EFFECT OF MERGERS AND ACQUISITIONS ON PROFITABILITY OF COMMERCIAL BANKS IN KENYA

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Declaration

This project is my own work and has not been submitted to any other University or College for an award.

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Dedication

This project is dedicated my father Kivindu and mother Fridah and the entire family for their support spiritual, financial and emotional and the continuous encouragement though out my studies.
Acknowledgement

Am thankful to almighty God for life, strength and provision this far, may his name be glorified forever. As I begin to reflect on the magnitude of this proposal, I am reminded of the team effort, the selfless Supervisor, family members, friends and Classmates Peter, Ann, Ruth, Julie, Wendo and Simon I am overwhelmed. There is difficulty in assigning a hierarchy since it has been a true team effort from the beginning.

To Mr.Nzulwa who has remained devoted to the vision that what we are doing will make a difference, by providing guidance all through the study. This Study will not be completed without your unswerving guidance, Dr.Kiliki and Jedidah who gave insights and ensured constant follow up on the progress of the work, much appreciation to Kenyatta University through the dean of school of Business Mr.Atheru for the financial support and to the giants whose shoulders i stand upon, the lecturers who have shaped so much of my financial understanding, strategies and skill, i acknowledge you in this study and i salute you once more.
Operational definition of terms

Acquisition - is an acquiring by one company of the share capital of another in exchange for cash, ordinary shares, loan stock, or some mixture of the two.

Expertise - Refers to the ability to execute a function or activity effectively by employing productive skills, experiences and competencies.

Merger - Corporate combination of two or more independent business corporations into a single enterprise, usually the absorption of one or more firms by a dominant one with aim of eliminating a competitor; to increase its efficiency; to diversify its products, services, and markets; or to reduce its taxes.

Profit - The surplus remaining after total costs are deducted from total revenue, and the basis on which tax is computed and dividend is paid. It is the best known measure of success in an enterprise.

Synergy - Refers to the concept that the value and performance of two companies combined will be greater than the sum of the separate individual parts or the potential financial benefit achieved through the combining of companies.
Abbreviations and Acronyms

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
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 as it requires much funds for listing and that those firms facing constraints on the market should consolidate their energies by resorting to merger/acquisition so as to expand their profitability as the merger/acquisition is not just for the best interest of the managers but also shareholders as it leads to an increase in shareholders’ wealth as opposed to each financial institution operating separately on its own.
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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 below: horizontal merger results when two or more firms in the same line of business are merged resulting in expansion of a firm's operations and elimination of a competitor; vertical merger occurs between different stages in the production or distribution process within the same line of business or industry, it results to increased control; co generic merger 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 involves the combination of firms in unrelated businesses (Hillier, Ross, Westerfield, Jaffe, & Jordan, 2004).

The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. This rationale is particularly alluring to companies when times are tough especially during financial crisis (Lambkin & Muzellec, 2008). Strong companies will act to buy other companies not only to create a more competitive and cost-efficient company but companies will come together hoping to gain a greater market share or achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone (Aber, 2005).

The advantages stemming from M&A’s have been evaluated in terms of the ability to exploit scale and scope of economies, gain market control, economize transaction costs, diversify risks, and provide access to existing expertise (McDonald, Coulthard, & Lange, 2005). Nonetheless, empirical evidence on M&As has also suggested that M&As might fail because of over-optimistic expectations of benefits and underestimation of post-integration difficulties like lack of market or technology relatedness and business culture clashes (Epstein, 2004).
According to Pike and Neale (2006), merger strategies are associated with the pooling of the interests of two companies into a new enterprise requiring the agreement by both sets of shareholders. Firms will thus seek that strategic position that will provide them with the maximum impact on the external environment, internal resources and competencies, and the expectations and influence of stakeholders (James, 2006).

A takeover or an acquisition, on the other hand, is as an acquisition by one company of the share capital of another in exchange for cash, ordinary shares, loan stock, or some mixture of the two: this directly results in the identity of the acquired being absorbed into that of the acquirer. Lin (2009) posits that a takeover is when the acquiring company gains control of another without the co-operation of its existing management. A number of scholars argue that mergers and acquisitions of companies are a common and important response to globalization and the changing market environment (Boateng, Qian, & Tianle, 2008).

