
Source: Author, (2014)

3.5. Data Collection

3.5.1. Data Collection Instruments

Data was collected by use of questionnaires with open ended and closed ended questions. This instrument was preferred due to its objectivity in data collection given that the respondents would give structured information. The questionnaire therefore, reduced cases of biasness. Further, use of questionnaires was convenient to the respondents and easy to analyze the collected data by the researcher.

3.5.2. Data Collection Procedure

The questionnaires were dropped in the banks and the managers were given three days to fill in the questionnaires. On the third day, the researcher collected the questionnaires from the respondents. In case, the researcher was unable to drop questionnaires to any respondent(s) during the first round, he would do so in the following week and provide three days for the questionnaires to be filled in. The second round of distributing questionnaires would also serve to collect the questionnaires which may not have been collected during the first round.

3.6. Data Analysis and Model

Data analysis is the process of bringing order, structure and meaning to the mass of information collected (Mugenda&Mugenda, 2003). The study used qualitative data thereby a need to employ a method that was suitable to the type of data. The data collected was analyzed through the help of SPSS (Statistical Package for the Social Sciences). Co-efficient of correlation (r) was obtained and used to determine the nature of relationship between the independent variables and the dependent variable. The multiple regression model below was used to analyze data:

$$ROE = a + b_1SV + b_2Pr + e$$

Where:ROE = Return on equity, SV = Shareholders’ value, Pr = Profit,a = constant and b_1 ,and b_2 ,are coefficients of the shareholders’ value and bank’s profit respectively.

3.7. Data Presentation

The analyzed data was presented by use of percentages, frequency tables, graphs and pie charts. The presented data was then used to make conclusions which in turn formed the basis for recommendations.

4. Research Finding and Discussions

In this chapter the collected data is analyzed and presented using various methods which includes frequency tables, pie charts, graphs and percentages. The research model is also analyzed and findings presented.

4.1. Response Rate

There was 93% response rate whereby 13 questionnaires were filled in and returned for analysis. This high response rate was achieved largely because the number of respondents was not large besides the researcher’s consistency in reminding the respondents to fill in the questionnaires in time. Response rates are calculated by dividing the number of usable responses returned by the total number eligible in the sample chosen. Mitchell (2007) suggests that the survey response rate should be calculated as the number of returned questionnaires divided by the total sample who were sent the survey initially. The essence of determining the response rate is to enquire whether it is sufficient enough to generalize the results to the target population. The response rate is presented in the table below:

| Targeted Population | Studied Population | Returned Questionnaires | Percentage |
|---------------------|--------------------|-------------------------|------------|
| 14 | 14 | 13 | 93% |

Table 2: Response Rate
Source: Author, 2014

4.2. Period in Merger/Acquisition

The study sought to find out the age of mergers and acquisitions in the banking industry in Kenya. The findings were as shown in the pie chart below:

