MERGERS AND ACQUISITIONS ON FINANCIAL PERFORMANCE AMONG SELECTED COMMERCIAL BANKS, KENYA

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ABSTRACT

There has been a recent upsurge in M&A activity within the Kenyan banking industry which is attracting attention, specifically in trying to understand the various motivations for mergers and how M&As affect financial performance and operational efficiency. This study looked at the effects of mergers and acquisitions on financial performance of commercial banks in Kenya. This study set to establish whether the many mergers and acquisitions that have happened in Kenya's banking sector have influenced financial performance. The main objective of the study was to establish the influence of mergers and acquisitions on financial performance of commercial banks in Kenya. The specific objectives of the study was to find out the influence of operating synergy, differential efficiency, risk diversification and market share development on financial performance of commercial banks in Kenya. Descriptive research was employed to investigate the effect of M&A on a specific financial performance of the commercial banks in Kenya. The study was anchored on three theories which include differential efficiency theory, financial synergy theory and hubris theory. The population of a study consisted of 9 banks that have merged or acquired in the period 2010 to May 2017 in Kenya. This included 3 mergers and 6 acquisitions. The study was collected using questionnaires to collect primary data. The study also used secondary data from audited annual financial statements of respective banks over the period. Financial data from statements of financial positions, statement of comprehensive income statements and statements of cash flows of respective commercial banks for five years before and after mergers were used to calculate and analyse the ROA, ROE and C/I from the published financial statements and reports for the merged banks for the period under study. Data collected was purely quantitative and it was analyzed by descriptive analysis. The descriptive statistical tools such as Statistical Package for Social Sciences (SPSS Version 21.0) and MS Excel was used to extract frequencies, percentages, means and other central tendencies. Tables and figures were used to summarize responses for further analysis and facilitate comparison. A multiple regression analysis was conducted to show the strength of the relationship between the variables. The study established that operational synergy, differential efficiency, risk diversification and market share development as indicators of mergers and acquisitions have a significant influence on the financial performance of the commercial banks in Kenya. The variables explained 98.2% of the changes in financial performance of the commercial banks. A unit improvement in the operational synergy led to a 0.755 increase in financial performance of the banks, a unit improvement in differential efficiency led to a 0.886 increase in financial performance of the banks, a unit improvement in risk diversification transformed to a 0.885 increase in performance of the commercial banks while a unit increase in market share development due to mergers and acquisitions led to a 0.959 increment in their financial performance. The study recommends that firms before mergers or acquisitions should conduct thorough risk analysis and assess ability of their partners before engaging in the transactions.

Key Words: *mergers, acquisitions, financial performance, commercial banks, Kenya*

INTRODUCTION

Mergers and acquisitions (M & As) are corporate restructuring activities conducted in a bid to enhance the firms' returns or increase the efficiency of their operations. There are enormous benefits attributed to M& As and this factor has increased their attractiveness globally hence the recent trend towards M&As. Generally, merging firms operate in the same industry or under same market conditions and structures (Franke, 2005). Baldwin (1998) argued in his study that firms that merge enhance their bargaining power over suppliers and thus compel the supplier(s) to supply inputs, goods and services to the merged firm at favorable cost. As a result of higher prices being charged to customers and low cost inputs enable the merging firms to make abnormal profits hence their success.

Hernandez and Juan (2010) concluded that, as the operating environment changes, firms realize that they lack the requisite strengths to compete favorably and survive as well as the limited time at their disposal for them to develop such strengths and capabilities. This realization is often coupled with the fact that opportunities present themselves only for a limited period waiting for the aggressive parties to capitalize on them. By efficiently doing so, these parties benefit immensely from the M&A. Therefore, with such realization, organizations scout for target firms with the appropriate capabilities and strategic strengths and acquire them.

There are various theories that explain the motivation for M&As as advanced by different finance and economics scholars as they aim to demystify the rationale for M&As. This study has identified five theories behind M&As. These include the theory of synergy, theory of economies, diversification effect theory, tax effect theory and disciplinary theory. In response to changes in the operating environment, various financial institutions such as insurance companies have merged or taken over other existing operations (acquisitions) (Akinyomi and Olutoye, 2014). Since 2010, 10 M&A deals have been conducted in the Kenyan insurance industry with about 50% of this taking place in 2014 and 2015 only.

Commercial banks have an essential role in the economy. One of their main duties is to collect funds from excess fund sectors and lend to customers with insufficient funds. From these financial intermediary activities, they have an important role in determining the amount and distribution of credit in the economy. Since an increase in bank credit leads to increased investment and in turn to increased employment levels, changes in bank lending behaviour have a marked impact on the economic development of the country. Banks change their lending decisions in response to changes in the structure of the banking market. One of the issues arising in this context is bank M&As. Since market structures can change as a result of mergers, bank mergers can have a significant impact on changes in bank lending behaviour (De Young et al, 2009).

Due to changes in the operating environment, several licensed institutions, mainly commercial banks, have had to merge (combine their operations in mutually agreed terms) or one institution takes over another's operations (acquisitions). Some of the reasons put forward for mergers and acquisitions are: to gain greater market power, gain access to innovative capabilities, thus reducing the risks associated with the development of a new product or service, maximize efficiency through economies of scale and scope and finally in some cases, reshape a firm's competitive scope (Hitt et al., 2007). Other reasons include a short-term solution to finance problems that companies face due to information asymmetries (Fluck and Lynch, 1999), revitalize the company by bringing in new knowledge to foster long-term survival (Vermeulen and Bakerma, 2001) and to achieve synergy effects (Lubatkin, 1987; Birkinshaw et al., 2000; Vaara, 2002).

