

**EFFECTS OF MERGERS AND ACQUISITIONS ON FINANCIAL
PERFORMANCE OF BANKS IN KENYA**

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**A research project submitted in partial fulfillment of the requirement for the
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DECLARATION

I declare that this research Project is my original work and has not been presented for a Degree in any other university.

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This Research Project has Been Submitted for Examination with My Approval as The University Supervisor
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DEDICATION

This research is dedicated to myself.

“Knowledge is like a garden: if it is not cultivated, it cannot be harvested. Unknown

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Banks in modern-day financial business have evolved which creates the need of such banks to re-evaluate its assets and strategies in order to be sustainable and improve on the ever-changing environment. This has brought about banks combine assets in order to maintain its performance in the financial market. Research done to explain the relationship between M&As and financial performance has never been well concluded, how firms acquire another firm's assets thus increasing its value (Bouba, 2011). According to DePamphilis (2008), a merger is a situation where companies buy shares from another company.

M&A is a recycling process until it becomes a daily routine for banks and other businesses to engage in. Some studies have concluded that M & A improves financial performance of post-merger firms (Mwanza, 2013). Meanwhile, Indhumathi, Selvam, and Babu (2011) argue that M&As have similar meaning since in all offers are made through bidding firms to the shareholder of target firms. A merger is the amalgamation of two existing companies to bring forth a new company where joint firms retain their identity while an Acquisition is taking control of the company by purchasing most of the company's ownership stake with no new company being formed (Cartwright & Schoenberg, 2006). Depamhilis (2008) further asserts that a company can acquire another by buying shares of stock or purchasing a company's assets.

M&A has three forms; horizontal, vertical and conglomerate mergers. Horizontal form of merger takes place in firms that operate in the same industries like banks and banking industry offering similar goods or services (Girma, Thompson, & Wright, 2011). A vertical merger on the other hand takes place among business entities producing totally different Goods and services that are input into the process of producing another product (Bouba, 2011). Finally, conglomerate mergers occur between firms that produce unrelated products (Bouba, 2011). Many organizations merge to enhance creativity, control market and power, diverse risks in order to minimize product development risks as their main motives. Therefore, this topic is discussed wider each day with no agreeable conclusion.

Financial performance of a company can defines the operation efficiency of the company in maximum utilization of the firm's assets in order to generate revenues that are used to develop the firm financially hence its size in the market. Financial performance generally

depicts the firm's health in the industry as a result of financial stability. Competitive nature of the company is also observed by comparing its financial performance with those that are in the same industry. In summary, financial performance is the crucial objective of profit oriented and another firm's desire to achieve (Kajirwa, 2015). High performance is an indicator of effectiveness and efficiency of the management in utilizing the company's resources which is detrimental to the country's economy in the long run (Fan, Li, & Di, 2006). This can be measured using techniques such as ROE, ROA, asset age and firm size (Ngatia, 2018). The most known are ROE and ROA hence this study will look at the two techniques which are used in computing performance of banks. ROA measures the company's profitability in relation to its total assets, whereas ROE measures net income attained as a percentage of equity of shareholders.

1.2 History of banking in Kenya

The story is of Kenya's banking is really about three banks – the National Bank of India (NBI), Standard Bank of South Africa (SBSA) and Barclays. The arrival of Barclays in Kenya changed the banking sector greatly as it sought to end the long relationship that the National Bank of India had with colonial government in Kenya (Cull et al., 2010). Also, when Barclays arrived, they found that the Standard Bank controlled many of the white accounts, so they set out to include more Africans as customers. Africans had bank accounts from around 1926, and by the 1950's Barclays had more African accounts than settler accounts.

Banks were mostly found in urban areas and with the ending of the Mau Mau uprising, there was an expectation that Kenya would remain a British colony for many decades. This resulted in several new banks setting up in Kenya in the 1950's. Meanwhile, NBI, SBSA, and Barclays all expanded by 100% opening up in new places around the country, even with mobile bank units to attract customers (Ochieng & Maxon, 1992). Despite the arrival of the new banks, the main competition remained between these three established big banks, and in 1954, Barclays sent a memo to the colonial government complaining about the unfair practice of them favoring the NBI who retained a monopoly of new business that dated back 60 years.

All banks eventually had to break with colonial past and the British empire, and a big loser in the period was SBSA which had concentrated on the white settler population. Kenyan politicians tried to engineer boycotts of businesses related to South Africa due to the Apartheid regime and African customers now shunned it (NJiffia, 2009). Officials at the

bank wrote to their headquarters about the problem and as a result, the name was changed by dropping “South Africa” from the name, and SBSA became “Standard Bank.”