Yanez, M (2007) argues that, despite the increasing popularity of mergers and acquisitions, reports indicate that more than two-thirds of large merger deals fail to create value for shareholders in the medium term. He found that the profitability of target companies, on average declines after an acquisition. Hernandez and Juan (2010) thus conclude that, it is in responses to environment, that an organization realizes that it does not have the strengths needed, nor the time required to develop such strengths as the opportunity might get lost, that it seeks and identifies another firm with which to merge or to acquire, that has appropriate capabilities and competences.

1.1.1 Historical development of Mergers

Morris (2004) underscore that the Mergers and acquisitions 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. The 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 the great merger movement, 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) add that, development by mergers tends to go in waves and tends to be selective in terms of industry and sector.

Shimizu, Hitt, Vaidyanath, & 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 thus therefore concluding that M & A’s were a dominant strategy for the 21st century. The waves were merging for monopolies, merging for oligopolies, conglomerate mergers, merging of skills and lastly merging for expansion.

1.1.2 Role of Mergers and Acquisitions on Firms’ Profitability

The definition of success may vary, but any activity that fails to enhance shareholders interest and value cannot be termed as a success (Hildebrandt, 2005). A long-term decline in shareholder 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 and 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 that had 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 profitability of the firm is arrived at. Olusola & Olusola (2012), concluded that profitability 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.
1.1.3 Mergers and Acquisitions in Kenya
In 2008, the then Finance Minister Amos Kimunya proposed to raise the minimum core capital for banks to 1 billion shillings from 250 million shillings, giving 2012 as the deadline for all banks to comply (Beck et al., 2010). Subsequently, Kenyan banks are set for consolidation to meet the deadline to boost minimum core capital. Two lenders, Equatorial Commercial Bank and Southern Credit Bank have already completed a merger citing the need to enlarge their branch network and balance sheet. The local implications on banks of enhanced capital rules abroad following the 2008 global financial crisis have also encouraged mergers and acquisitions in the sector.

Beck et al., (2010) posits that increased competition and capital adequacy requirements are the key drivers behind sector consolidation. Among the recent mergers are CFC/Stanbic Bank mergers, EABSAkiba Bank merger, EABS/ECOBANK. The 2003 merger of two local companies Apollo Insurance and Panafsic Insurance to form APA Insurance Company is a clear case of locally owned firms merging to create more synergies and remain competitive in a fast growing insurance industry, highly dominated by multinationals. 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 two local firms merging across industries). A report by Botchway (2010) indicated that (M&A) is a critical vehicle in facilitating corporate growth and productivity.

1.2 Statement of the problem
Empirical studies done on the area of mergers and acquisitions regarding their effect on profitability have not been conclusive on the nature of the relationship. Due to changes in the operating environment, several licensed institutions, mainly commercial banks, have had to merge; 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). However, some studies have shown that not all mergers are profitable due to poor management of the post-mergers challenges and hence the question whether mergers are profitable or not?

Pasiouras and Kosmidou (2007) found a positive relationship between the size and the profitability 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. Another determinant of bank profitability is the risk a bank is facing. Javaid, Anwar, Zaman, and Gafoor (2011), who examined bank mergers in Portugal, Spain, France and Germany, find that the loans-to-assets ratio, as a proxy for risk, has a positive impact on the profitability of banks this is contrary to (Athanasoglou, Brissimis, & Delis, 2008) among others who find a negative and significant relationship between the level of risk and profitability.

The above evidences, fail 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. Therefore, since the importance of merger and acquisition cannot be overemphasized, this prompted the researcher’s interest to establish the relationship of bank mergers with profitability on the commercial banks in Kenya.

1.3 Objectives of the study

1.3.1 General objective

The study was set out to determine the effect of mergers and acquisition on profitability of commercial banks in Kenya.

1.3.2 Specific objectives

1. To study the effect of capital base on profitability of mergers of commercial banks in Kenya.
2. To determine how efficiency because of merger affects profitability of commercial banks in Kenya.
3. To determine how competition influences profitability of mergers of commercial banks in Kenya.
4. To investigate the effect of expertise on profitability of mergers of commercial banks in Kenya

1.4 Research questions

1. What is the effect of capital base on the profitability of commercial bank mergers in Kenya?
2. How does the efficiency affect the profitability of commercial bank mergers in Kenya?
3. What effect does revenue have on profitability of commercial bank mergers in Kenya?
4. What is the relationship between expertise and profitability of commercial bank mergers in Kenya?

1.5 Significance of the study

The findings of this study are useful to the following:

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.

Individual Kenyan businesses: firms which intend to consolidate operations or aligning their strategies through alliances in future will be able to learn from experiences of firms under study.

