EFFECT OF MERGERS AND ACQUISITIONS ON THE FINANCIAL PERFORMANCE OF COMPANIES LISTED IN THE NSE.

BY

MUHINDI PERIS MWIHAKI

REGISTRATION NUMBER: 113241

A Management Research Proposal Submitted to the Strathmore Business School in Partial Fulfillment for the Degree of Bachelor of Commerce of Strathmore University.

Declaration

I certify that this work has not previously been submitted to or authorized for a degree by this or any other university except when adequate reference is provided in the research study itself, the research study contains no material previously published or authored by another individual, to the best of my knowledge and belief.

Muhindi Peris Mwihaki

Signature: ……………….

Date: ………………

Approval

The research proposal of Muhindi Peris Mwihaki was reviewed and approved by the following:

Mr. John Waweru Kamau

Strathmore Business School

Signature: J.W.K

Date: 28th Feb 2022

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ABSTRACT

Merger and acquisition activity is one of the main strategic financial tools that a firm can adopt so as to improve the overall performance of the company. Financial performance of a firm is crucial in that it seeks to bring out how well a company utilizes its financial assets, the method of financing, how it maintains and earns more returns as well as how the firm's objectives can be sustainable in the future. The purpose of this study was to be used as a source of information as well as a focal point for further research to be carried out as to why certain sectors in the NSE experience more merger and acquisition activity specifically the banking and petroleum industry. This information can be used by investors, general management as well as the Government. The variables of the study that were involved are liquidity, market share and financial management practices. The study in turn adopted a descriptive research design so as to describe and predict the relationship between the effect of liquidity, market share and financial management practices. Consequently, the population of focus was all the firms listed in the NSE where purposive sampling was used to select firms that have exclusively experienced merger and acquisition activity as from 2008 to 2021. Data analysis was carried out on the data collected from the financial statements as a source of secondary data. Inferential statistics, ratio analysis, regression analysis and the event study approach were used was used to assess the impact of the event on the variables as well as on the financial performance of the firm. The findings indicated that the merger activity influenced it as there was a significant change pre- and post-acquisition. There was also a positive relationship between liquidity and market share and a negative relationship with financial management practices in association to financial performance of firms. The use of the regression model suggested that 51.2% of the variance in financial performance would be explained by liquidity, market share and financial management practices. The value of this study was that it clearly reflected on how the sectors in the NSE are differently affected by the merger and acquisition activity by use of a case-by-case example of Total Kenya and NCBA Bank Kenya.

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CHAPTER ONE: INTRODUCTION

1.1. Background Of the Study

Over the recent years, the corporate world has experienced significant changes in terms of increase in mergers and acquisitions. In a world where competition among organizations is high, the need to curve out a competitive advantage for one's products is necessary. Different reasons have driven firms to embrace mergers and acquisitions in relation to their set objectives and as such, mergers and acquisitions have been used extensively for the purpose of increasing revenues and profitability, restructuring the business organization, increasing market share and eliminating competition (Ondieki, 2015).

According to a report by the Central Bank of Kenya (2017) research, mergers and acquisitions are strategic advancement tactics used by many firms not only to stay competitive, but also to grow their borders, market share, and domination internationally. It is crucial in external business expansion, operating as a corporate restructuring and control plan. It is distinct from internal growth decisions, such as those based on investment assessment procedures. Mergers and acquisitions may help organizations develop quickly and serve as a vehicle for capital market discipline, improving management efficiency and profits.

In recent years, a substantial number of mergers and acquisitions have taken place in the banking sector in Kenya, partly occasioned by the need to meet the growing minimum core investment obligations as well as to build up the institution's market share in the local banking industry. Between 1994 and 2010 there were 20 successful mergers, with the number increasing to 28 by 2014 (Joash & Njangiru, 2015).

According to a report by Business Daily Africa (2019), in the Kenyan business environment mergers and acquisitions have slowed down in the first four months of 2015 compared to a similar period in 2014 despite the multi-billion-shilling Equity and Centum share deals. Kenya has kept its position as the leading merger and acquisition strategy hotspot in East Africa despite this.

The Deal Drivers Africa report published by merger market (2020), ranks Kenya among Africa's most sought-after country for M&A transactions. Additionally, until the onset of the covid-19 pandemic, M&A activity had increased significantly in recent times with Kenyan deals dominating the market. Like in many emerging markets, private- equity driven transactions are one of the main drivers of mergers and acquisitions activity in Kenya. In recent years, the country has seen an increase in interest from private equity and venture capital firms looking to invest in banking and financial services, energy, and real estate among other sectors where there is an increase in the uptake of the M&A strategy.

1.1.1. Mergers and Acquisitions

Brigham and Daves (2010) define a merger as any combination of two or more prior economic units that results in a single economic unit, with synergy happening when the whole is greater than the sum of the parts. They are also seen as an important financial instrument that enables organizations to develop more quickly while also rewarding owners and investors (Sherman, 2011). According to Kivindu (2013), companies use mergers and acquisitions to reduce corporate risk by diversifying their portfolio, making it easier to enter new markets through strategic placements, and taking advantage of economies of scale.

Mergers and Acquisitions are important as they lead to pulling together of resources, but only if it results in a competitive advantage. Some of the benefits are access to technology and products, increased customer base, enhanced market position and a stronger financial position.

Access to a higher market share is another benefit of mergers and acquisitions. Furthermore, consolidated organizations might control a larger market share giving them a significant competitive advantage. Companies that desire to reposition themselves in the market can gain from mergers and acquisitions. Companies can quickly expand their market coverage and change their market position by improving their capabilities and resources in product development (Mboroto, 2012).

Mergers and acquisitions are being proposed to meet rising market demand and competition, diversify into international markets, employ growing new and pricey modern technology or to meet the new threshold capital required by the regulators such as in the banking sector (Kithinji & Waweru, 2010). 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.

1.1.2. Mergers and Acquisitions listed in the Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) is a leading African Exchange, based in Kenya – one of the fastest-growing economies in Sub-Saharan Africa. Founded in 1954, NSE has a six-decade heritage in listing equity and debt securities. It offers a world class trading facility for local and international investors looking to gain exposure to Kenya and Africa's economic growth. It plays a vital role in the growth of Kenya's economy by encouraging savings and investment, as well as helping local and international companies access cost-effective capital. NSE operates under the jurisdiction of the Capital Markets Authority of Kenya. The NSE share market is divided into 11 major sectors which include, agricultural, automobiles and accessories, banking, commercial and services, constructions and allied, energy and petroleum, insurance, investment, manufacturing and allied, real estate and telecommunication & technology (NSE, 2021).