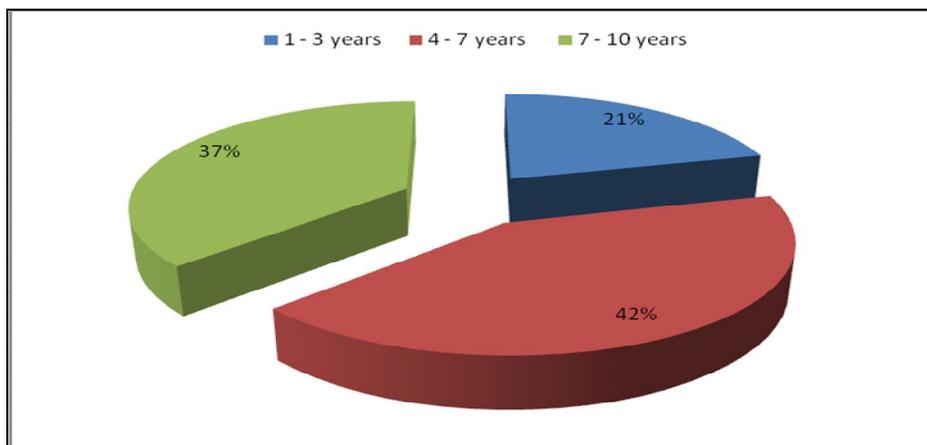


Figure 2: Period of Time in Merger/Acquisition
Source: Author, 2014

The findings of the study revealed that the majority of the mergers/acquisitions in the banking sector are 4 – 7 years followed by those between 7 – 10 years old as represented by 42% and 37% respectively. The remaining 21% of the mergers/acquisitions were done between 1 – 3 years ago as shown in figure 2 above.

The period of merger/acquisition was significant in determining the stage in which the organizations were in the process. The very young mergers/acquisitions would be going through teething problems while the ones that are above 7 years may be stable and reaping the consequences/returns of merger/acquisition. This study focused on the mergers and acquisitions that have taken place in the banking industry from year 2000. The period in which mergers and acquisition took place is most likely to have been largely influenced by internal forces of the organizations given that these findings do not connect one acquisition/merger to another. External influence may be such factors as competition and technological advancements.

4.3. Reason and Process of Merger/Acquisition

All the organizations that were studied indicated that the merger/acquisition process was a one-time process and not a step-to-step process i.e. 100% of the respondents noted that their organizations had a one-time merger/acquisition meaning that it was done once and not over a long period of time.

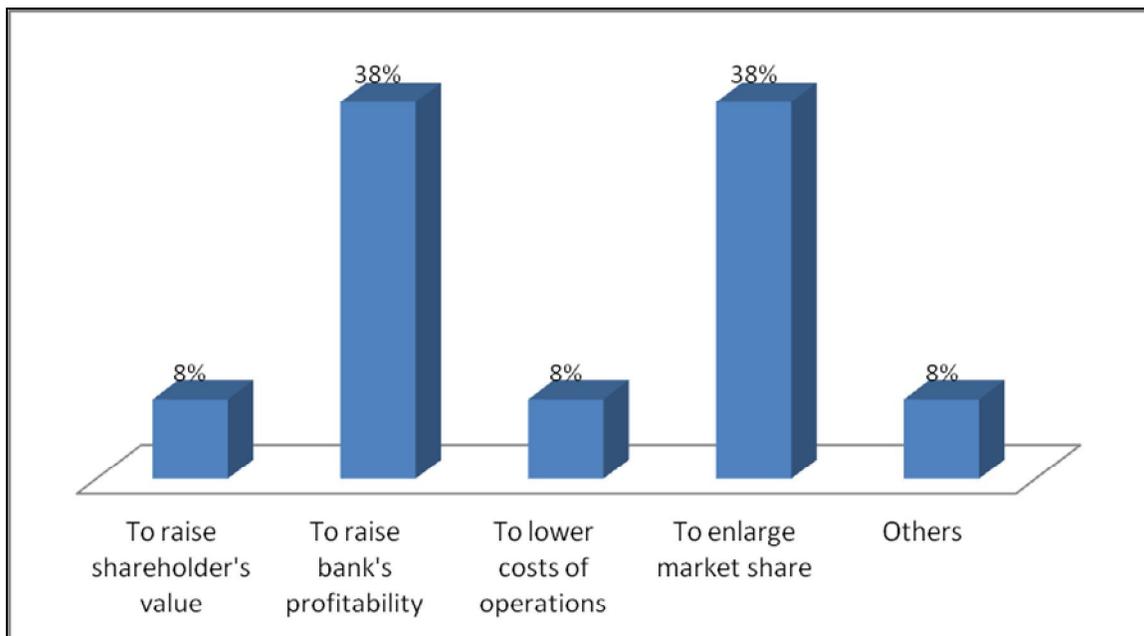


Figure 3: Major reason for merger/acquisition

Source: Author, 2014

On the main reason for merger/acquisition, the study found that the main reason why banks merged or acquired was to raise their profitability and to enlarge their market share as 38% of the respondents indicated. Only 8% of the banks merged and/or acquired to raise the shareholder's value while another 8% did so to lower their costs of operations. The remaining 8% of the banks merged and/or acquired for other reasons that were not listed in the questionnaire as indicated in the graph above labeled figure 3.