Since 1989 several banks have merged to become one big enterprise to control market in the banking industry. To begin with, the first merger and acquisition was first approved in 1989 where 9 financial institutions combine to form consolidated bank of Kenya. This was followed by another Acquisition where Indosuez Merchant Finance and Banque Indosuez merged to form Credit Agricole Indosuez which was approved in 1994 (CBK, n.d.). Consequently, Stanbic Bank (k) ltd and Stanbic Finance (k) Ltd merged in 1995 to form Stanbic Bank Kenya Ltd. In 1996 CBA Financial services and Commercial Bank of Africa merged to form Commercial Bank of Africa Ltd. There has been more and more banks merging since 1996 with NIC-CBA merger being the latest merger and acquisition strategy which was approved in June 2019.

1.3 Problem statement.

The effects of M&A on companies’ financial performance is important not only to banks but to any organization as a whole as it show the health of the organization in meeting its set objectives and safeguarding the stakeholder’s interest in the industry. Previous researchers conclude that merged companies and banks have generally higher positive returns on the target companies but have zero returns on the bidding companies. This is because the bidding companies pay premiums to the target companies to safeguard the target companies’ stakeholders’ interest (Fluck & Lynch 1998)

Several studies have sought to explore the effects of M&A on the financial performance in the banking sector but all of them come with a mixed conclude results as observed by these researchers. On examination by Marembo (2011) on the same study on M&A on financial performance in the banking sector noted that M&A did not enable banks to attain strong, competitive and efficient markets since several other factors determined performance, such as operational strategy, macroeconomic factors such as demand and supply and product and service quality.

Mwanza (2013) carried out a study on the same topic of discussion but was much on insurance companies. The conclusion from the study was that M&A enhanced the financial performance on of merged firms. However, the study by Mwanza considered a two-year pre and post mergers financial performance data which may be too short to rely on and draw conclusions.

Similarly, Smit and Ward (2007) also carried out a research to determine whether large acquisitions add value to the companies quoted on the Johannesburg stock exchange limited. The conclusion of the study was that large acquisition generally gives a zero NPV investment for acquiring companies and the shareholders. This was a contradiction to that of Wu, An, and Liang (2011) who found that bidding companies received significant and positive abnormal returns. Frinsen (2005) study on the effect of horizontal merger announcement between Air France and KLM found that Air France shareholders as the bidder firm experienced insignificant returns whereas KLM shareholders experienced significant positive abnormal returns.

As seen in the above conclusions by the various researchers it can be observed that no certain conclusions have been made as to whether M&A will always lead to positive effect on the financial performance of the firms post merging or being acquired. This study therefore seeks to establish whether M&A have an effect on the financial performance banks in the banking sector by taking a longer duration in the study and provide adequate explanation on how M&A will depict the financial performance in the banking industry

1.4 Research Objective

The general objective of this study is to investigate the effect of M&As on financial performance of banks in Kenya.

1.4.1 Specific Objectives

1.4.1.1 To establish the effects of M&A on return on equity (ROE) of commercial banks in Kenya.

1.4.1.2. To determine the effects of M&A on profitability of commercial banks in Kenya pre and post-merger.

1.4.1.3 To investigate the effects of M&As on the market share of commercial banks in Kenya.

1.5 Research Questions

1.5.1 What are the effects of M&As on return on equity (ROE) of commercial banks in Kenya?

1.5.2 What are the effects of M&As on profitability of commercial banks in Kenya?

1.5.3 What are the effects of M&As on market share of commercial banks in Kenya?

1.6 Value of the Study

1.6.1 Organizations

This study will be beneficial to private institutions like banks which have not merged, along with those which have partially merged on how to handle merger and acquisition.

1.6.2 Stakeholders

It will also benefit various stakeholders in the public sector to understand the benefits of M&As, their effects and challenges faced by banks when entering M&As as well as potential benefits and challenges after entering M&As.

The study will help current investors and customers of mergers to be able to analyze their performance and why it is important to them as investors or customers of these firms.

1.6.3 The management of organizations

The study will be helpful to the management in the banking sector as it will provide them with more information and insight on the connection between mergers and performance level of firms hence be able to make executive decisions.

1.6.4 Policy makers

Policy makers such as the CBK will also be able to benefit from this study since they will be able to devise new norms in setting up a fitting degree of merger procurements. The discoveries will be utilized to come up with successful strategies for overseeing liquidity levels of firms.

1.6.5 Researchers

Other researchers will be able to build their research on the same topic of study, by building a base on their findings and use this research as a reference point. The study can also be used by other researchers to come up with research gaps of their study on this topic.