In Kenya, merger and acquisition are a strategy that has been widely used by companies that intend to grow their asset value and increase their market share. Since 2000 to 2014, a total of 19 companies have engaged in either a merger and/or acquisition (CBK, 2014).

According to a report issued by merger market, Kenya is one of Africa's most sought-after countries for mergers and acquisitions, with a total of seven corporations pursuing this strategy between 2014 and 2017. Even though this slowed due to numerous businesses trying to restructure and downsize their numbers because of the covid-19pandemic, there was an increased steady trend with 8 mergers and acquisitions occurring between 2017 and 2019 (Mri et al., 2020).

1.1.3. Mergers and Acquisitions in relation to Financial Performance

Financial performance is a measurement of what a company has accomplished during a period in which it has performed well. The goal of assessing success is to gain meaningful information on the flow of finances, their usage, effectiveness, and efficiency. Furthermore, the knowledge gained might motivate managers to make the best decision possible (Amal, Sameer, & Yahya, 2012).

Financial performance is critical to a company's success since it indicates the financial health of competitors and how they compare to other industry players. Because of the benefits that mergers and acquisitions are supposed to bring, they've been employed to improve organizational performance. Mergers and acquisitions are typically thought of to improve financial performance. Management is considering mergers and acquisitions as a method to reduce costs and expenses while also improving shareholder value (Njangiru & Gwaya, 2015).

1.1.4. Effect of Market Share on Financial Performance.

Market share, according to Mwando (2013), is the percentage of the whole market that a company controls. It's a measure of a company's competitive advantage. Mergers and acquisitions boost the company's market share, which improves profitability because as the company grows, it can scale as well, giving lower pricing and limiting the growth of competitors, making it a solid indication of the firm's financial performance.

According to findings from a study of Bulgarian banks, the relationship between market share and bank profitability is positive and statistically significant; however, the estimation also suggested that the profitability of Bulgarian banks is influenced only by factors related to their management decisions, not by changes in the macroeconomic environment (Genchev, 2012).

1.1.5. Effect of Liquidity on Financial Performance.

Liquidity is a metric that businesses use to assess their ability to meet short-term obligations, and it's one of the most essential goals of working capital management, revenue optimization, and financial performance (Almeida, Campello & Weisbach, 2014).

According to the findings, careful consideration and planning of funding liquidity management is one of the ways to improve financial performance, and as a result, firms must increase their operating cash flow to positively influence their financial performance. This is positively attributed to when firms merge, thus increasing their operating cash flow (Waswa, Mukras, & Oima, 2018).

According to Banafa (2020), when commercial banks used a merger and acquisition strategy, their financial performance improved, as well as their financial performance and liquidity management techniques. However, according to a study done in China and Malaysia, bank liquidity levels have no impact on bank performance (Said &Tumin, 2011).

1.1.6. Effect of Financial Management practices on Financial Performance.

Financial management techniques can be characterized as a discipline that examines how businesses make financial decisions and the instruments they employ (Lasher, 2010). Cash management, capital budgeting decisions, financial analysis and forecasting, and portfolio management are some of the common financial management strategies used by businesses, according to Marembo (2012). Financial management practices have a moderately favorable link with financial performance, implying that combining these practices will ensure a firm's increased profitability.

Adoption of good financial management techniques is a difficulty for most businesses. Working capital management ensures that the company can meet its daily financial obligations, capital budgeting ensures proper coordination of all financial practices in the company, and effective cash management ensures transparency and accountability in the company's transactions; when all of these are integrated into the company's operations, the goal is to improve profitability (Uluyol, 2013).

However, additional costs may be paid in implementing these financial management procedures, putting a financial strain on the company, and resulting in lower profits (Abaniset, 2013). Many business leaders may be hesitant to implement certain financial management methods because of this. Other elements that influence how financial management methods impact firms include firm size, risk level, capital intensity, leverage, and industry considerations.

1.2. Problem Statement

Corporations are regularly presented with the opportunity to expand their economic operations and income through mergers and acquisitions as global rivalry grows and the economy progresses toward globalization (Mander & Goldsmith, 2014).

The Kenyan economy is not immune to mergers and acquisitions, as evidenced by the firms listed on the Nairobi Securities Exchange (NSE). Mergers and acquisitions are common among publicly traded companies, particularly in the banking and insurance sectors. Numerous studies, including Mwangi (2014), Kainika (2017), and Njambi and Kariuki (2018), have been done to explain the influence of mergers and acquisitions on the financial performance of commercial banks, insurance firms, and financial services.

Recent studies demonstrate that studies on the effect of mergers and acquisitions on the financial performance of organizations in various sectors, as well as the motivations of these firms to pursue a merger and acquisition strategy to improve their financial performance are lacking.

Further studies have been conducted to show that specific sectors in the Nairobi Securities Exchange tend to experience mergers and acquisitions as compared to others (Gwaya & Mungai, 2015). The area of focus will be on all sectors in the NSE with the banking, commercial and services, energy and petroleum and the manufacturing sectors as a representation of the firms that have undergone mergers and acquisitions.

The goal of this study was to provide additional information to investors so that they can make informed judgements about which sector to invest in based on merger and acquisition financial performance in various sectors as well as illustrate that mergers and acquisitions have a significant impact on the financial performance of companies listed in the NSE. The key determinants of this research to highlight financial performance are market share, liquidity, and financial management practices.

1.3. Research Objectives

1.3.1. General Objective

To determine the effect of mergers and acquisitions on the financial performance of companies listed in the NSE.

1.3.2. Specific Objectives

1. To evaluate the effect of market share upon mergers and acquisitions on the financial performance of companies listed in the NSE.
2. To analyze the effect of liquidity upon mergers and acquisitions on the financial performance of companies listed in the NSE.
3. To assess the effect of financial management practices upon mergers and acquisitions on the financial performance of companies listed in the NSE.

1.4. Research Questions.

1. What is the effect of market share upon mergers and acquisition on the financial performance of companies listed in the NSE?
2. What is the effect of liquidity upon mergers and acquisition on the financial performance of companies listed in the NSE?
3. What is the effect of financial management practices upon mergers and acquisitions on the financial performance of companies listed in the NSE?

1.5. Scope of the study

The research was confined to Kenya as it involved companies listed in the Nairobi Securities Exchange. The NSE has grouped companies according to sectors based on what the firms specialize in. The study focused on all sectors in the NSE with the banking, commercial and services, energy and petroleum and the manufacturing sectors as a representation of the firms that have undergone mergers and acquisitions.