Profitability is the primary goal of all business ventures. Without profitability the business will not survive in the long run (Hofstrand, 2005). This explains why the main reason of mergers/acquisitions in banks is to raise their profitability. Enlargement of the market share is largely to raise the income and eventually the profitability of the organization. This therefore means that the main agenda of merging and acquiring in this case was to raise their profits.

4.4. Financial Performance

Under financial performance, the study sought to find out the changes in kind of change in net profit of the merged/acquired banks and how much of such changes were influenced by the merger/acquisition. The same information regarding return on capital was also sought.

4.4.1. Change in Net Profit and Return on Capital as a result of Merger/Acquisition

The study sought to find out how net profit of the merged/acquired banks changed after the process. The purpose of this was to determine the effect of merger/acquisition on net profit of the merged banks.

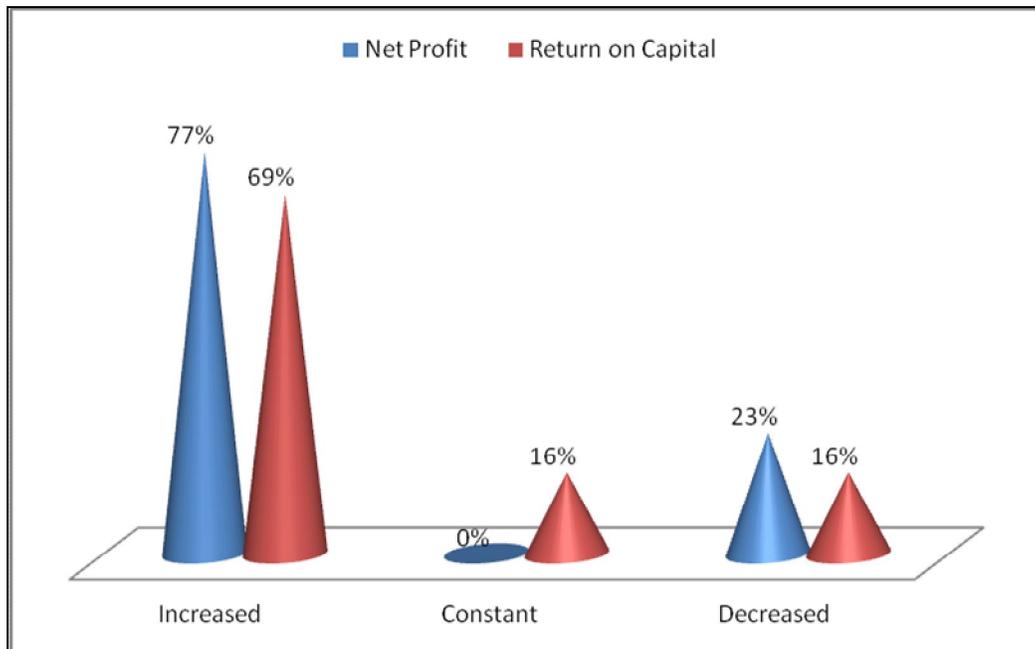


Figure 4: Change in Net Profit and Return on Capital
Source: Author, 2014.

The findings showed that 77% of the merged/acquired banks increased their net profit while 23% of them decreased as shown in the pie chart above labeled figure 4. On return on capital, 69% of the banks had increased in their return on capital, 16% of them had their return on capital remain constant while 16% of them had their return on capital decrease after the merger/acquisition process.