The impact of bank mergers in the banking industry has raised concerns among policymakers as to whether bank borrowers can benefit from the consolidations. The consequences of bank M&As on the welfare of borrowers have been investigated from two perspectives: credit availability and loan pricing behaviour. Although several researchers have examined the impacts of bank M&As (comprehensive reviews of the literature are provided in the studies of Berger, Demsetz and Strahan, 1999; and DeYoung, Evanoff and Molyneux, 2009), most of them take their evidence from US bank mergers.

According to Kemal (2011), M&As 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 among others. The reasoning behind any corporate merger is that two companies are better than one because they increase shareholder value over and above that of the two separate firms, Sharma (2009). The motives behind M&As are economies of scale, increase in market share and revenues, taxation, synergy, geographical and other diversification. Over a long time, the Kenyan economy has been state controlled and to some extent consumer controlled because the consumer is aware of the price differentials, variety, functionalities and qualities in goods. However, liberalization coupled with the opening up of the economy has resulted in competition of the Kenyan Business environment both internally and externally (Rankine, 1998).

The need for survival for the local firms and the need to penetrate the local and the global market have occasioned mergers, takeovers and buyouts. Little has been done to clearly access the success or failure of mergers and the factors that determine the choice of partners in the Kenyan context, Harney (2011). Financial performance is the most influential variable in determining growth of firms through M&As in Kenya. However, industry concentration, sales growth, stock market index and GDP growth also determines growth of firms through M&As but to a lesser extent. The study concludes that firms should be encouraged to embrace M&As growth strategy in corporate finance especially when pursuing the Financial performance and wealth objectives.

Mergers and Acquisitions

Hax and Majluf (1996) define M&A's as a means of establishing the organizational purpose in terms of its long-term objectives, action programs and resource allocation. A major obstacle faced by organizations seeking to merge or acquire others has been that identification of the business area in which a firm should participate in order to maximize its long-term financial performance, Hill and Jones (2001). David (1997) defines a merger as a process that occurs when two organizations of about equal size unite to form one enterprise. Thus, mergers involve friendly restructuring of the assets and resources for the companies involved in the combination, David (1997). Majority of mergers are friendly and are recommended by the directors and shareholders of both companies, Hill and Jones (2001).

A merger is the combination of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock where one company or both loose entity. According to Halper (1983), mergers occur when an acquiring firm and a target firm agree to combine under legal procedures established in the states in which the merger participants are incorporated. Manne (1965) argued that in a merger, the acquiring concern will be a corporation and not an individual, and the medium of exchange used to buy control will typically be shares of the acquiring company rather than cash. A merger requires the explicit approval of those already in control of the corporation. And most statutes require more than a simple majority vote by shareholders to effectuate a merger. The term "acquisition" is used to refer to any takeover by one company of the share capital of another in exchange of cash, ordinary shares, or loan stock Halper (1983). M&As has been the popular method of increasing the size and value of firms in modern times. Compared to the older system of increasing value through organic growth, M&A's are faster and in most cases cheaper. The terms 'mergers' and 'acquisitions' have been used interchangeably in this study.

Financial Performance of Commercial Banks in Kenya

Pandey (2008) defines financial performance as a subjective measure of how well a firm uses assets from its primary mode of business to generate revenues. He further says that the term can also be used as a general measure of a firm's overall financial health position over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Evaluating performance of firms is critical in order to ascertain whether the business is viable. A key performance measure used in modern financial management is the financial ratio analysis. The type of financial analysis varies according to the specific interests of the party involved. According to Holtzman (1994) trade creditors are interested primarily in the liquidity of the firm. Their claims are short term, and the ability of the firm to pay these claims is best judged by means of a thorough analysis of its liquidity. The claims of bondholders on the other hand are long term. Accordingly, they are more interested in the cash flow ability of the firm to service debts in the long run. The bondholders may evaluate this ability by analyzing the capital structure of the firm, the major sources and uses of funds, the profitability over time and projections of future profitability. Investors in a Company's common stocks are concerned principally with present and expected future earnings and the stability of these earnings about a trend as well as their covariance with earnings of other Companies. As result, investors might concentrate their analysis on a company's profitability. They would be concerned with the financial condition insofar as it affects its ability to pay dividends and avoid bankruptcy.

There are different ways of measuring financial performance, but all measures should be taken in aggregation. Most growing businesses ultimately target increased profits which make it important to know how to measure profitability. The key standard measures of financial performance include: gross profit margin which measures how much money an organization has made after direct costs of sales have been taken into account; operating margin lies between the gross and net measures of profitability after overheads are taken into account before interest and tax payments known as the EBIT (earnings before interest and taxes) margin. Net profit margin is a much narrower measure of profits, as it takes all costs into account, not just direct ones. All overheads, as well as interest and tax payments, are included in the profit calculation.