1.6. Significance of the study

1.6.1. The Management

The study can be used by corporate executives who act as agents for shareholders and whose primary goal is to maximize the firm’s profits. Management will be informed about the benefits and drawbacks of using mergers and acquisitions as a strategic tool. They will be able to determine how to realize value creation and as a result, accelerate the firm's growth as well as whether to use the strategy or not.

The study may help the management update themselves on the current industry practices because of its very dynamic nature of the business environment in which the organizations are a part of it. It may assist both the management and the shareholders with information that may assist in predicting and ensuring good timing for the adoption of the merger and acquisition strategy.

1.6.2. The Government

The government benefits from the growth of businesses through mergers and acquisitions because this is an indicator of economic prosperity. Because the merger and acquisition tool would be available to all sectors of the Nairobi Securities Exchange, the government will be able to have a say in existing enterprises by boosting their financial capacity. Potential investors will be interested since they will be seeking for firms that are involved in mergers and acquisitions before making an investment choice.

It can also be beneficial to the regulator of companies as well as the Capital Markets Authority in understanding the best ways to mitigate risks and in coming up with appropriate regulations as this may guide the government on matters pertaining to regulations on mergers and acquisitions as well as policies related to it.

CHAPTER TWO: LITERATURE REVIEW

2.1. Introduction

This chapter elaborates information on past and recent research relevant to this study that forms the basis of argument for this research proposal. It comprises the theoretical review, empirical review, research gap and the conceptual framework.

2.2. Theoretical Review

The following theories were used in this project proposal to show how mergers and acquisitions have affected the financial performance of firms listed on the Nairobi Securities Exchange in respect to the stated objectives. The study adopted the BCG matrix theory (Henderson, 1986), the Synergy theory (Seth, 1990) and the Hubris - Behavioral theory (Roll, 1986).

2.2.1. Boston consulting group matrix theory (BCG)

The Boston Consulting Group Matrix is a business planning tool used to evaluate a firm's strategic plan in relation to relative market share and market growth rate by Bruce Henderson in the year 1968. The assumption of the matrix is that an increase in relative market share will result in increased cash flow. According to this theory, an organizations' market share will impact its financial performance as it will affect the amount of returns it makes since profit maximization is a firms' top-most priority. Mueller (1985) suggests that market share represents the percentage of an industry, or a market's sales earned by a company over a period and studies have shown that when one or more firm's merge, their market share increases and decreases their costs.

Mergers and acquisitions, according to Amihud (1981), can help a merged firm gain a monopoly on the market by increasing its market share. He also demonstrates how a bigger market share can lead to stronger market power, which affects customers, resulting in an increase in cash flows and so boosting the firm's financial performance.

Market share is a solid measure of competitive strength and has a significant impact on an investor's decision-making process. Before a merger or acquisition, a company can use the BCG matrix to evaluate its products' market share and performance, as well as determine which strategy to use, build, hold, harvest, or divest in the product. Therefore, the theory is important, it demonstrates how a combined firm's products impact market share in the economy, as well as how it's a key indicator of firm performance.

2.2.2. Synergy Theory

According to Seth (1990), the synergy hypothesis is illustrated as that, the combined firm's worth is lower than the aggregate value of both independent enterprises prior to merger and acquisition. It's also anticipated that the two organizations' worth and performance would be integrated if two components may unite to increase efficiency or scale.

Ansoff (1987) studied mergers and acquisitions from the perspective of corporate strategy synergistic effect. He argues that strategy consists of market scope, development, competitive advantage, and synergy. Among them, the synergy shows how companies identify their capabilities and opportunities through the matching relationship to develop new business successfully.

On a study by Weston (1998), the factor of mergers and acquisitions total value increase is dependent on management synergy where companies which have different management level combinations can bring efficiency improvements, operating synergy which allows for the firms to increase their operating income and achieve higher growth and financial synergy whose source is the lower cost of internal financing and external financing. Organizations with a high internal cash flow and few investment possibilities will have excess cash flow, whereas companies with a low internal capital production capability and numerous investment opportunities will require extra funding.

This theory is relevant in that through the aspect of financing and the motives behind mergers and acquisitions, increased cash flow will be achieved hence the firm will be able to meet its short-term obligations, save on costs and take to more investment opportunities boosting financial performance.

2.2.3. Hubris Theory

The Hubris hypothesis states that administrators and managers want to acquire firms for their self-interest and that the pure economic advancement to the acquiring firm is not the only intent or even the dominant motive in the acquisition. It refers to the pride of the administrators in the acquiring firm hence having a behavioral aspect to it. This hypothesis also implicitly shows that the efficient market can provide the best indicator of the firm’s value (Roll, 1986).

This means that managerial incentives are critical in determining merger and acquisition results, because management might act in ways that maximize their own personal worth and commit to empire building rather than focusing on shareholder value (Trautwein, 1990).In another study by Billiet and Qian (2003), they observed the history of 2487 CEOs and 2795 deals over the years 1980 to 2002. They measured overconfidence by the tendency of CEOs to overinvest in the stock of their own companies and their statements in the media. Results showed that doing acquisitions was 65% more likely for the overconfident group of CEOs in their sample, they also determined that these CEOs were more likely to make lower-quality, value-destroying acquisitions.

Consecutively, Firth (1991) showed that an increase in shareholder value resulted in executive remuneration in a study on the link between executive compensation and mergers and acquisitions.

This theory will be of great significance as it highlights the motives and how to have a successful merger and acquisition transition so as to prevent potential failure and this will be achieved through the proper implementation of effective financial management practices so as to realize firm performance.

2.3. Empirical Review

Since mergers and acquisitions have been the most popular way of corporate strategy to improve financial performance, empirical research studies on corporate mergers and acquisitions focus on the influence of mergers and acquisitions on company performance.

2.3.1. The relationship between market share and financial performance

Misigah (2013) examined the influence of mergers and acquisitions on the financial performance of Indian pharmaceutical firms from 2000 to 20017, he discovered that a firm’s profitability is directly proportional to its size, sale efforts, and export and import intensities, but inversely proportional to its market share and product demand using panel data estimate approaches. His findings revealed that, in the long run, mergers and acquisitions have no substantial impact on business profitability, presumably due to X-inefficiency and the entry of new firms into the market.

Ombaka and Jagongo (2018) investigated the impact of mergers and acquisitions on the financial performance of commercial banks. The population of a study in Kenya consisted of nine banks that merged or acquired each other between 2010 and May 2017. There were three mergers and six acquisitions among the deals. When operational synergy, differential efficiency, risk diversification and market share development are considered as indicators of mergers and acquisitions, the study discovered that they have a significant impact on the financial performance of Kenyan Commercial Banks.