4.4.2. Influence of Merger/Acquisition on Net Profit and Return on Capital

On the level of influence of merger/acquisition on net profit of the banks 8% of the respondents indicated that the merger/acquisition did not have any influence. About 16% indicated that the influence was very low, 31% indicated that the influence was low while another 31% indicated that the influence was high. The remaining 16% of the respondents noted that the influence of mergers/acquisitions on net profit was very high.

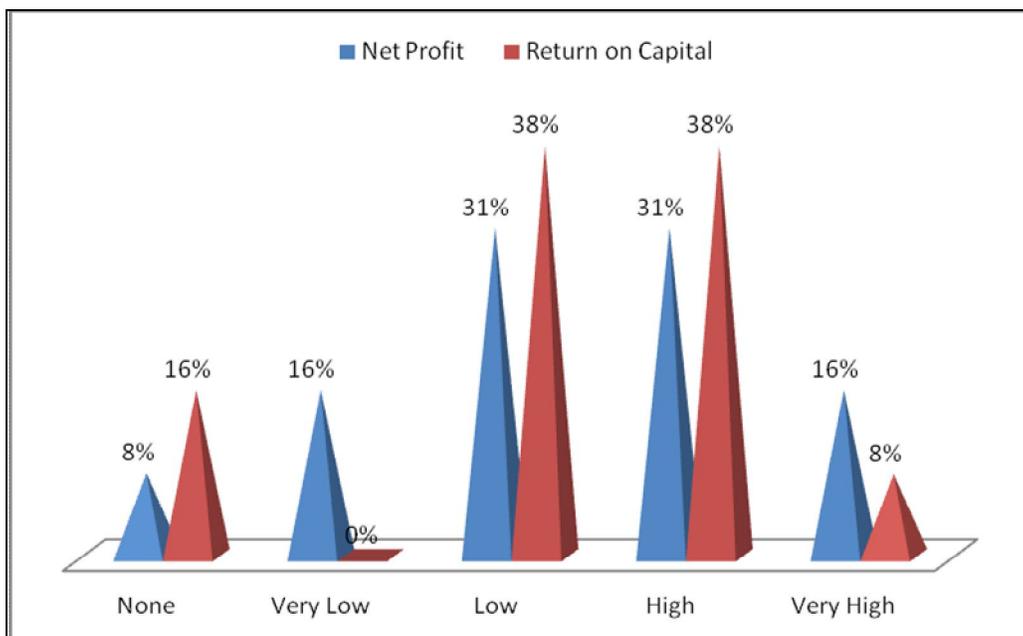


Figure 5: Influence of Merger/Acquisition on Net Profit and Return on Capital
Source: Author, 2014

On the influence of mergers/acquisitions on return on capital, 16% of the respondents indicated that there was no influence, 38% indicated that there was low influence while 38% indicated the influence was high. The remaining 8% of the respondents noted that the influence of merger/acquisition on return on capital was very high as shown in the graph above labeled figure 5.

4.5. Effect of Mergers/Acquisitions on Shareholders' Value

On the effects of mergers/acquisitions on the shareholders' value majority of the respondents agreed that the merger/acquisition in their banks raised the price of shares with 8% more strongly agreeing.