Consequently, creditors and regulators concerned about failure also look to profits to protect their interests although the measures ignore firm's risk. Profits depend on three primary structural aspects of financial institutions: Financial leverage, Net interest Margin and non-portfolio income sources. Return on Equity, (ROE) and Return on Assets (ROA) are the most commonly applied financial performance ratios used to assess financial performance, Akhavein (1996).The success of M&As was measured quantitatively in terms of increased Financial performance and share price, by comparing pre and post-acquisition performance. Mintzberg and Quinn (1991) stated that the classic expressed rationale for mergers have been to increase profits and shareholder value.

Financial Performance and Mergers and Acquisitions

There are inconclusive results on the literature on the consequences of mergers and acquisitions (M&A) on the overall financial performance of an entity. This proposal aims at synthesizing and analyzing prior literature of mergers and acquisitions and its effects on the financial performance in an attempt to determine factors that might influence post-mergers and acquisitions performance. Previous studies have used varieties of measures to examine the impact of M&A on overall financial performance of an entity, where measures might be accounting measures-based, market measures-based, mixed measures, or qualitative measures-based. Managers should be aware of such factors and their impact on post-merger/acquisition corporate performance to accurately evaluate proposed offers of mergers and acquisitions and take sound decisions, Feroz et al (2005).

In the series of studies that had been carried out elsewhere since 1921, researchers had been unable to demonstrate that merger active firms were more profitable, or had higher stock prices, following the merger activity. Lucey (2000) indicated that the financial performance of the company can be expressed in terms of income generated from its operations, after offsetting expenses when the financial performance of the firm is arrived at. Bidder variables are operationalized by assessing firm financial performance which tends to positively influence M&As. Large and profitable firms often have or can better access financial resources that are needed to acquire other firms. More over large firms are expected to engage more in diversifying M&As as there may be few opportunities left for growth in their own industry ceteris paribus. These financial resources can also create value when used to acquire a financially constrained target firm thus a positive relation between financial performance, firm size and M&As, Gaughan (2002).

Mergers and Acquisitions at Commercial Banks in Kenya

In 2008, the then Finance Minister, Mr Amos Kimunya, proposed to raise the minimum core capital for banks to KES 1 billion from KES 250 million, giving 2012 as the deadline for all banks to comply, Kenyan banks consolidation (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 this year, 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 may also encourage M&As in the sector. Increased competition and capital adequacy requirements under Base III are likely to be the key drivers behind sector consolidation. Among the recent mergers are CFC/Stanbic Bank merger, City Finance Bank/Jamii Bora Kenya merger, EABS Bank/Akiba Bank merger, EABS Bank/Ecobank acquisition, Fina Bank/Guaranty Trust Bank acquisition, K-Rep Bank/Centum acquisition, and Equatorial Commercial Bank/Mwalimu Sacco Society acquisition.

STATEMENT OF THE PROBLEM

There has been a recent upsurge in M&A activity within the Kenyan banking industry which is attracting attention, specifically in trying to understand the various motivations for mergers and how M&As affect financial performance and operational efficiency. This study sets out to investigate the effects of M&As on the financial performance of commercial banks in Kenya and explores changes induced by mergers on financial performance. The study is motivated by the fact that there is a relative deficiency of empirical evidence demystifying the specific impact of M&As involving Commercial banks in Kenya. A number of studies on M&A activities in the Kenyan context provide mixed results. For instance, Marembo (2012) studied the impact of M&As on the financial performance of commercial banks and established that merging or acquiring other firms did not achieve strong, efficient and competitive markets since performance was dependent on several factors. However, Marangu (2007) resolved in his study that significant improvement in performance of the non-listed insurance firms resulted from merging compared to the non-listed insurance firms that had not merged within the same period.

In most merger arrangements, there is lack of systematic and thorough attention paid to potential problems of the integration, particularly in aspects of financial performance, Jemison & Sitkin (1986). Harney (2011) reported that over the recent years, most mergers that have occurred in Kenya are yet to show the direct effects in terms of Financial performance. There is no clear indicator of the benefits of a merger. There exists a high degree of calculated risk-taking to tap opportunities that come the way of business, but there is risk avoidance in business and where risk is low, development is also low and industrial advance merit becomes nearly static, Rankine (1998). M&A's could also be a very expensive venture in terms of funds required to prosecute it successfully, Harney (2011). Corrupt practices at public and private sector level are another impediment. This needs to be discouraged and incidence of corrupt practices should be severely punished because M&A deals requires confidence and trust to promote consummation, Lambrecht (2004). Locally, studies on M&As have produced mixed results. Katuu (2003) conducted a survey of factors considered important in M&A decisions by selected Kenyan based firms. Njenga (2006) also conducted a survey on investigation into whether the demerger of coffee market societies have created or eroded owners' wealth in parts of Central Kenya. Njenga found mixed results on whether demerger leads to wealth creation or erosion of coffee firms as depicted by both positive and negative returns on post-merger firms. Muya (2006) carried out a survey of experiences of mergers and found that mergers do not add significant value to the merging firms. There are limited studies focusing on the impact of M&A on pre and post financial performance of listed commercial banks in Kenya. This study therefore sought to fill this knowledge gap by analyzing the performance of Commercial banks before and after M&As.