Based on a study conducted by Ashfaq, Usman, Hanif, and Yousaf (2014) to examine the influence of merger and acquisition activities on post-merger financial performance of non-financial sector enterprises in Pakistan. The study sample comprised sixteen companies that had engaged in merger and acquisition activity between 2000 to 2009 and were also listed on the Karachi stock exchange. The effect of mergers and acquisitions was investigated using absolute and relative financial performance. financial performance after the merger was assessed using ratios such as the return on equity, return on assets and earnings per share. In the presence of overseas competitors, enterprises maintain their market share, according to the research.

2.3.2. The relationship between liquidity and financial performance.

A sufficient degree of liquidity, according to Dang (2011) is positively associated with firm profitability. According to the aforementioned author, the most frequent financial ratios that show a bank's liquidity status are customer deposit to total asset and total loan to customer deposits. However, a study conducted in China and Malaysia discovered that bank liquidity levels have little bearing on bank performance (Said &Tumin, 2011).

Fatima (2014) investigated the impact of mergers and acquisitions on insurance companies' financial performance in Pakistan. Six financial ratios were examined in their research. The sample for investigation consisted of ten insurance companies that merged between 2007 and 2010. Their null hypothesis was that synergy improved financial performance and efficiency as a result of mergers and acquisitions. The alternative premise was that the financial effects of mergers and acquisitions were unclear. They rejected the alternative hypothesis in terms of profit after tax, return on assets, leverage, and earnings per share based on the data presented. They accepted their null hypothesis and found that, based on their findings, merger objectives were not clearly met, synergy was not generated, and economies of scale were not realized.

2.3.3. The relationship between financial management practices and financial performance.

Akinyomi (2014) analyzed the influence of mergers and acquisitions on the financial efficiency of Nigerian insurance companies based on a study. By comparing data before and after the merger, he was able to assess financial efficiency by comparing operational profits, net income, and net assets of sample companies. The study found that post-merger financial efficiency was higher than pre-merger financial efficiency. The study found that mergers boosted a bank's profit potential by comparing seven-year pre-merger and post-merger financial performance data.

After the merger and acquisition, the study found that return on asset, return on equity, net interest margin, capital adequacy ratio, and non-performing loans all improved. Mergers, on the other hand, did not strengthen the ability of financial institutions to perform intermediate duties, as seen by the dropping loan-to-deposit ratio.

Mitema (2014) focuses on the influence of mergers and acquisitions on value creation in the Kenyan insurance industry. The study examined a sample of four Kenyan insurance companies that had gone through mergers or acquisitions between 2000 and 2014. The outcomes of the study revealed a positive significant association, indicating that mergers and acquisitions add value to listed companies and have a favorable influence on both book and fundamental value. This study employed a descriptive research approach and regression analysis to look at companies in a variety of industries to investigate if mergers and acquisitions affect shareholder returns.

According to Barasa (2015), a CAPM event study was used to investigate the influence of M&A on share prices of NSE-listed companies. He studied nine companies that merged between 2007 and 2014. The study discovered that merger and acquisition announcements had a significant impact on total accumulated share returns for the various quoted corporations before and after the implemented strategy and indicated that mergers and acquisitions have a beneficial impact on short-term shareholder returns.

2.4. Research Gap

Various research papers reveal the impact of mergers and acquisitions on a firm's financial performance when they are implemented as a profit-maximizing strategy. However, the studies do not clearly show the motivations behind the merger and acquisition agreement because it is often used to create synergy rather than because of a lack of company strength (Ismail, Abdou & Annis, 2011).

There also appears to be no proof as to the factors that influence the financial performance of companies listed on the NSE, or how different sectors are affected. It's also unclear whether industries that engage in more mergers and acquisitions far better than those that don't.

According to Nyakundi (2017), his research focuses on the impact of mergers and acquisitions on the company performance of NSE-listed companies. He concludes from his research that mergers and acquisitions have little impact on the financial performance of companies listed on the NSE. He bases his conclusion on the use of liquidity ratios, such as the quick ratio, debt ratio, and current ratio, as the only indicators of firm performance.

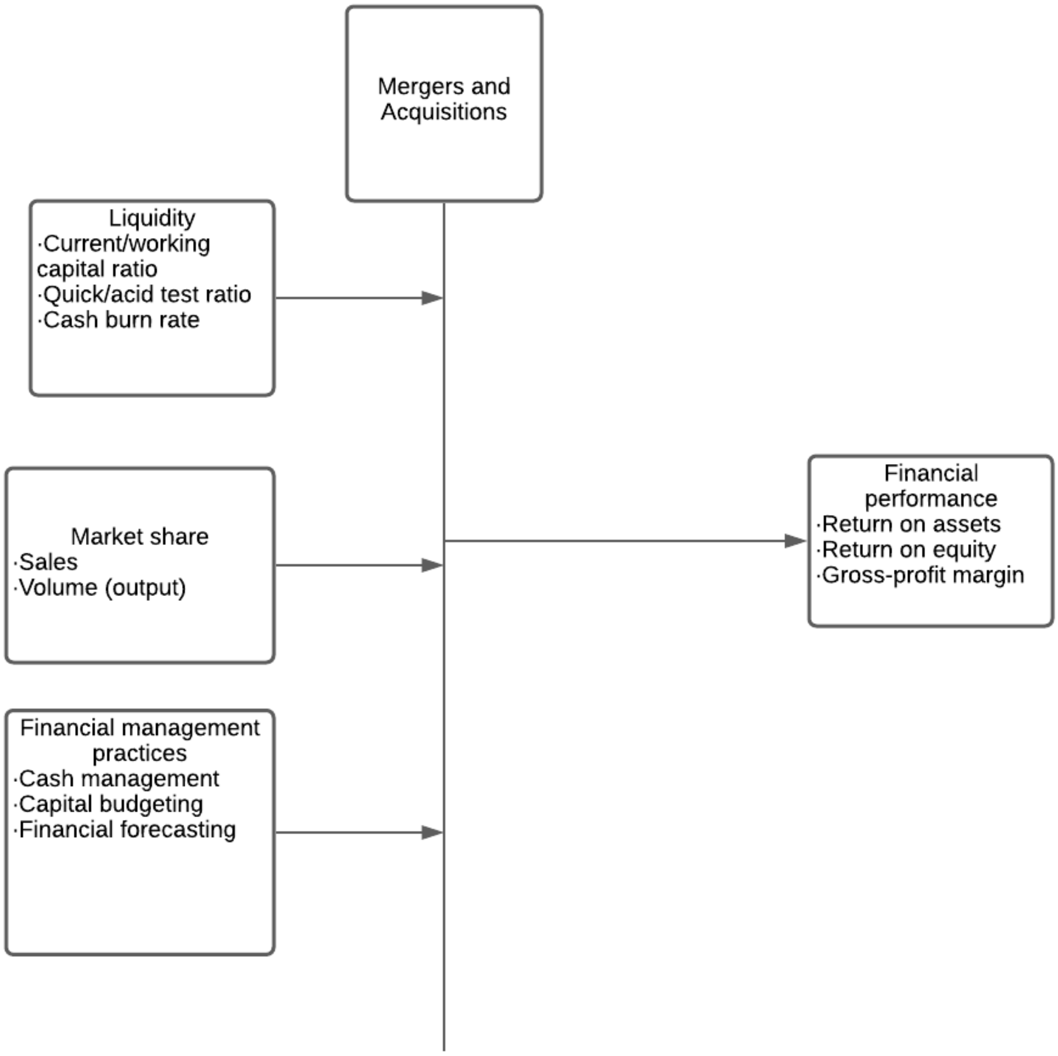
Based on existing literature, more research into the various sectors of the Nairobi Securities Exchange is needed to determine how each sector is impacted by the mergers and acquisitions that have occurred, as well as how this affects the financial results and growth of the enterprises affected. Furthermore, potential investors and financial analysts will have sufficient information to make informed decisions on whether or not to invest in companies in various areas.