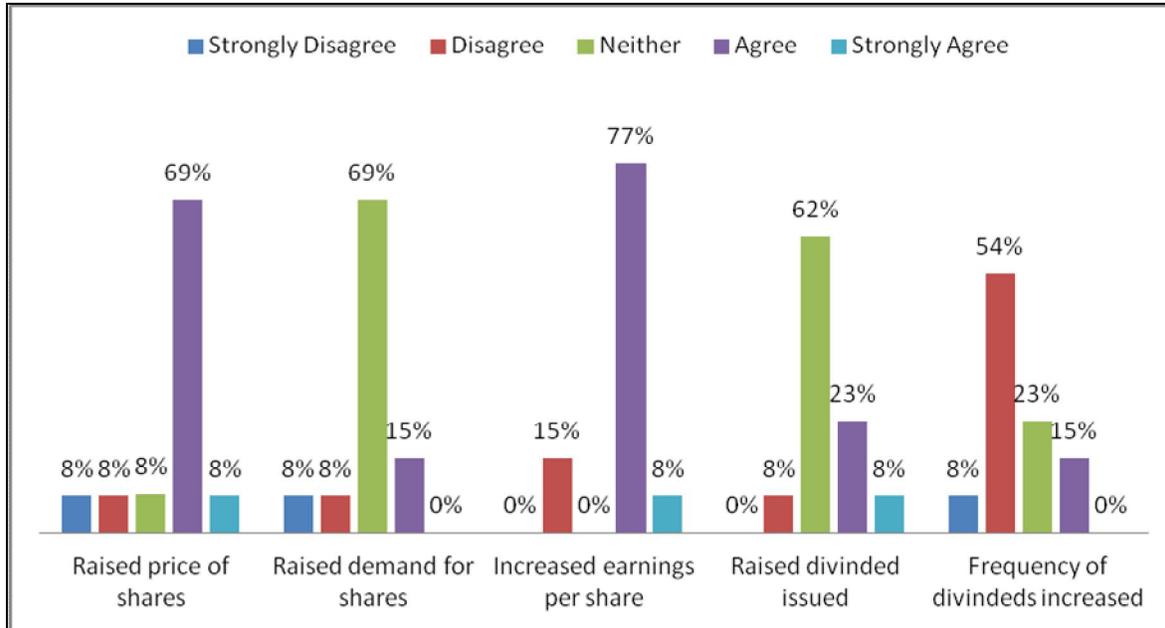


Figure 6: Effect of Mergers/Acquisitions on Shareholders' Value
Source: Author, 2014

On the other hand 8% disagreed and another 8% strongly disagreed. The remaining 8% neither agreed nor disagreed. On the demand for shares only 15% of the respondents indicated that the merger/acquisition increased demand for shares while about 16% disagreed. The majority of the respondents i.e. 69% neither agreed nor disagreed. On the earnings per share of the bank, a very high percentage of the respondents i.e. 77% agreed that the merger/acquisition raised it and 8% more strongly agreed making a total of 85% of the respondents who agreed that the earnings per share in their banks increased. Only about 15% of the respondents disagreed with the statement that the merger/acquisition increased the earnings per share. On the amount of dividends given by the bank, about 31% of the respondents in total agreed that the merger/acquisition raised the dividends issued to the shareholders while about 8% of the respondents disagreed. The majority who were about 61% of the respondents neither agreed nor disagreed. Finally, on the frequency of issuing dividends, only 15% of the respondents agreed that the merger/acquisition in their organizations increased the frequency while about 62% of the respondents in total indicated that the merger/acquisition did not increase the frequency of issuing dividends by the organizations. The remaining 23% of the respondents neither agreed nor disagreed with the statement as shown in figure 6 above.

4.6. Effect of Mergers/Acquisitions on Profitability of Banks

On the effect of mergers/acquisitions on profitability of the bank, the research sought to establish the effect on customers' volume, gross profit, net profit and market share. On the size of market share, majority of the respondents i.e. 77% indicated that the process of merging their business enlarged the bank's market share while only 23% of the respondents disagreed. However, on net profit of the bank, only 39% of the respondents agreed that the merger/acquisition increased the net profit while 46% and 15% neither agreed or disagreed and disagreed respectively. For the gross profit 46% agreed that the process increased the profit, 31% neither agreed nor disagreed while the remaining 23% disagreed. Finally, on the effect on the number of customers, about 77% of the banks increased their customers as a result of the merger/acquisition and only 23% of them did not increased in the number of their customers as shown in the graph below.