Scholars who are interested in further research in this field will be able to investigate any research gap in the study not researched or be under researched by the researcher in the course of providing the evidences supporting the research topic and research problems.
1.6 Scope of the study
This project is on the effect of mergers and acquisition on the profitability of commercial banks in Kenya. The researcher based the work on the licensed commercial bank mergers approved by the central bank of Kenya (CBK). The study focused on commercial banks that were merged or acquired in the period 2000 to 2010 a period of ten years. This was done in Nairobi since all the commercial banks’ headquarters are in Nairobi.

1.7 Limitations of the study.
Time constraint was a major factor to the researcher, as the study required enough time in distribution, collection and analysis of questionnaire.

Some banks hid information from students who desires such information in order to maintain the banks secrecy thereby making it difficult for students to gather information for their research. However, this was curbed through acquisition of letter of data collection from the university.

Financing was also a factor since some trend data was purchased from the Nairobi securities exchange (NSE); however, the researcher worked closely with data provided by the central bank and observed the trends.
2.1 Introduction
This Chapter outlines the various theories and opinions propagated by various writers and authors of corporate finance and strategic management. 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 Framework

2.2.1 Monopoly – market power Theory
This theory viewed that Mergers were executed 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).

2.2.2 The Value-Increasing Theories
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 theory of efficiency 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, 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.

Dunis & Klein (2005) evidence this suggestion that we must, however, distinguish between ‘operative synergies’ or ‘efficiency gains’ achieved through economies of scale and scope – and ‘allocative synergies’ or ‘collusive synergies’ resultant from increased market power and an improved ability to extract consumer surplus when commenting on value creation in
mergers and acquisitions. Most of the more recent literature concludes that operating synergies are the more significant source of gain and that operating synergies may exist but may not be realised (Bernile & Bauguess, 2011)

2.2.3 The Value-Destroying Theories

The impact of mergers and acquisitions on the performance of the acquiring firm remains, however, at best, “inconclusive” and, at worst, “systematically 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 can be divided into two groups: the first assumes that the bidder’s management is ‘bounded rational’, and thus makes mistakes and incurs losses due to informational constraints despite what are generally value-increasing intentions. The second assumes rational but self-serving managers, who maximize a private utility function, which negatively affects firm value and profitability.

Within the first category, the theory of managerial hubris Roll (1986) suggests 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).

Berkovitch and Narayanan (1993) find strong evidence of hubris in US takeovers, and Goergen and Renneboog (2004) find the same in a European context. The latter estimate that about one third of the large takeovers in the 1990s suffered from some form of hubris. Malmendier and Tate (2005) show that overly optimistic managers, who voluntarily retain in-the-money stock options in their own firms, more frequently engage in less profitable diversifying mergers, and Rau and Vermaelen (1998) find that hubris is more likely to be seen amongst low book-to-market ratio firms that is, amongst the so-called ‘glamour firms’ than amongst high book-to-market ratio ‘value firms’.

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 Empirical review

2.3.1 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). 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.

### 2.3.2 Efficiency and profitability

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 profitability. 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 profitability is expected to be high.

The dynamic merger analysis indicates that the cost efficiency of merging banks is positively affected by the merger, while the relative degree of profit efficiency improves only marginally (Christopoulos, Lolos, & Tsionas, 2008). According to Devos, Kadapakkam, & Krishnamurthy (2009) comparatively the new companies surveyed had improved assets turnover and experienced a reduction in capital expenditures. There search findings however; differed from a survey conducted on 41 large banks that had completed a merger process in the United States of America; the survey reports and average improved of 13% on cost savings rather than an improvement or increase in income ((Altunba`cs & Marqués, 2008).
Odeck (2008) found that merged banks have increased efficiency in the years after the merger; this is especially true when the deal occurred between two banks operating on the same local markets, and when the size of the new entity was not too big. These sounds intuitively correct, as it is easier to implement cost savings when the institutions involved are not located too far from each other, and when the overall size of the new bank remains manageable.

Cloodt, Hagedoorn, & Van Kranenburg (2006) found that mergers between two equally-sized banks generated better efficiency gains there is great potential for efficiency and productivity improvements in the bus industry; mergers outperformed non-mergers as far as scale efficiency was concerned; and the merger process led to productivity improvements in the post-merger periods for the reasons that merged companies utilized their scale economies to improve efficiencies while the non-mergers significantly became more technically innovative in order to be competitive.