GENERAL OBJECTIVE

The main objective of this study was to investigate the relationship between M&As and the financial performance of commercial banks in Kenya

SPECIFIC OBJECTIVES

1. To establish the influence of organizational operating synergy on the financial performance of commercial banks in Kenya.
2. To investigate the effect of differential efficiency on financial performance of commercial banks in Kenya.
3. To assess the effect of risk diversification on financial performance of commercial banks in Kenya.
4. To establish the market share development on the financial performance of commercial banks in Kenya.

THEORETICAL REVIEW

Several theories have been advanced towards the justification and impact of M&As. Theories on M&As can broadly be classified into two major categories; value increasing theories and value decreasing theories. According to the value increasing school, mergers occur, broadly, because mergers generate 'synergies' between the acquirer and the target, and synergies, in turn, increases the value of the firm (Hitt 2001). Examples of these theories are the differential efficiency theory, financial synergy theory and Hubris Theory. Value-Destroying Theories on the other hand advocate that mergers may fail to create value; it is suggested – with somewhere between 60% and 80% classified as 'failures' (Singh, 1999). Examples of this theory include the Hubris Theory.

Differential Efficiency Theory

According to differential theory of merger, one reason for a merger is that if the management of a company X is more efficient than the management of the company Y than it is better if company X acquires the company Y and increase the level of the efficiency of the company Y. According to this theory if some companies are operating at level which is below the optimum potential of the company than it is better if it is taken over by another company. This theory also implies that management of a company is also not efficient in running the company and therefore there are always chances that it will be taken over by other companies. Differential theory can be particularly helpful when a company decides to take over other company in the same industry because than it would mean that company which is taking over other company can expand without much cost because of the efficient utilization of all the resources. However there is one risk to this, which is if the acquiring company pays too much for acquiring the company, but in reality the resources do not get utilized in a manner which is forecasted than it can lead to problems for acquiring company.

According to this theory, some firms operate below their potential and consequently have low efficiency. Such firms are likely to be acquired by other, more efficient firms in the same industry. This is because, firms with greater efficiency would be able to identify firms with good potential operating at lower efficiency. They would also have the managerial ability to improve the latter's performance. However, a difficulty would arise when the acquiring firm overestimates its impact on improving the performance of the acquired firm. This may result in the acquirer paying too much for the acquired firm. Alternatively, the acquirer may not be able to improve the acquired firm's performance up to the level of the acquisition value given to it. The managerial synergy hypothesis is an extension of the differential efficiency theory. It states that a firm, whose management team has greater competency than is required by the current asks in the firm, may seek to employ the surplus resources by acquiring and improving the efficiency of a firm, which is less efficient due to lack of adequate managerial resources. Thus, the merger will create a synergy, since the surplus managerial resources of the acquirer combine with the non-managerial organizational capital of the firm. When these surplus resources are indivisible and cannot be released, a merger enables them to be optimally utilized. Even if the firm has no opportunity to expand within its industry, it can diversify and enter into new areas. However, since it does not possess the relevant skills related o that business, it will attempt to gain a 'toehold entry' by acquiring a firm in that industry, which has organizational capital along with inadequate managerial capabilities.

This theory suggests that mergers will only occur when they are expected to generate enough realizable synergies to make the deal beneficial to both parties (Trautwein, 1990). It is the symmetric expectations of gains which results in a ‘friendly’ merger being proposed and accepted. If the gain (value) is 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 acquiring firm, the bidder would not complete the deal.

Efficiency theory predicts value creation with positive returns to both the acquirer and the target firm (Banerjee and Eckard, 1998) evidence this suggestion. Chatterjee (1986) suggests that there is a difference between ‘operative synergies’ and ‘efficiency gains’ achieved through economies of scale and scope. According to him operating synergies of mergers states that economies of scale exist in industry and that before a merger take place, the levels of activity that the firms operate at are insufficient to exploit the economies of scale. The efficiency gains accrue from operating synergies which are achieved through the transfer of knowledge, economies of scale and economies of scope.

Pandey (2008) suggests that a combination of two or more companies may result in more than the average Financial performance due to cost reduction and efficient utilization of resources. This may happen because of the perceived economies of Scale, Synergy and Operating Economies. M&As can increase the market share of the merged firm. M&As may be carried out in order to achieve a monopoly over the market. It is an explanation of horizontal and conglomerate M&As. Market power can be accomplished through the deliberate reduction of supply, cross-subsidizing products and deterring potential market entrants (Trautwein, 1990; Rodermann, 2004). These benefits are also referred to as collusive synergy (Chatterjee, 1986). Monopoly decreases competition, firms could increase the prices they charge their customers for their products and/or decrease the prices they pay their suppliers for raw material.

Efficiency theory is relevant in this study as it asserts how firms operating below their potential and consequently have low efficiency. Such firms are likely to be acquired by other, more efficient firms in the same industry. This is because firms with greater efficiency would be able to identify firms with good potential operating at lower efficiency. They would also have the managerial ability to improve the latter’s performance.

Financial Synergy Theory

According to this theory, financial synergy occurs as a result of the lower costs of internal financing versus external financing. A combination of firms with different cash flow positions and investment opportunities may produce a financial synergy effect and achieve lower cost of capital. Tax saving is another considerations. When the two firms merge, their combined debt capacity may be greater than the sum of their individual capacities before the merger. The financial synergy theory also states that when the cash flow rate of the acquirer is greater than that of the acquired firm, capital is relocated to the acquired firm and its investment opportunities improve.