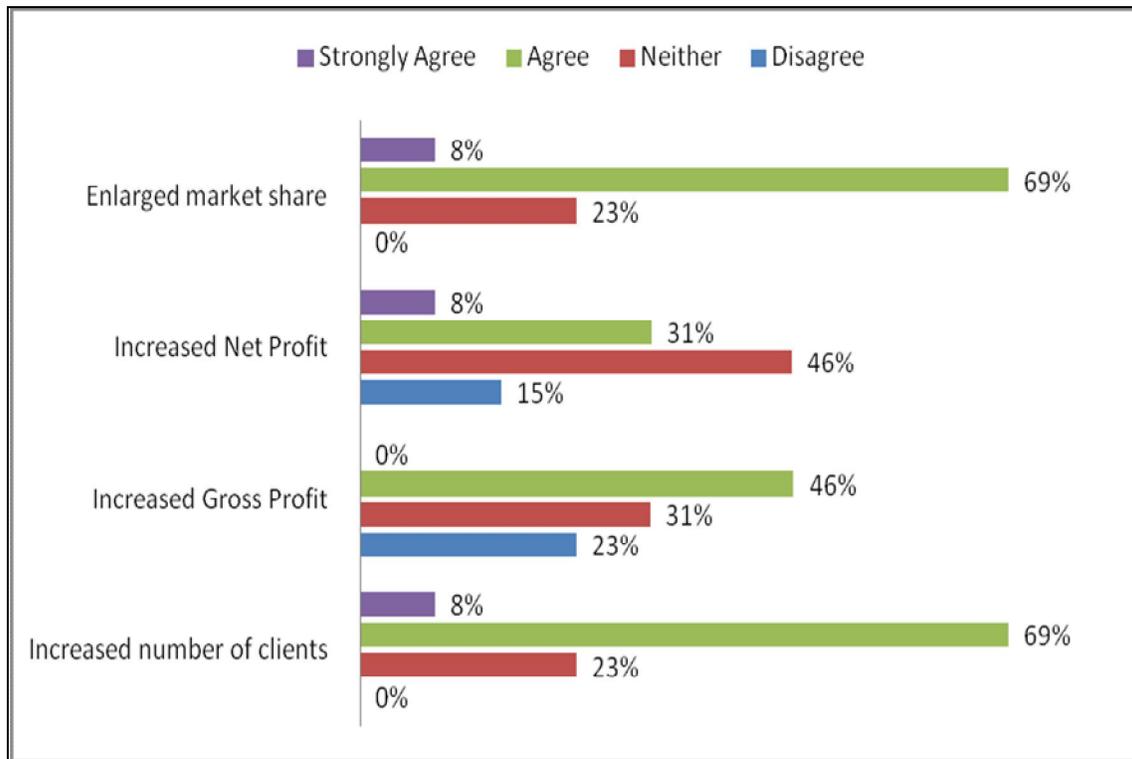


Figure 7: Effect of Mergers/Acquisitions on Profitability of Banks
Source: Author, 2014

4.7. Model Analysis

4.7.1. Model Summary

The study used a multiple regression model to determine the influence of independent variables on the dependent variable. The dependent variable was performance of the merged/acquired banks in terms of return on capital, while shareholders’ value on mergers, profitability on mergers, synergy on mergers and operational efficiency were the independent variables. The R-value was 0.697, as indicated in table 3 below, which represented the sample correlation and, therefore, indicated a high degree of correlation. This implies that there was connection between the independent variables and the dependent variable making this study valid.

| Regression Statistics | | | | |
|-----------------------|---------|---------|---------|----------------|
| Multiple R | 0.69701 | | | |
| R Square | 0.66154 | | | |
| Adjusted R Square | 0.66154 | | | |
| Standard Error | 0.11031 | | | |
| Observations | 13 | | | |
| ANOVA | | | | |
| | SS | MS | F | Significance F |
| Regression | 2.16501 | 0.27760 | 1.16444 | 0.03481 |
| Residual | 4.76009 | 0.13809 | | |
| Total | 6.9251 | | | |

Table 3: Model Analysis
Source: Author, 2014

4.7.2. Regression Coefficients

Using Excel, the values of the β s in the regression model $ROE = a + b_1SV + b_2Pr + b_3Sy + b_4OE + e$ were used to determine the causal effect of the independent variables on the dependent variable. Below are the values as extracted from Excel.