Cloodt, Hagedoorn, & Van Kranenburg (2006) in another study to determine whether banks involved in horizontal mergers achieve efficiency improvements relative to other firms indicate that during 1981–1986, horizontal bank mergers did not yield efficiency gains. Notably, the findings are based on the mergers believed to be most likely to result in efficiency gains, i.e., they are horizontal mergers, the firms exhibit considerable deposit overlap, and the acquiring firms are, on average, more efficient than the acquired.

Behr & Heid (2011) their results on hospital mergers showed no significant effect on technical efficiency and a significant negative effect of 2–2.8% on cost efficiency. However, positive effects on both cost and technical efficiency were found in one merger where more hospitals were involved, and where administration and acute services were centralized and thus cost efficiency is results to profit efficiency. Through firms merging or acquiring each other, the employees with different competencies and skills come together and a new team is formed of the best performers and this eliminates inefficient employees and management increasing efficiency.
2.3.3 Competition and profitability

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 profitability. 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.

2.3.4 Expertise and profitability

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 profitability (Panagiotakopoulos, 2012). He adds that productivity and profitability 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 profitability of women-owned firms, whereas measures of financial capital had a greater impact of the profitability 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.
2.3.5 Financial profitability Measurement

Performance measurement enables stakeholders to hold organizations accountable and to introduce consequences for performance (Ross, Westerfield, Jaffe, & 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 profitability due to synergies. Several financial profitability measures have been adopted between the financial statements analysis and long term planning (Ross, Westerfield, Jaffe, & Jordan, 2008). In this study several financial ratios have been adopted Return on Equity (ROA), a measure of bank profitability 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 profitability and has become the most common measure of bank profitability in the literature.

\[
\text{ROA} = \frac{\text{Net income}}{\text{Total assets}}
\]

ROA provides useful information about bank profitability, 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 profitability.

Thus, on review of the financial performance measures of banks, ROA and ROE will be considered as a general measure of banks' profitability.
Other ratios to be used in the study to indicate efficiency and capitalization are as shown below;

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

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

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

2.3.6 Research Gaps
From the studies conducted, there is mixed evidence about the effect of mergers and acquisitions on the profitability of commercial banks. It is therefore, important for bankers, bank regulators, supervisors, investors and researchers to understand how mergers and acquisitions affect the profitability 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 profitability 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 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.
2.4 Conceptual Framework

Conceptual framework is a schematic diagram of the independent variables and the dependent variables. The independent variables in this research will be capital base, efficiency, competitiveness and expertise. The dependent variable of the study will be bank profitability which will be indicated by return on assets and return on equity.

Independent variables

- **CAPITAL BASE**
  - Financial capital ratios
  - (Debt equity ratio, Equity to asset ratio)

- **EFFICIENCY**
  - Costs (Cost income ratio, operating ratio)

- **COMPETITIVENESS**
  - Product lines
  - Differentiation
  - Market power
  - Focus

- **EXPERTISE**
  - Skills
  - Experiences
  - Competencies

Dependent variables

- **BANK PROFITABILITY**
  - ROA
  - ROE

Figure 2.4: Conceptual framework, Source: (Author, 2013)
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.

3.2 Research Design
Research design is the ultimate blueprint for the collection, measurement and analysis of data (Kothari, Ramanna, & Skinner, 2010). The study used descriptive research design. Cooper & Schindler (2006) describes this method to be a detailed description of events, situations and interactions between people and things. 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 bank managers.

3.3 Target Population
Mbwesa (2006) defines population as an entire group of individuals, events or objects having common observable characteristics. The population of interest in this comprised of 24 banks that merged or been 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 3). The period selected provided insightful and relevant information on the profitability of mergers and acquisition in Kenyan Banking industry.

3.4 Sampling Design
Purposive sampling technique was be used in this study. This is because of the variation in date of merger or acquisition and the uniform periods before and after merger, this will involve 3-5 years before and after the merger hence provide information on medium and long-term effect of merger or acquisition on profitability of commercial banks. The sample includes 8 bank mergers, which resulted from merging of 16 banks in the study period of 10 years from 2000 to 2010. The table below shows the sampling frame. The respondents included bank managers from various departments like; finance, operations, human resource
and planning and strategy departments. Thus five respondents were required from each bank.