The Hubris Theory

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. The Hubris theory constitutes a psychological based approach to explain M&As. It states that the management of acquiring firms over rates their ability to evaluate potential acquisition targets. This managerial over optimism typically results in erroneous decisions which are overpriced (Trautwein 1990). Over-confidence increases the probability of overpaying (Hayward and Hambrick, 1997; Malmendier and Tate, 2008), and may leave the winning bidder in the situation of a winner's-curse which dramatically increases the chances of failure (Dong, 2006).

In an auction environment the winning bid is usually in excess of the estimated value of the target company and is likely to represent a positive valuation error. The positive valuation error represents the 'winners curse'. The winner is cursed in the sense that he paid more than the company's worth. In particular, the hubris theory states that when a merger or acquisition announcement is made, the shareholders of the bidding firm incur a loss in terms of the share price while those of the target firm generally enjoy a contrary effect. The prime reason behind this is that when a firm announces a merger offer to the target, the share price of the target firm increases because shareholders in the target firm are ready to transfer shares in response to the high premium that will be offered by the Acquiring firm, (Machiraju, 2010).The risk of potential failure, due to overrated acquisition price which significantly exceeds the fair value of the target company, increases in an auction. This phenomenon is the basis of the winner's curse hypothesis that argues that the value of a target traded in an auction is usually lower than the acquisition price (Hofmann, 2004).

EMPIRICAL REVIEW

This section stipulates the three objectives and what other researchers and authors have done in the area of M&As.

Operational Synergy and Financial performance

Organization's operational synergy can be achieved through horizontal, vertical and conglomerate mergers. This theory assumes that economies of scale exist in the industry and prior to a merger; the firms are operating at levels of activity that fall short of achieving the potentials for economies of scale. There are four kinds of synergies: cost, revenue and market power and intangibles. Cost synergies are again broken down into fixed cost and variable cost synergies. Fixed cost synergies like sharing central services such as accounting and finance, the office, executive and higher management, legal, sales promotion and advertisement etc. can substantially reduce overhead costs. Variable cost reduction is associated with increased purchasing power and productivity (Yin, 2003).

Revenues synergies are associated with cross-selling products or services through complementary sales organizations or distribution channels that sell different geographic regions, customer groups or technologies. Intangibles include brand name extensions and sharing of know how. This kind of synergy is realized by transferring of these intangible capabilities from one firm to another (Clay, 2012).

Mergers and Acquisitions can be classified as horizontal, vertical or conglomerate (Gaughan, 2002, Chunlai Chen and Findlay, 2003). In horizontal M&A, the acquiring and the target companies are competing firms in the same industry. According to Chunlai Chen and Findlay (2003), horizontal M&A has grown rapidly over recent years due to global restructuring of many industries in response to technological change and liberalization. Vertical M&A are combinations of firms in client-supplier or buyer-seller relationships. The firms involved seek to reduce uncertainty and transaction costs by upstream and downstream linkages in the value chain and to benefit from economies of scope (Chunlai Chen and Findlay, 2003). Lastly, a company may attempt to diversify risks and attain economies of scope by engaging in conglomerate M&A transactions where involving companies operate in unrelated businesses.

An example of conglomerate M&A is Philip Morris, a tobacco company, which acquired General Foods in 1985 for US$5.6 billion (Gaughan, 2002). In addition, M&A could also be classified as ‘friendly’ or ‘hostile’ (Chunlai Chen and Findlay, 2003). When an M&A transaction is undertaken in a friendly manner, the board of the target company agrees to the transaction. On the contrary, a hostile deal is one that pits the offer against the wishes of the target, since the board of the target refuses the offer.

Fatima and Shehzad (2014) studied the impact of M&As on financial performance of insurance companies in Pakistan. In their study, six financial ratios were analysed. Ten insurance companies which got into mergers from 2007 to 2010 were selected as the sample for analysis. 3 year pre-merger and 3 year post-merger data points were taken for all the 10 cases and their averages compared. Their null hypothesis was that M&As enhanced Financial performance and efficiency through synergy. The alternative hypothesis was that the effects of M&A on financial performance were not clear. Based on the given evidence, they rejected the alternative hypothesis regarding profit after tax, return on assets, leverage and earnings per share. They accepted their null hypothesis and concluded that from their analysis, the objectives of mergers were not clearly achieved, synergy was not created, neither were economies of scale achieved.

Joshua (2011) evaluated the impact of merger and acquisition on financial efficiency of insurance companies in Nigeria. In his study, he used operating profits, net income and net assets of sample companies to determine financial efficiency by comparing data before and after merger the merger. The study established that there was higher post-merger financial efficiency compared to the pre-merger periods. Viverita (2008) studied the impact of M&As on banks in Indonesia. From a comparison of seven year pre-merger and post-merger financial performance data, the study revealed that mergers increased a bank's profit potential. The study results indicated improvements in return on asset, return on equity, net interest margin, capital adequacy ratio and non-performing loans after the M&As. However, mergers could not improve the financial institutions' ability to perform intermediary functions as indicated by falling loan to deposits ratio.