This research tries to examine business performance holistically, taking into account market input, industrial influence, financial management, and the element of returns that affect the firm's financial success. The impact of mergers and acquisitions on the financial performance of companies listed on the NSE will be demonstrated using market share, liquidity, and financial management practices indicators.

2.5. Conceptual Framework

The conceptual framework comprises the independent variables that act as indicators and include the market share, liquidity and financial management practices and influence the dependent variable which is financial performance and the intervening variable as merger and acquisition which limits the study to firms which have specifically adopted the merger and acquisition strategy. The variables used in this study are used as a measure for firm performance and are a reflection of a firm's returns.

Independent variables Intervening variable Dependent variable



Source: Author (2021)

2.6. Operationalization of Variables

This section seeks to describe the various measurement scales that will be used to assess each of the variables mentioned in the conceptual framework. The financial performance is measured in terms of profitability using the return on equity (ROE), return on assets (ROA)and gross-profit margin, liquidity is measured using the current ratio, quick ratio and cash burn rate, market share is measured in terms of sales, volume (output) and customer's preference while financial management practices are measured in terms of cash management, capital budgeting analysis and financial analysis and forecasting.

Variable	Indicators	Measurement
Financial performance	• Gross-profit margin • Return on assets (ROA) • Return on equity (ROE)	Ratio scale
Liquidity	• Current/working capital ratio • Quick/acid test ratio • Cash burn rate	Ratio scale
Market Share	• Sales • Volume (output)	Ratio scale
Financial management practices	• Cash management • Capital budgeting • Financial forecasting	Ratio scale

CHAPTER THREE: RESEARCH METHODOLOGY

3.1. Introduction

This chapter outlines methods used to collect and analyze data for the research study. It entails the research design, the population sample of the study, the sampling technique that was used, the data collection methods as well as the data analysis, research quality and issues to do with ethical considerations in relation to the research study.

3.2. Research Design

Research design is a process that gives a framework for a researcher to collect and display data in order to improve the research's reliability, efficiency, and flexibility (Springer, 2017). The study used a descriptive research strategy to describe the research topic and so answer the questions of what, when, and how these variables influence the research topic.

The relevance of this research design is consistent with the stated objectives that cover our scope of the study, whereby the purpose is to describe and predict the relationship between the effect of liquidity, market share, financial management practices upon mergers and acquisitions on the financial performance of companies listed on the NSE, as well as the measurement of these variables, and whether mergers and acquisitions have a significant effect on the financial performance of companies listed on the NSE.

3.3. Population of the study

Population is the unit of study, according to Acharya and Prakash (2013), and refers to the complete collection of elements to whom a researcher wants to draw some conclusions. The target population for this study was selected from the 63 firms that are listed on the Nairobi Securities Exchange and are divided into 11 sectors.

3.4. Sample and sample design

A sample, according to Boddy (2016), is a subset of a population in which the selected elements chosen for participation in a study are utilized as a point of reference for the investigation. Purposive non-probability sampling was used because the elements were chosen based on the study's purpose, as not all companies listed on the NSE have an equal chance of participating, and it was limited to those that had undergone mergers and acquisitions to minimize bias and allow for proper in-depth analysis. The sample survey was conducted on 5 firms that have completed mergers and acquisitions and are listed on the NSE between 2008 and 2020 and then narrowed to two firms from sectors that have experienced merger and acquisition activity.

3.5. Data collection methods

The research was based on secondary data from the NSE's banking, commercial and services, energy and petroleum, and manufacturing sectors. These statements are available on the Nairobi Securities Exchange and the appropriate corporate websites. Current assets, current liabilities, total liabilities, net worth, and total assets are all information found in the financial accounts. Stock and share prices of corporations listed on the Nairobi Securities Exchange that have engaged in mergers and acquisitions are among the data available from the securities exchange.

3.6. Data Analysis

Data analysis, according to Cooper and Schindler (2014), is the process of editing and reducing obtained data to a manageable quantity, providing summaries, searching for patterns, and using statistical methods. The study used inferential statistics and the event study approach to analyze the data. The inferential statistics methods implemented were regression and correlation on the series of data. The event study or event history analysis method examines the impact of an event on the financial performance of companies as well as it aims to assess whether there are any abnormal or excess returns earned by security holders accompanying specific events. The study compared the performance of the firms two years before and two years after the merger and acquisition activity.

The study also used ratio analysis to analyze the effect of liquidity, market share and financial management practices on the financial performance of companies listed in the NSE. Ratio analysis has the benefit of removing any existing contradictions in the study data (Abduh, Hasan, & Pananjung, 2013). Ratio analysis also assists the researcher in organizing and analyzing data in a systematic manner, and it is appropriate for analyzing financial performance since it confirms the association between the variables in the firm's financial statements.

A multiple linear regression model was employed to clearly show the association between the dependent and independent variables. It was useful in identifying the extent to which the independent factors impacted the dependent variable. The following is a generalized form of the multiple linear regression model that was used:

$$Yi = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \varepsilon$$

Where:

Yi refers to the initial observation of the dependent variable, financial performance as measured by the net profit margin (NPM). The net profit margin (NPM) is calculated by dividing the net profit of a firm by the total revenue (also known as total sales) (Brigham & Ehrhardt, 2011).

- ROE is calculated by dividing a firm's net income by the total shareholders' equity (Subramanyam & Wild,2009).
- ROA is calculated by dividing a firm's net income by the total assets (Kramer & Johnson, 2009).