Table 3.4: Sampling frame

<table>
<thead>
<tr>
<th>Time Frame</th>
<th>No of banks that merged</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-2003</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>2004-2005</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>2006-2008</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>2009-2010</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>24</td>
<td>16</td>
</tr>
</tbody>
</table>

Source (CBK, 2011)

3.5 Data collection

The researcher used self-administered questionnaires for primary data through drop and pick method to specific managers. The study also used secondary sources of data from published audited annual reports of accounts for the population of interest, C.B.K., N.S.E., C.M.A and the selected bank Mergers.

3.6 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 analysed using regression technique as shown in the regression model below. A linear regression model was used to indicate the extent to which each independent variable affected profitability of commercial banks in Kenya. The model is as below

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e \]
Where \( Y \) presented profitability the depended variable, \( \beta_0 \) is a constant term, \( X_1 \)-Capital base, \( X_2 \)-Efficiency, \( X_3 \)-Competitiveness and \( X_4 \)-expertise are the independent variables and \( \varepsilon \) is the disturbance term.
CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

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 on profitability of commercial banks in Kenya.

4.2 Demographic Information

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.

![Gender of respondents](image)

Figure 4.2.1 Gender of the respondents

4.2.2 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 congeneric as shown in figure 4.3 below.

**Figure 4.2.2** The type of merger the bank has undergone

### 4.2.3 Level of education

The study 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 4.2.3: level of education**
4.2.4 Area of management

On area of management of the respondents, 33% were finance managers, 16.67% were operation managers, 16.67% were information technology managers and 33.33% were human resource managers. The number of finance and human resource managers was high taking a percentage of 33.33% each as opposed to operations and information technology managers which had 16.67% each this indicated that finance and human resource were the key departments among the commercial banks.

Area of Management

<table>
<thead>
<tr>
<th>Area of Management</th>
<th>Finance</th>
<th>Operations</th>
<th>Information Technology</th>
<th>Human Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>33.33%</td>
<td>16.67%</td>
<td>16.67%</td>
<td>33.33%</td>
</tr>
</tbody>
</table>

Figure 4.2.4 Area of management

4.2.5 Years of experience

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

To understand the effect of merger or acquisition 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 as indicated by a mean of 4.1667 and a standard deviation of 0.75277; the merger or acquisition has afforded more assets seeing its growth and profitability as indicated by a mean of 4 and standard deviation of 0.63246 and lastly they attested 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 4.3: Aspects of capital base

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

4.4 Efficiency

Efficiency was another independent variable in the study to determine whether the merging or acquisition had an effect on profitability of commercial banks. The findings showed the different extends 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 has 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 4.4: Aspects of efficiency

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

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 4.5: Aspects of competitiveness

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

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 had any effect on the profitability of commercial banks. The respondents' respondent to the different aspects of expertise at different levels of agreement where the mean and standard deviation were computed as shown in the table 4.6. The respondents agreed that the bank has 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 has been eliminated through reviewing of job descriptions and specifications as shown by a mean of 4.1667 and a standard deviation of 0.40825; specializations have enhanced invention and innovation hence meeting the customers emerging needs shown by a mean of 4.3333 and a standard deviation of 0.51640; the bank mergers have 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 4.6: Aspects of Expertise

<table>
<thead>
<tr>
<th>Aspects indicating efficiency</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>The bank has attracted a rich pool of skilled and efficient professionals</td>
<td>4.6667</td>
<td>.5164</td>
</tr>
<tr>
<td>Inefficient management has been eliminated through reviewing of job descriptions and specifications</td>
<td>4.1667</td>
<td>.40825</td>
</tr>
<tr>
<td>Specialization has enhanced invention and innovation hence meeting the customers emerging needs</td>
<td>4.3333</td>
<td>.5164</td>
</tr>
<tr>
<td>The bank has improved work culture and ethics through frequent trainings, workshops and seminars</td>
<td>4.0000</td>
<td>.63246</td>
</tr>
</tbody>
</table>

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.

Table 4.7: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.937</td>
<td>0.878</td>
<td>0.865</td>
<td>0.65244</td>
</tr>
</tbody>
</table>

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 (profitability 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 profitability of commercial banks in Kenya.
Table 4.8 Coefficient of determination

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>.843</td>
<td>.175</td>
<td>4.847</td>
<td>.000</td>
</tr>
<tr>
<td>The capital base</td>
<td>.642</td>
<td>.082</td>
<td>.586</td>
<td>.000</td>
</tr>
<tr>
<td>Expertise</td>
<td>-.212</td>
<td>.083</td>
<td>-.246</td>
<td>.006</td>
</tr>
<tr>
<td>Efficiency</td>
<td>.167</td>
<td>.063</td>
<td>.223</td>
<td>.011</td>
</tr>
<tr>
<td>Competitive</td>
<td>.143</td>
<td>.082</td>
<td>.132</td>
<td>.034</td>
</tr>
</tbody>
</table>