This means that 18.79% of the percentage change in return on equity is caused by the shareholders' value. As the bank's shareholders value increase the return on equity of the bank increases. Profitability as a result of merger/acquisition causes about 20.56% of the percentage change in return on equity of the banks that have merged/acquired in a positive way. On the other hand about 24.89% of the percentage change in return on equity caused synergetic effect that arises from a merger/acquisition. Operational efficiency resulting from merger/acquisition affects about 33.1% of the percentage change in return on capital. However, there is another component of changes in return on equity that is accounted for by other factors outside the four independent variables that are captured in this study. The specific model is as given below:

$$ROE = 2.55 + 0.1879SV + 0.2056Pr + 0.2489Sy + 0.331OE$$

| | Coefficients | Standard Error | t Stat |
|--|--------------|----------------|----------|
| Intercept | 2.550254 | 0.139062 | 2.408013 |
| Bank's Profitability/Return on Equity (Pr) | 0.2056493 | 0.155043 | 1.004679 |
| Shareholders' Value Values (Sv) | 0.1879022 | 0.011017 | 1.988714 |
| Synergy Values (Sy) | 0.2489022 | 0.004672 | 1.957294 |
| Operational Efficiency Values (OE) | 0.3309761 | 0.129584 | 0.886723 |

Table 4: Regression Coefficients

Source: Author, 2014

5. Summary, Conclusion and Recommendations

5.1. Summary of Major Findings

The findings of this study revealed that majority of the banks i.e. 42% merged or acquired other banks between 4 and 7 years ago. The recent mergers i.e. those that are below 4 years since they merged accounted for only 20% of all the mergers and acquisitions in the banking sector. On the main aim of merging or acquiring in the banking sector, it was established that most banks merged to raise their profitability through enlargement of their market share. The banks that merged or acquired for the purpose of enlarging their market share and raise their profitability accounted for about 76% of all the mergers and acquisitions in the banking industry in Kenya. The study further established that the mergers and acquisitions among the banks in Kenya raised the shareholder's value through raising the demand, price and earnings per share. However, the mergers and acquisitions did not have a significant effect on the amount of dividends declared to the shareholders and the frequency of issuing dividends. On the profitability of the banks, the mergers and acquisitions had a significant positive effect since the majority of the banks increased their market share, gross profit and net profit significantly. The number of account holders in the majority of these banks notably increased.

Finally, it was found out that all the two independent variables in the study, namely; shareholders' value and bank's profitability contributed significantly to the changes in return on capital of the banks that had gone through merger/acquisition processes. The two independent variables affected the return on capital of the banks positively, that is, an increase in the variable led to an increase in the return on equity of the bank.

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5.2. Conclusion

According to this study, the main reason why organizations and mostly within the Kenyan banking industry merge and/or acquire others, is to enlarge their market share and increase their profitability. This is achieved through two or more banks coming together, combining their resources together with one agenda to raise their profitability. Such resources as skills, management systems, equipment, processes and procedures are strengthened through the mergers and acquisitions with an aim of raising their productivity. In such a scenario, unless otherwise, the productivity is most likely to rise hence justifying the mergers and acquisitions in the banking sector.

These mergers and acquisitions increase the value of the shareholders' through raising the demand and consequently the price of the organizations' shares in the stock market. In events where the shares are not listed in the stock market the overall worth of the shareholding in a merged or acquiring organization also rises. While the merging and/or acquiring process may not have significant effect on the amount of dividends issued and how often they are issued, it raises the earnings per share given that the process increases the profitability of the organizations.