$\beta 0$ = The constant term of the equation.

$\beta 1$, $\beta 2$, $\beta 3$ = The coefficient terms of the independent variables.

$X1$ = Market share computed in form of percentage in change in terms of size either increase or decrease in the number of customers or sales before the merger activity and after the merger activity

$X2$ = Liquidity, measured by the current/ working capital ratio which is calculated by current assets divided by current liabilities

- Cash burn rate measures how long the company keeps running if the cash inflows begin to dry up. It is calculated by dividing current assets by the daily operating expenses.

$X3$ = Financial management practices, measured by the debt/equity ratio so as to assess the finance risk of the business. The ratio is calculated by dividing a firm's total liabilities divided by the total shareholders' equity (Palepu & Healy, 2013).

ε = The error term that accounts for the variability in financial performance that cannot be explained by the linear effect of the independent variables (Anderson, Sweeny, Williams, Camm, & Cochran, 2015).

Microsoft Excel was used to compute and analyze the data. The analyzed data was then utilized to conduct correlation and event studies to determine the impact of mergers and acquisitions on the financial performance of companies listed in the NSE. In chapter four, the results and findings are given.

3.7. Research Quality

Research quality outlines the aspects of study design, it relates to the judgment regarding the match between the methods and questions, selection of subjects, measurement of outcomes, protection against systematic and non-systematic bias and inferential error (Walliman, 2010).

Depending on the sort of research project and data collection method used, there are five approaches for establishing research quality: reliability, validity, objectivity, pilot testing, and triangulation.

3.7.1. Reliability

According to Price (2015), reliability refers to a measure's consistency. It's also when a measurement process produces consistent results over multiple measurements. Due to the issue of bias and distortion in data collection, this method of determining research quality will apply to this research study because it is in line with the data collection method of document analysis of financial statements. As a result, the aspect of reliability brought about accurate data collection, analysis, and conclusions from the study.

3.7.2. Validity

The accuracy with which a method measures what it claims to measure is referred to as validity (Taherdoost, 2016). This aided in determining how well the findings match up with existing ideas and other metrics of the same notion. It was relevant to this study because it ensured the accuracy of the results and established the measurement of the variables, which indicate whether mergers and acquisitions have a substantial impact on the financial performance of NSE-listed firms.

3.8. Ethical Considerations

Research ethics involves the application of fundamental ethical principles to research activities which include design and implementation of research. It promotes the aims of research such as knowledge, truth and avoidance of error (Qamar, 2018). The use of transparency and objectivity for the study was maintained whereby, transparency was exhibited in the disclosure of methods, materials, assumptions and analysis and other information used to evaluate the study while objectivity was maintained by ensuring the research will be used solely for academic purposes to avoid biases in experimental design, data analysis and data interpretation.

CHAPTER FOUR: RESULTS AND FINDINGS

4.1.Introduction

This chapter presents the results and findings of the data collected from two firms, that is Total Kenya and NCBA bank which are a representation of the sectors that experience merger and acquisition activity mostly and how it affects their financial performance. Specifically, the findings are analyzed based on the effect of market share, effect of liquidity and the effect of financial management practices on the financial performance of Total Kenya and NCBA bank.

4.2.Sample Representation

4.2.1. Total Kenya PLC

Based on the data collected from Total Kenya PLC's financial statements, table 4.1 below provides a brief overview of the firm's financial performance, before the acquisition (pre-acquisition) of Chevron Kenya, the year of acquisition and after the acquisition (post-acquisition). The values provided are in ratio scale.

Table 4.1: Overview of Total Kenya PLC financial performance

	Pre-acquisition		Acquisition Period	Post-acquisition	
Year	**2007**	**2008**	**2009**	**2010**	**2011**
Net profit margin	0.0119	0.0128	0.0117	0.0116	0.0007
ROA	0.0625	0.0710	0.0233	0.0457	0.0016
ROE	0.16	0.20	0.08	0.14	0.006
Current/working capital ratio	1.25	2.18	0.65	1.17	1.10
Cash burn rate	7.82	16.32	8.47	5.68	6.39
Market share (% change)	20.4	22.01	21.9	23.2	25.85
Debt-equity ratio	0.37	0.39	0.41	0.33	0.37

Source, Author (2021)

The net profit margin (NPM) remained stable until the year of purchase, when it began to decline and then fell significantly two years later. The NPM began to rise two years after the acquisition. The return on assets (ROA) and return on equity (ROE) ratios both followed a similar trend, with the ROA fluctuating somewhat before the purchase and then dropping throughout the acquisition year. It increased again one year after the acquisition but fell into a loss in the second and third years. Pre-acquisition, the ROE was likewise constant, it did, however, drop during the year of acquisition before increasing one year later. It then declined in the second and third years after the takeover. Pre-acquisition, the debt-to-equity (D/E) ratio varied before increasing throughout the year of purchase. Following purchase, the D/E ratio shifted once more.

4.2.2. NCBA Bank Kenya

Based on the data collected from NCBA Bank Kenya financial statements, table 4.2 below provides a brief overview of the firm's financial performance, before the acquisition (pre-acquisition), the year of acquisition and after the acquisition (post-acquisition) when NIC and CBA merged to form NCBA. The values provided are in ratio scale.

Table 4.2: Overview of NCBA Bank financial performance

	Pre-acquisition		Acquisition period	Post-acquisition	
Year	**2017**	**2018**	**2019**	**2020**	**2021**
Net profit margin	0.079	0.0807	0.1496	0.0872	0.1245
ROA	0.027	0.0279	0.0229	0.0094	0.0197
ROE	0.161	0.1627	0.1682	0.0687	0.1475
Current/working capital ratio	1.20	1.21	1.16	1.15	1.16
Cash burn rate	32.9	30.08	31.74	13.18	22.79
Market share (No. of branches)	44	53	78	64	84
Debt-equity ratio	4.93	4.81	6.35	6.27	-

Source, Author (2021)

The net profit margin increased steadily up until the year of acquisition then significantly dropped due the onset of the covid-19 pandemic, the return on assets and return on equity was following a steady trend and has been declining over the period after the merger. The current/ working capital ratio has been constant over the period. The cash burn rate, however, has been fluctuating before the acquisition and assuming a normal trend after the event. The market share significantly increased due to the number of mergers being opened up within the country, although due to the covid-19 pandemic some of the branches were temporarily closed to limit contact operations. The debt equity ratio has been increasing over time after the merger.