As per the SPSS generated table above, the equation \(Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon\) 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 profitability 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 profitability, the same way a unit increase in efficiency will lead to 0.167 increase in profitability, again a unit increase in efficiency will decrease profitability by 0.212 and finally a unit increase in competitiveness will lead to 0.143 increase in profitability respectively. This depicts that capital base continues to have the leading effect on commercial banks profitability followed by efficiency then competitiveness and expertise which shows a negative relationship between merger or acquisition and the profitability 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 and the profitability of commercial banks in Kenya since their levels of significance are below 0.05 which is the significance level.
CHAPTER FIVE
SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter discusses 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 on the profitability of commercial banks in Kenya. The specific objectives included: determining the effect of capital base on the profitability of commercial banks, determining the effect of efficiency on the profitability of commercial banks, how efficiency as a result of mergers or acquisition affects the profitability of commercial banks and finally to determine the effect of competitiveness on the profitability of commercial bank mergers and acquisitions in Kenya.

5.2 Summary of findings
The findings showed that, most of the commercial banks had undergone a horizontal type of merger as shown by 50% on the graph this is in line with Pandey (2010) view that horizontal mergers are aimed at reducing competition. The respondents had undergraduate degrees followed by masters' degrees then PHDs had the least percentage. However, most of the respondents regarding the area of management were human resource 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 the bank increase 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 profitability of commercial banks, the findings as per the different aspects showed that most of the respondents agreed that the merger costs reduced as a result of synergies and economies of scale. Technology was also an aspect of efficiency and the respondents agreed
that it led to reduced customer service time and increased inventions and innovations through research and development these findings on efficiency were in line with (Gakure, Keraro, Okari, & Kiambati, 2010) who argued 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 profitability.

As regards competitiveness, the mergers and acquisitions were 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, 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. Expertise was also an aspect to test the effect of mergers and acquisitions in profitability of commercial banks. The 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 profitability of commercial bank mergers and acquisitions which were 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 profitability 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 Conclusions
Thus study thus concludes that profitability of commercial mergers and acquisitions 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 profitability 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 profitability, the same way a unit increase in efficiency will lead to 0.167 increase in profitability, again a unit increase in expertise will decrease profitability by 0.212 and finally a unit increase in competitiveness will lead to 0.143 increase in profitability respectively. This depicts that capital base
continues to have the leading effect on commercial banks profitability followed by efficiency then competitiveness and expertise which shows a negative relationship between merger or acquisition and the profitability of commercial banks. The negative relationship between expertise and profitability is an indication that the hiring of more professionals calls for an extra expense in the firm which negatively affects profitability 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 profitability of commercial banks in Kenya since their levels of significance are below 0.05 which is the significance level. As regards profitability 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 profitability 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 Recommendations

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

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

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 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 banking sector. There are many challenges facing the formation of mergers. A study should be carried to find out the challenges on formation of mergers and why many firms had not formed mergers despite the advantages got from formation of the mergers. Further study should also be done on other
factors that could affect profitability of commercial bank mergers and acquisition since the study only covered 87.8% of the factors.
REFERENCES


Bernile, G., & Bauguess, S. (2011). Do merger-related operating synergies exist?


APPENDICES

Appendix 1: Cover letter

Gladys KaseviKivindu
Department of accounting and finance
School of Business, Kenyatta University
P.O BOX 43844-00100
Nairobi; Kenya
Email: gladowest@gmail.com

Dear informants,
I am a Master of Business Administration (MBA) student of Kenyatta University. My area of specialization is finance and am currently conducting a study on "The effect of mergers and acquisitions on profitability of commercial banks in Kenya". The purpose of the study is to justify the existence of mergers and acquisition by looking at whether they are profitable or not.

Participating in this survey is voluntary and the job of the participant will not be affected by filling the questionnaire or not filling it. The activity takes 20 minutes to complete. Additional information is encouraged to make the study more meaningful. All provided information will be treated with utmost confidentiality.

I appreciate your time and support in completing this study, a final copy will be availed upon request.