Differential Efficiency and Financial Performance

This theory stresses on differential efficiencies of different management of different companies. Manne (1965) highlights the existence of a positive correlation between corporate managerial efficiency and the market price of shares of that company. If a company is poorly managed the market price of the shares of that company falls as compared to the market price of the shares of other companies in the same industry. This difference in share price of companies indicates the potential capital gain that can accrue if the management of the company passed into the hands of a more efficient management. The company in question becomes an attractive takeover target for those who believe that they can manage the company more efficiently. Firms operating in similar business are more likely to be acquirers since they would better possess the ability to detect under-performance and will have the know-how to turnaround the company.

Takeover is seen as an effort by the shareholders of the acquired company to discipline the management of the company. Managers often have problem in abandoning their old strategies, even when these strategies do not contribute to the growth of the company. When the need to restructure is overlooked by the management, the capital markets through the market for corporate control come to rescue. The shareholders of the target company through the takeover market pass on the control to the more efficient management. The price paid to the shareholders has to be at a premium over current market price (Jensen and Ruback, 1983) to solicit them to sell their shares.

Saboo and Gopi (2007) investigated how differential efficiency of mergers impacted the operating and financial performance of acquiring firms in India by comparing financial ratios before and after merger. They determined the pre-merger and post-merger differences in financial ratios for the firms that had restructured through domestic acquisitions and those that had gone for international/cross-border acquisitions. The results showed variations in how financial performance was impacted depending on acquisition type. According to the findings of the study, mergers impacted positively on the financial performance of firms that had acquired domestic targets and a slight negative impact on firms involved in cross-border acquisitions.

Kivindu (2013) conducted a study to determine the effects of M&A efficiency on bank Financial performance in Kenya by conducting a pre-merger and post-merger comparison of Financial performance for 24 banks that had undergone through M&As in Kenya. The study employed a descriptive research design and the population of interest comprised the 24 banks that merged or had been acquired in Kenya during the study period. The study analysed ROA, ROE equity, profit before tax and capital adequacy ratio. The study results revealed that institutions with weak capital base consolidated in an effort to achieve synergies and thus enjoy economies of scale that would improve their financial performance as opposed to listing in stock exchanges that attracted substantial costs. In addition, M&As improved the financial performance of the post-merger firms through improved capital base, efficiency and competitiveness.

Risk Diversification and Financial Performance

Unlike the stakeholders of a company who reduce their diversifiable risk by holding a portfolio of well-diversified scripts, managers' income from employment constitutes a major portion of their total income. Hence risk attached with a manager's income is to a large extent a function of firm's performance. Managers invest heavily in organization capital during their tenure with the firm. A major part of this capital may be firm specific, increasing the employment risk of the managers. Managers can thus be expected to diversify their risk by engaging in conglomerate mergers (Amihud and Lev, 1981). Similarly a firm engaged in manufacturing/marketing of a single product, which is in the maturity or decline phase of its life cycle, might like to invest the cash flows into growing businesses.

The learning by employees has been developed over time. This learning may also be firm specific. It makes sense to employ this organization capital in growth businesses instead of letting them get destroyed with the withered business. Market synergies are discussed in the section on market power. Marembo (2012) conducted a study to establish the impacts of M&As and risk management on the overall financial performance of banks in Kenya. The study focused on the comparative analysis of 27 bank's financial performance for the pre-merger acquisition period with the objective of getting an indication of the relative financial performance of the acquiring firm as well as the target firm. The study compared the premerger and post-merger financial ratios including earnings per share, return on equity, return on assets and capital adequacy ratio.

The findings of the data analysis showed that a bank's financial performance improves with the mergers/acquisition. This is because the merger/acquisition brings about higher capital and customer base which are important ingredients in firm performance. With increased commercial bank's stability and ability to lend the company in turn makes higher profits. The study also determined that the merger activity alone could not achieve efficiency in terms of performance since some other factors came into play in determining the financial performance of firms.

Tuni (2011) studied the impacts of M&A on Financial performance of financial institutions in Kenya. The study zeroed on two overriding objectives: To determine the Financial performance of merged institutions before and after the merger/acquisition and to determine the impact of M&A on the Financial performance of the financial institutions. A sample of 20 financial institutions was selected from the population of interest of 70 institutions that had merged. 10 years' financial statements from the 20 financial institutions were used to calculate and analyse the performance indicators being earnings per share, ROA and ROE. It was found that before the merger, 7, 8 and 7 institutions had positive ROA, ROE and EPS respectively. On the year of the M&As, there was a change on the performance exhibited by these indicators. After the M&As, 6, 8 and 8 financial institutions posted an improvement in ROA, ROE and EPS respectively

Market Share Development Financial Performance

Acquisitions, especially horizontal mergers may also be undertaken to destroy competition and establish a critical mass. This might increase the bargaining power of the company with its suppliers and customers. Economies of scale may also be generated in the process. Example of this could be VIP's takeover of Universal Luggage and its thereafter putting an end to Universal's massive price discounting, which was eating their profits. The HP and Compaq merger also created the largest personal computers company in India. Internationally, as well this move was supposed to put IBM under immense pressure (Martynova and Renneboog, 2006). Organic route of growth takes time. Organizations need place, people, regulatory approval and other resources to expand into newer product categories or geographical territories. Acquisition of another organization with complementary products or geographic spread provides all these resources in a much shorter time, enabling faster growth.