Further, mergers and acquisitions expand the capital base of the organization thus enabling the organization to access more resources and especially credit facilities that ensure that the business is liquid throughout the year. This enhances the stability and effectiveness of operations of the organization increasing the customer's satisfaction. In return, the profits may rise in the short and medium term while the organization increases the chances of growth and expansion in the long term. Customer loyalty is an immeasurable asset to any business. This study established that mergers and acquisitions raised the customers' loyalty in the banking sector. Customer loyalty, in the study, was characterized by customer's trust, confidence and general admiration to the organization's products which is as a result of the almost perfect satisfaction that they give to the customers.

5.3. Recommendations

The researcher recommends that further study should be carried out on the effect of mergers and acquisitions on financial performance of different sectors such as manufacturing and processing industries to enable in drawing a parallel with the effects in the banking sector. Key factors that determine success in mergers and acquisitions should also be established in order to provide critical insight to the merging and acquiring organizations before, during and after the process. This would be important since this study revealed that there is a percentage of organizations, though small, whose financial performance did not improve after the merger and acquisition. On the other hand, mergers and acquisitions should be well thought about processes which in view of this study should not necessarily be a one-time process. The process can be elongated to ensure that there is complete mutual understanding between or among the merging or acquiring organizations. This implies that intensive and extensive feasibility studies should be carried out before the merging or acquiring process is undertaken.

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APPENDICES

Appendix 1: List of the Banks to be studied

| NO. | Institution | Merged with | Acquired by | Name after merger | Date approved |
|------------|------------------------------------|--|---------------------------|------------------------------------|----------------------|
| 1. | Universal Bank Ltd. | Paramount Bank Ltd. | | Paramount Universal Bank | 11.01. 2000 |
| 2. | National Bank of Kenya Ltd. | Kenya National Capital Corporation | | National Bank of Kenya Ltd. | 24.05.2000 |
| 3. | Citibank NA | ABN Amro Bank Ltd. | | Citibank NA | 16.10.2001 |
| 4. | Bullion Bank Ltd. | Southern Credit Banking Corp. Ltd. | | Southern Credit Banking Corp. Ltd. | 07.12.2001 |
| 5. | Co-operative Merchant Bank Ltd. | Co-operative Bank Ltd. | | Co-operative Bank of Kenya Ltd. | 28.05.2002 |
| 6. | Biashara Bank Ltd. | Investment & Mortgage Bank Ltd. | | Investment & Mortgage Bank Ltd. | 01.12.2002 |
| 7. | Credit Agricole Indosuez (K) Ltd. | | Bank of Africa Kenya Ltd. | Bank of Africa Bank Ltd. | 30.04.2004 |
| 8. | First American Bank Ltd. | Commercial Bank of Africa Ltd. | | Commercial Bank of Africa Ltd. | 01.07.2005 |
| 9. | East African Building Society | Akiba Bank Ltd. | | EABS Bank Ltd. | 31.10.2005 |
| 10. | CfC Bank Ltd. | Stanbic Bank Ltd. | | CfCStanbic Bank Ltd. | 01.06.2008 |
| 11. | EABS Bank Ltd. | | Ecobank Kenya Ltd. | Ecobank Bank Ltd. | 16.06.2008 |
| 12. | Savings and Loan (K) Limited | Kenya Commercial Bank limited | | Kenya Commercial Bank limited | 01.02.2010 |
| 13. | City Finance Bank Ltd. | Jamii Bora Kenya Ltd. | | Jamii Bora Bank Ltd. | 11.02.2010 |
| 14. | Equatorial Commercial Bank limited | Southern Credit Banking Corporation Ltd. | | Equatorial Commercial Bank limited | 01.06.2010 |

Source: Central Bank of Kenya (2011)