Yours faithfully,
Gladys Kivindu (0723-776895)
Appendix 2: Questionnaire

Instructions: Please tick where appropriate (/)

Section A: Demographic information

1. Gender
   Male ( ) Female ( )
2. What type of a merger has the bank undergone
   Horizontal ( ) Vertical ( ) Congeneric ( ) Conglomerate ( )
3. Highest level of qualification achieved
   Diploma ( ) Degree ( ) Masters ( ) PhD ( )
   Others (Please specify) ____________________________
4. What is your area management in the organization?
   Finance ( ) operations ( ) Information technology Human resource ( )
   Others (Please specify) ____________________________
5. For how long have you worked for the firm?
   1-5 years ( ) 6-10 years ( ) 11-15 years ( ) 16-21 years ( )
   Others (Please Specify) ____________________________

Section B: Capital base

Rank the following statements with the following labels

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. The capital base of the bank has increased as a result of merger or acquisition.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. The capital increment resulting from merging has helped in expansion?</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>8. The bank been able to meet the core capital requirement as per the Central bank requirement?</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>9. The merger or acquisition has afforded more assets for the company seeing its growth and profitability?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Section C: Efficiency

Please Rank the following statements with the following labels
5.Strongly agree ( ) 4. Agree ( ) 3. Neutral ( ) 2. Disagree ( ) 1.Strongly Disagree ( )
10. Merging/ acquisition have reduced costs of running the bank?  
11. Service costs have reduced?  
12. Marketing costs have reduced?  
13. Salaries and operating costs have reduced?  
14. Improved technology has increased innovation hence meeting customer demands efficiently?  
15 Improved technology has advanced research and development hence provision of efficient services.  
16. Improved technology has reduced customer service time and related costs as they can serve themselves at their convenience?  

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Merging/ acquisition have reduced costs of running the bank?</td>
<td></td>
<td></td>
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<tr>
<td>11. Service costs have reduced?</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>12. Marketing costs have reduced?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Salaries and operating costs have reduced?</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>14. Improved technology has increased innovation hence meeting customer demands efficiently?</td>
<td></td>
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<tr>
<td>15. Improved technology has advanced research and development hence provision of efficient services.</td>
<td></td>
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</tr>
<tr>
<td>16. Improved technology has reduced customer service time and related costs as they can serve themselves at their convenience?</td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Section D: Competitiveness

17. What are some of the differentiated products and services the bank is offering to customers? For example different interest rates for different products like school fees, business loan etc

Rank the following statements with the following labels to explain the extent to which the bank has fared since the merger/ acquisition
5. Strongly agree ( )  4. Agree ( )  3. Neutral ( ) 2. Disagree ( ) 1.Strongly Disagree ( )

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>18. The number of product lines has increased over the years after the merger or acquisition?</td>
<td></td>
<td></td>
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<tr>
<td>19. The merger or acquisition has increased the number of branches all across the country making services easily</td>
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<tr>
<td>accessible to the customers?</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>20. The merger has been able to capture a great number of customer groups?</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>21. The merger or acquisition has been afforded the bank more loan products to different clients.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>22. The attractiveness of the bank merger has increased customer deposits reducing the lending rates?</td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

Section E: Expertise

Rank the following statements with the following labels to explain the extent to which the bank has fared since the merger/acquisition


<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>23. The bank has attracted a rich pool of skilled and efficient professionals?</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>24. Inefficient management has been eliminated through reviewing of job descriptions and specifications and selecting the best performers from the different banks merging.</td>
<td></td>
<td></td>
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<tr>
<td>25. The bank has embraced specialisation hence innovation and invention of skills and means to meek customers emerging demands.</td>
<td></td>
<td></td>
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<tr>
<td>26. The bank has improved work culture and ethics through frequent trainings, workshops and seminars.</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
Appendix 3: Observation schedule