Ndora (2010) studied the effects of M&As on the financial performance of insurance companies in Kenya. A sample of six insurance companies that had merged between the year 1995 and 2005 were used from a population of 42 registered insurance companies in the country as at that time. To measure financial performance, financial performance ratios, solvency ratios as well as capital adequacy ratios were computed for the firms. ROA, operating profit, and ROE were analyzed. The information for the five years before and after the merger was compared and the results tabulated. The findings indicated an improved post-merger financial performance of the firms compared to the pre-merger period financial performance of the merging firms. The study concluded that M&A resulted in increased financial performance of an insurance company.

Misigah (2013) studied the effect of M&As on the growth of banks in Kenya. The study population comprised of 15 banks that had merged between the year 2000 and 2010. Comparative analysis was used to compare the effects of mergers on growth in assets, financial performance and shareholders' value during the pre-merger and post-merger period. Results from respondents indicated that the main reason why the bank undertook merger was growth in shareholders' value and growth in financial performance. The banks achieved these objectives as growth was significant as a result of the mergers and financial performance was achieved through the synergistic effect.

RESEARCH METHODOLOGY

Research Design

Research design is the basic plan that indicates an overview of the activities that are necessary to execute the research project. This research problem was studied through the use of a descriptive research design. According to Cooper & Schindler (2003), a descriptive study is concerned with finding out the what, where and how of a phenomenon. This study therefore is able to generalize the findings to all the enterprises. This method concerned the intense investigation of problem solving situations in which problems are relevant to the research problem.

Target Population

A population is defined as a complete set of individuals, cases or objects with some common observable characteristics, (Mugenda & Mugenda, 2003). The population for this study were top management employees of commercial banks in Kenya. There are 42 commercial banks in Kenya registered and regulated by the Central Bank of Kenya. The board of management was also be incorporated in the study. Banks that have been involved in mergers and acquisitions since 2010 to date were included in the study. This included 3 mergers and 6 acquisitions. The managers among the banks were ranked into top, middle and low level management employees. This brought to 255 the total target population.

Sampling Design

Sampling techniques provide a range of methods that facilitate to reduce the amount of data need to collect by considering only data from a sub-group rather than all possible cases or elements. According to Mugenda and Mugenda (2003), a sample of 30% of the target population is significant and representative of the entire population. Therefore a sample of management employees who were obtained through purposive random sampling technique to ensure the required information was obtained that totalled to 76 employees was sampled.

Data Collection Procedures and Instruments

With regard to the role of M&As on financial performance of commercial banks in Kenya, the study used both primary and secondary data. Primary data was collected by use of open and closed ended questionnaires. Secondary data was collected from the banks' financial statements. Secondary data is the data that is gathered from other purposes and used in the recent project usually the secondary data are found inside the company, libraries, research centers, internet and etc. Secondary data involves the collection and analysis of published material and information from other sources such as annual reports, published data.

Data Analysis and Presentation

Before processing the responses, the completed questionnaires were edited for completeness and consistency. Quantitative data collected was analysed by the use of descriptive statistics using

SPSS (Version 22) and presented through percentages, means, standard deviations and frequencies. The information was displayed by use of bar charts, graphs and pie charts and in prose-form. This was done by tallying up findings as obtained, computing percentages of variations in response as well as describing and interpreting the data in line with the study objectives and assumptions through use of SPSS (Version 22) to communicate research findings. Content analysis was used to test data that is qualitative in nature or aspect of the data collected from the open ended questions. In addition, the study conducted a multiple regression analysis. The multiple regression equation was: $Y = \beta 0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$

Where: Y = Financial performance of commercial banks in Kenya; B0 - intercept coefficient; εi – error term (extraneous variables); X_1 – Operating synergy on mergers and acquisitions; X_2 – Differential efficiency on mergers and acquisitions; X_3 – Risk diversification on mergers and acquisitions; X_4 – Market share on mergers and acquisitions; β1, β2, and β3 =regression coefficients

RESEARCH RESULTS

Operational Synergy and Financial Performance

The study established that the horizontal mergers which involves organizations with same ability, market, customers and industry coming together, promotes a wide resource base as indicated by a mean of 3.77, vertical mergers also involves a stronger firm (financially) takes up a weaker firm to gain a stronger financial stability as indicated by a mean of 3.21. Mergers were also instrumental in gaining customer confidence as indicated by a mean of 2.14 although to a limited extent, mergers and acquisitions also improved employee motivation and confidence due to perceived improvement in organizational performance. Conglomeration was also discovered to aid in increasing an organization’s geographical, product, market and customer scope as indicated by a mean of 2.33. Mergers and acquisitions also aided in promoting creativity and innovation due to integration of human resources as indicated by a mean of 3.56. They also led to improved problem solving and communication among merged organizations or those engaged in an acquisition. This indicates that mergers and acquisitions are meant to make a business more competitive, financially strong and solvent.

Differential Efficiency and Financial Performance

The study realized that differential efficiency due to mergers and/or acquisitions leads to management effectiveness (2.88), leads to increased organizational efficiency (3.12), makes employees to strive to keep up with the new organizational status and league(3.78) which improves their performance, improved service delivery by employees (3.66), improves creativity and innovation of staff and firm (3.71), creates and provides a large pool of resources at the firm’s disposal (4.11) and also improves the degree of staff welfare (2.87) since there are new opportunities, challenges and room for growth and career development. This indicates that differential efficiency greatly improves financial performance of commercial banks involves in mergers or/and acquisitions.