4.3.Descriptive Analysis

According to Handzic (2015), descriptive analysis is a type of data analysis that helps describe, show, or summarize data points in a constructive way such that patterns might emerge that fulfill every condition of the data. Descriptive analysis can be illustrated through the measures of central tendency such as mean, median and mode, and also the measures of dispersion or variation which are range, standard deviation, variance, skewness, and frequency distribution.

This study described the nature of the data using mean, standard deviation, variation, and skewness. Mean is described as the arithmetic average, standard deviation as the average difference of the observed values of the variables from the mean, variance is the squared deviation of each value from the mean and skewness measures the degree and direction of asymmetry as well how much the data deviates from the normal distribution in a set of data (Groebner, Shannon & Fry, 2014).

Descriptive analysis was carried out on Total Kenya and NCBA to summarize the data of how the merger event had an effect on the financial performance of both firms before and after the merger and acquisition.

4.3.1. Descriptive analysis of Total PLC Kenya

Based on the data computed, Total Kenya's mean dropped after acquiring Chevron Kenya from 0.580 units to 0.236, the standard deviation however improved after acquisition hence an indicator other factors influenced the performance of Total Kenya with the variance as the squared deviation from the mean, the nature of the data is highly skewed to show much the data is greatly affected by other factors that were not considered during the study as it increased to 1.84 units after the acquisition.

Table 4.3 Analysis of Total PLC Kenya before and after acquiring Chevron Kenya

	Mean	Standard Deviation	Variance	Skewness

Pre-acquisition	0.580	7.89	62.29	1.28
Post-acquisition	0.236	8.39	70.51	1.84

Source, Author (2021)

4.3.2. Analysis of NCBA Bank Kenya after the merger event

According to the analysis on NCBA Bank, the mean dropped from 1.179 units to 0.906 units after acquisition, then after the acquisition the standard deviation improved to 26.34 units to indicate the consideration that the variables have an impact on the financial performance of the firm. The nature of the data is highly skewed as it indicates a value greater than 1, indicating that other variables may be at play in affecting the financial performance of the firm after the merger activity.

Table 4.4 Descriptive analysis of NCBA Bank

	Mean	Standard Deviation	Variance	Skewness
Pre-acquisition	1.179	18.23	332.36	1.16
Post-acquisition	0.906	26.34	693.97	1.78

Source, Author (2021)

4.4.Correlational Analysis

Correlation analysis is a statistical method used to measure the strength of the linear relationship between two variables and compute their association. A high correlation points to a strong relationship between the two variables, while a low correlation means that the two variables are weakly correlated (Weirers, 2011). It is arranged in light of the set objectives with reference to the sample representation of the area of study.

4.4.1. Total Kenya PLC

4.4.4.1. Effect of market share upon M&A on financial performance

The market share of Total Kenya was measured based on the number of sales it makes in comparison to the petroleum industry as a percentage of change. The market share increased from 22.01% to 23.2% after the acquisition.

With a data sample size of 5, the Pearson correlation coefficient (r) was 0.859, indicating a positive significant linear relationship between market share and financial performance, as measured by the NPM ratio; $r(5) = 0.859$, $p<0.01$.

4.4.4.2. Effect of liquidity upon M&A on financial performance

Liquidity was measured using two ratios for the purposes of accuracy, that is the current/working capital ratio and the cash burn rate. The current ratio prior to the acquisition was at 2.18 and after it was at 1.17 reflecting the ability of the firm's short-term assets to meet short term liabilities. The cash burn rate was at 16.32 then after acquisition it was at 5.68 then increased to 6.39 which is a measure of how long the company keeps running if the cash flows begin to dry up.

The Pearson correlation coefficient (r) is 0.913 with a data sample size of 5, showing a statistically significant positive linear association between liquidity and financial performance (NPM); $r (5) = 0.913$; $p<0.01$.

4.4.4.3. Effect of financial management practices upon M&A on financial performance

Financial management practices are measured using cash management, capital budgeting and financial forecasting; this was reflected through the computation of the debt-equity ratio to show how well a firm manages its finances, the form of financing and whether the type of financing is sustainable in the future of the company. The debt equity ratio was at 0.39 then later decreased to 0.37.

The Pearson correlation coefficient (r) is -0.054 with a data sample size of 5, demonstrating a slight negative linear association between D/E and NPM; $r (5) = -0.054$; $p<0.01$.

4.4.2. NCBA Bank Kenya

4.4.4.1. Effect of market share upon M&A on financial performance

The market share of NCBA Bank was measured using the number of customer deposits as well as the number of branches opened to serve the market in relation to the overall growing market. The number of branches of NIC and CBA was at 53 when they merged the branches increased to 78 which are able to serve the market extensively.

With a data sample size of 5, the Pearson correlation coefficient (r) was 0.859, indicating a positive significant linear relationship between market share and financial performance, as measured by the NPM ratio; $r (5) = 0.859$, $p<0.01$.

4.4.4.2. Effect of liquidity upon M&A on financial performance

For the sake of precision, liquidity was calculated using two ratios: the current/working capital ratio and the cash burn rate. Prior to the merger, the current ratio was 1.21, and thereafter, it was 1.15, indicating the firm's capacity to cover short-term commitments with short-term assets. The cash burn rate was 30.08 before acquisition, 13.18 after acquisition, and 22.79 after acquisition, which is a measure of how long the firm can continue to operate if cash flows dry up.

The Pearson correlation coefficient (r) is 0.913 with a data sample size of 5, showing a statistically significant positive linear association between liquidity and financial performance (NPM); r (5) = 0.913; $p<0.01$.

4.4.4.3. Effect of financial management practices upon M&A on financial performance

The debt-equity ratio was computed to illustrate how successfully a corporation manages its finances, the kind of financing, and if the type of financing is sustainable in the future of the organization. The debt-to-equity ratio was 4.81 at the time of the merger, but it was later raised to 6.27.

The Pearson correlation coefficient (r) is -0.054 with a data sample size of 5, demonstrating a slight negative linear association between D/E and NPM; r (5) = -0.054; $p<0.01$.

4.5. Regression Analysis

A multiple regression analysis was carried out and the table below provides the model summary findings, which reveal that the correlation coefficient (R) was 0.743 and the coefficient of determination (R^2) was 0.512. This suggests that 51.2 percent of the variance in financial performance may be explained by market share, liquidity, and financial management variables.

Model	R	R Square	Adjusted R Square	Std. Error of the estimate
1	.743[b]	.512	0.41	.181321

b = market share, liquidity, financial management practices

Source, Author (2021)

4.6. Summary of Findings

The goal of the research was to analyze financial performance, liquidity, financial management practices, and market share impact on NSE-listed firms before and after mergers and acquisitions. In a tabular manner, the findings and outcomes were presented. The descriptive analysis and event study clearly indicated that the merger and acquisition event impacted the financial performance of the companies listed in the NSE.