A: First bank
B: Second bank
AB: Sum of the first and the second bank

<table>
<thead>
<tr>
<th>Year/Variables</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Value in Ksh.)</td>
<td>A:</td>
<td>A:</td>
<td>A:</td>
<td>AB:</td>
<td>AB:</td>
<td>AB:</td>
</tr>
<tr>
<td></td>
<td>B:</td>
<td>B:</td>
<td>B:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets (Value in Ksh)</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>A:</td>
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<td>A:</td>
<td>AB:</td>
<td>AB:</td>
<td>AB:</td>
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<tr>
<td></td>
<td>B:</td>
<td>B:</td>
<td>B:</td>
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<tr>
<td>Market share %</td>
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<td></td>
<td>A:</td>
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<tr>
<td>Profit after interest and tax</td>
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<tr>
<td>(Value)</td>
<td>A:</td>
<td>A:</td>
<td>A:</td>
<td>AB:</td>
<td>AB:</td>
<td>AB:</td>
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<td>B:</td>
<td>B:</td>
<td>B:</td>
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<tr>
<td>Return On Assets (ROA) %</td>
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<td>B:</td>
<td>B:</td>
<td>B:</td>
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<tr>
<td>Return On Equity (ROE) %</td>
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<td>B:</td>
<td>B:</td>
<td>B:</td>
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<tr>
<td>Share holders' equity (Value)</td>
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<tr>
<td></td>
<td>A:</td>
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<td>AB:</td>
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<td></td>
<td>B:</td>
<td>B:</td>
<td>B:</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source (Research data)
Appendix 4: List of mergers and acquisitions

<table>
<thead>
<tr>
<th>No.</th>
<th>Institution Merged with</th>
<th>Current Name</th>
<th>Date approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Universal Bank Ltd.</td>
<td>Paramount Bank Ltd.</td>
<td>11.01.2000</td>
</tr>
<tr>
<td>2</td>
<td>Kenya Commercial Bank</td>
<td>Commercial Bank Ltd.</td>
<td>21.03.2001</td>
</tr>
<tr>
<td>3</td>
<td>Co-operative Merchant Bank Ltd.</td>
<td>Co-operative Bank of Kenya Ltd</td>
<td>28.05.2002</td>
</tr>
<tr>
<td>4</td>
<td>First American Bank Ltd.</td>
<td>Commercial Bank of Africa Ltd</td>
<td>01.07.2005</td>
</tr>
<tr>
<td>5</td>
<td>Prime Capital &amp; Credit Ltd.</td>
<td>Prime Bank Ltd.</td>
<td>01.01.2008</td>
</tr>
<tr>
<td>6</td>
<td>CFC Bank Ltd.</td>
<td>Stanbic Bank Ltd.</td>
<td>CFC Stanbic Bank Ltd.</td>
</tr>
<tr>
<td>7</td>
<td>Savings and Loan (K) Ltd.</td>
<td>Commercial Bank Ltd.</td>
<td>01.02.2010</td>
</tr>
<tr>
<td>8</td>
<td>City Finance Bank Ltd.</td>
<td>Jamii Bora Bank Ltd.</td>
<td>11.02.2010</td>
</tr>
<tr>
<td>9</td>
<td>Equatorial Commercial Bank Ltd.</td>
<td>Commercial Banking Bank Ltd</td>
<td>01.06.2010</td>
</tr>
</tbody>
</table>

Acquisitions

<table>
<thead>
<tr>
<th>No.</th>
<th>Institution Acquired by</th>
<th>Current Name</th>
<th>Date approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Mashreq Bank Ltd.</td>
<td>Dubai Bank Ltd.</td>
<td>01.04.2000</td>
</tr>
<tr>
<td>11</td>
<td>Credit Agricole (K) Ltd.</td>
<td>Indosuez Bank of Africa Ltd.</td>
<td>30.04.2004</td>
</tr>
<tr>
<td>12</td>
<td>EABS Bank Ltd.</td>
<td>Ecobank Bank Ltd.</td>
<td>16.06.2008</td>
</tr>
</tbody>
</table>

Source (CBK, 2011)
Appendix 5: Profitability ratios before and after merger or acquisition

Return on Assets (ROA)

<table>
<thead>
<tr>
<th></th>
<th>Years before merger mean of ROA</th>
<th>Years after merger</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Bank1</td>
<td>2.27%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Bank2</td>
<td>1%</td>
<td>-7%</td>
</tr>
<tr>
<td>Bank3</td>
<td>0.07%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Bank4</td>
<td>1.6%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Bank5</td>
<td>3.2%</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

Return on Equity (ROE)

<table>
<thead>
<tr>
<th></th>
<th>Years before merger mean of ROE</th>
<th>Years after merger</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Bank1</td>
<td>18.5%</td>
<td>22.7%</td>
</tr>
<tr>
<td>Bank2</td>
<td>9.1%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Bank3</td>
<td>0.56%</td>
<td>3.01%</td>
</tr>
<tr>
<td>Bank4</td>
<td>17.1%</td>
<td>13.4%</td>
</tr>
<tr>
<td>Bank5</td>
<td>30.7%</td>
<td>31.7%</td>
</tr>
</tbody>
</table>

Source (Research data)