Risk Diversification and Financial Performance

The study revealed that most banks involved in mergers and/or acquisitions have experienced a number of risks however they have managed to tame most of them. As indicated by the mean most financial risks have been suppressed (2.88), employee turnover has however increased significantly (2.45), future of the banks is certain after the mergers and acquisitions(3.44), post-merger or acquisition growth has been consistent although at a slow base (2.77), more risks have been tamed (3.56), management confidence has been enhanced (3.88) and they have promoted a degree of inferiority (2.11) for vertical mergers. This indicates that most mergers and acquisitions have managed to address most of the risks however employee turnover has been a challenge but inclusivity has been upheld among the players that have been merged or acquired.

Market Share Development and Financial Performance

It was realized that to a very great extent mergers and acquisitions have increased market share for those banks involved at a mean of 4.11, the market coverage has also gone global for some (3.25), customer service has improved (3.11), customer loyalty has also increased (2.75), their brands have also gained market favour (2.55), some have taken over more players hence gaining monopoly (2.09) although to a small extent while some have led to reduction of the number of players in the market due to consolidation of small players through acquisitions and mergers. (2.87). This indicates that mergers have led to increased market share development and hence financial performance of the banks involved in merges and acquisitions.

REGRESSION ANALYSIS

The researcher conducted multiple regression analysis to establish the influence of mergers and acquisitions on financial performance of commercial banks in Kenya. The findings are indicated in subsequent sections;

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.982	0.962	0.951	0.885

Table 1 indicates the model summary. From the findings, R was 0.982, R square was 0.962 and adjusted R squared was 0.951. An R square of 0.982 implies that 98.2% of changes in financial performance of commercial banks that have merged or been acquired in Kenya are explained by the independent variables of the study. There is however other factors that influence performance of the commercial banks that are not included in the model which account for 1.8%. An R of 0.982 on the other hand signifies strong positive correlation between the variables of the study.

Table 2: ANOVA

Model	SS	df	MS	F	Significance
Regression	621.04	5	621.4	776.005	0.0942
Residual	361.40	362	0.950		
Total	982.44	367			

From the ANOVA table above, the value of F calculated is 776.005 while F critical is 499.545. Since the value of F calculated is greater than F critical, the overall regression model was significant and therefore a reliable indicator of the study findings. In terms of p values, the study indicated 0.000 which is less than 0.05 and therefore statistically significant.

Table 3: Regression Coefficients

Model	Unstandardized coefficients		Standardized Coefficients	T	Sig
	B	Std Error	Beta		
Constant	6.86	0.654		7.012	0.000
Operational synergy	0.755	0.022	0.811	14.15	0.00
Differential efficiency	0.886	0.033	0.120	11.04	0.000
Risk diversification	0.885	0.029	0.127	1.15	0.000
Market share development	0.959	0.031	0.384	4.42	0.000

The resultant regression equation becomes;

$$\mathbf{Y = 6.86 + 0.755X_1 + 0.886X_2 + 0.885X_3 + 0.959X_4}$$

Where: Y is the financial performance of commercial banks that have undergone merges or acquisitions in Kenya; β0, β1, β2, β3 and β4 are the regression coefficients and X1, X2, X3 and X4 represent operational synergy, differential efficiency, risk diversification and market share development respectively.

This implies that when all the variables of the study are held constant, performance of commercial banks involved in mergers and acquisitions in Kenya will be at the intercept which is 6.86 A unit improvement in operational energy while all other factors held constant results in 0.755 increase in performance of the banks, a unit increase in differential efficiency with other factors ceteris paribus leads to 0.886 increase in performance of the commercial banks. Similarly a unit increase in risk diversification while other factor ceteris paribus, translates to a 0.885 increase in performance of commercial banks in Kenya while a unit increase in market share development with other factors held constant leads to a 0.959 improvement in financial performance of the commercial banks that have merged or acquired.

CONCLUSIONS

The study concluded that operational synergy, differential efficiency, risk diversification and market share development as indicators of mergers and acquisitions have a significant influence on the financial performance of the commercial banks in Kenya. The variables explained 98.2% of the changes in financial performance of the commercial banks. A unit improvement in the operational synergy led to a 0.755 increase in financial performance of the banks, a unit improvement in differential efficiency led to a 0.886 increase in financial performance of the banks, a unit improvement in risk diversification transformed to a 0.885 increase in performance of the commercial banks while a unit increase in market share development due to mergers and acquisitions led to a 0.959 increment in their financial performance. The high levels of uncertainties given mergers or acquisitions, high levels of risks and employee turnover due to poor staff cohesion led to poor performance of the mergers. Horizontal mergers could not grow faster due to low resource base while vertical mergers grew faster due to high resource endowment but high employment risks were faced.

RECOMMENDATIONS

It was recommended that for the banks that have mergers or acquired to perform well financially, their operational synergy, efficiency, risk management and market share development need to be improved, cultivated and implemented diligently. There is need for the employees to work together and closely for easy bonding and skill development coupled with mentorship programs. The commercial banks involved in mergers and acquisitions need to calculate their moves and engage with the right partners in the transactions to avoid high risk engagements which can lead to poor performance and even insolvency.

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