The ratio analysis aided in computing the data from the financial statements to reveal insights regarding profitability, liquidity, operational efficiency, and solvency, it also marked how a company is performing over time while comparing a company to another within the same industry or sector.

The regression and correlation analysis highlight how the independent variables that are market share, liquidity and financial management practices interact and the degree of association with the dependent variable financial performance.

CHAPTER FIVE: DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter summarizes the research, discusses the findings, and draws conclusions based on them. The chapter also discusses some of the study's weaknesses and improvement suggestions and future research have been proposed as well.

5.2. Discussion of findings

The overall goal of this research was to look into the impact of mergers and acquisitions on the financial performance of businesses listed on the Nairobi Stock Exchange (NSE), using Total Kenya PLC and NCBA Bank Kenya as examples of the petroleum and banking sectors that have seen a lot of merger and acquisition activity. The study was directed by the following particular research objectives: to investigate the impact of market share, liquidity, and financial management techniques on the financial performance of firms listed on the NSE following mergers and acquisitions.

The findings are discussed in this part of the chapter. The section is organized according to the study's research goals. The presentation of the research findings is contrasted and compared to earlier study findings in the discussion.

5.2.1. The effect of liquidity upon merger and acquisition on financial performance.

The current/working capital ratio and the cash burn rate were used to accurately estimate liquidity. Both in the case of Total Kenya and NCBA Bank Kenya, the current ratio declined after the merger and acquisition activity while the cash burn rate declined then later increased over the period after the merger.

According to research done in China and Malaysia where customer to total asset ratio was used, bank liquidity was indicated to have a minimal impact on bank performance (Said &Tumin, 2011).

In reference to this study, there is a statistically significant positive linear association between liquidity and financial performance since the Pearson correlation coefficient (r) is 0.913.

5.2.2. The effect of market share upon merger and acquisition on financial performance.

The amount of client deposits as well as the number of branches built to service the market in relation to the total increasing market were used to calculate NCBA Bank's market share and Total Kenya's market share was calculated as a percentage of change in the number of sales it makes in comparison to the petroleum sector.

Based on a study conducted by Ombaka and Jagongo (2018), illustrated that when operational synergy, differential efficiency, risk diversification and market share development are considered as indicators of mergers and acquisitions, the study indicated there was a significant impact on the financial performance of Kenyan Commercial Banks.

The study findings also demonstrated there is a positive relationship between market share and the financial performance of firms listed in the NSE.

5.2.3. The effect of financial management practices upon merger and acquisition on financial performance.

Cash management, capital budgeting, and financial forecasting were used to describe financial management practices. The debt-equity ratio was calculated to show how well a company manages its finances, the sort of financing it uses, and if that financing is sustainable in the long run.

Mitema (2014) focused his research on the impact of mergers and acquisitions on value creation in Kenya's insurance market. Between 2000 and 2014, four Kenyan insurance businesses underwent mergers or acquisitions, according to the report. The study's findings found a substantial positive relationship, demonstrating that mergers and acquisitions add value to publicly traded firms and have a favorable impact on both book and fundamental value.

NCBA Bank Kenya had a higher debt equity ratio as compared to Total Kenya, this is to indicate that different sectors in the NSE are affected differently in terms of financial management practices based on the method of financing such as debt or equity. Therefore, the study reflected the findings that financial management practices have a weak relationship with financial performance; this is a result of the different sectors at play in the NSE.

5.3. Conclusions

The first objective of the study was to evaluate the effect of market share upon merger and acquisition on the financial performance, the findings exhibited there is a positive relationship between market share and the financial performance of firms listed in the NSE. The second objective of the study was to analyze the effect of liquidity upon merger and acquisition on the financial performance; there is a statistically significant positive linear association between liquidity and financial performance. The third objective of the study was to assess the effect of financial management practices upon merger and acquisition on the financial performance, the study reflected the findings that financial management practices have a weak relationship with financial performance; this is a result of the different sectors at play in the NSE.

The research reflected that the merger and acquisition activity impacts the financial performance of companies listed in the NSE hence the importance of carrying out an event study.

5.4. Recommendations

The research provides the following recommendations: first, firms with a small market share should merge in order to improve their performance and maximize shareholder value. Companies should take advantage of the fact that market share appears to have the biggest impact on financial success. Second, the study suggests that organizations from various manufacturing lines and industries participate in M&As to diversify their risks. The study found that a firm's liquidity level has a beneficial impact on its performance since it represents the firm's ability to meet its short-term obligations.

A high debt-to-equity ratio shows that a company relies on debt to fund its operations and satisfy its obligations rather than equity. A negative debt to equity ratio means that a company's liabilities exceed its equity. In order to make the debt-to-equity ratio positive and appealing to investors and lending institutions, the firm's management can take steps to lower its obligations by boosting sales revenue, restructuring the firm's debt, effectively managing the firm's inventory, and attracting new investors.

5.5. Suggestions for further research

Further research on the impact of mergers and acquisitions on the financial performance of Kenyan enterprises is needed to establish trends over longer time periods and identify new possibilities in Kenya's various industries. Because there are numerous elements that affect a firm's financial success, multiple combinations of variables should be employed, not only liquidity, market share, and financial management techniques. Future studies should incorporate a variety of qualitative and quantitative parameters to generate more comprehensive and detailed results, since there are numerous approaches for measuring a firm's success.

Extensive studies should be conducted on the various firms across the different sectors in the NSE not only the banking and Petroleum industry as well as up to date research on the recent merger and activity of firms in Kenya.

5.6. Limitations of research

When conducting the investigation, the researcher encountered various difficulties. First, the analysis relied on publicly available secondary data from the listed companies. Some of the data, however, could not be found on the internet, so the researcher had to hand gather it from the NSE resource center. This was a constraint that impacted the study's completion timelines.

The research was extensive since it had to focus on various methods of analysis to interpret the data, the event study which had to investigate the financial performance two years before and two years after the merger and acquisition activity, this was a lot of data to compute hence time consuming and tedious to sort through.

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APPENDIX

MERGERS AND ACQUISITIONS OF COMPANIES LISTED IN THE NSE

COMPANY LISTED IN THE NSE	SECTOR IN THE NSE	YEAR OF M&A
Total Kenya Ltd	Energy and Petroleum	2008
East African Breweries Ltd	Manufacturing & allied	2010
TPS Eastern Africa (serena) Ltd	Commercial & services	2012
NCBA Group PLC	Banking	2019
KCB Group Ltd	Banking	2019