1.7 Scope of the Study

The population of this study will involve financial institutions in that have either merged or undergone acquisition in the last ten years and their M&A activities approved by the CBK. In addition, the study will focus on the banks that have merged or undergone acquisition in Kenya only and not beyond the region. It will also only focus on the financial sector, especially commercial banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter, the aim is to build more on what we have stated in chapter one above in terms of the problem statement set and the objectives of this study. The chapter will also discuss literature relevant to the study from a broader perspective to describe the effects of M&A on financial performance of banking industry in Kenya. More particularly, this section will start with the theoretical review of the theories that are relevant to the formation and reasons behind M&As and the study then proceed to the empirical review then lastly the conceptual framework.

2.2 Theoretical Review

The study will majorly focus on three theories to explain mergers and acquisitions in the banking sector, they include, differential efficiency theory, free cash flow theory and size and return to scale theory.

2.2.1 Efficiency Theory

The two types of efficiency theories are the differential efficiency theory and inefficiency management theory. Differential efficiency theory implies that as long as company A is more efficient compared to company B, and where both these firms operate in a similar industry, organization A can lift the efficiency of organization B at least to the level of organization A by M&A. Meanwhile, inefficiency management theory suggests that information on company B's inefficiency can be available publicly and not only for company A, but also other organizations in other industries can ascertain efficiency of company B to the level of the organization that takes over. These theories are similar in considering M&A as an efficient tool to improve the efficiency of companies. Copeland and Weston (1988) consider that this theory can provide a theoretical basis for horizontal takeovers, whereas inefficiency management theory can support M&As.

In the literature of economics, efficiency assumes the optimal allocation of resources. In other words, a company is considered to be Pareto efficient if there are no other available options to allocate resources without a detrimental impact elsewhere. But at the organizational level, a company cannot be regarded as efficient unless all of its operations are efficient. An inefficient company is defined only if there is another one that performs better in similar conditions, hence avoids the issue of assessing the intangible parts of a

company as part of an evaluation criterion for efficiency.

Similarly, the notion of efficiency in M&A literature can be said to arise from the concept of synergy, which is interpreted as the outcome of combining as well as coordinating the good parts of the firms involved while disposing off of the redundant ones. Synergy arises where the market value of the two merged companies is higher than the sum of their respective values. Nonetheless, as Copeland and Weston (1988, p. 684) point out, the market value of two companies in an M&A should be equal to the sum of their individual values. This is due to the fact that the value of a company is estimated as the sum of the value of investment projects.

2.2.2 Size and Return to Scale Theory

Usually, the benefits of a firm's size are associated with "synergies." In other words, it is the positive increase associated with the combination of two or more firms through M&A to achieve more in terms of operation and performance (Yin, 2003). For instance, in a case where company A acquires company B for cash, the synergy will result into a total gain in value for shareholders of both company A and B. In this case, Synergy $V_{AB} - [V_A + V_B]$. Similarly, in a case where the synergy is positive, it means that the combination of the two companies (V_{AB}) is more valuable than when they operate separately as individual companies.

At the same time, the size and return to scale theory suggest that the cash flows from synergy are: $\Delta CF_t = CF_{ABt} - [CF_{At} + CF_{Bt}]$. Where the value is positive, it means that the combination of the two companies results in a greater cash flow than when the companies operate individually. In a case where there is no value created as a result of the combination of companies A and B, that is, where the synergy = 0, it means that the M&A is a zero-sum game, whereas the gain for shareholders of company B will remain equal as that for shareholders of company A. Additionally, where $V_{AB} > V_A + V_B$, it means that both companies A and B are anticipated to benefit from the merger or acquisition (Fan, Li, & Di, 2006). Regarding economies of scale, the average costs tend to decline with large size. Therefore, large companies seem to be in a position to implement specialization compared with small firms. Combination of firms can enable the companies to operate more efficiently than when they are separate companies.

Economies of scale enables companies to operate more efficiency in many ways. In addition, economies of scale relate to the average cost per unit of production of goods or

services. producing goods and services. Where the per unit cost of production is lower as the production levels increase, it means that there is an economy of scale. However, when firms come together, their overheads will be reduced while their operational efficiency will also improve as they will share production facilities, merge resources, coordinate and integrate resources to achieve more benefits.

2.3 Empirical Review

In Kenya, the recent trends of M&A have fostered more and profound understanding of whether these strategies can actually improve financial performance of firms, especially banking institutions. To date, more and more M&A deals have been initiated in Kenya since 2010, with about 50% of the deals taking place between 2014 and 2015. This has been facilitated by factors and reasons that have motivated mergers in the banking sector in Kenya and around the globe, including the need to meet statutory requirements, increased competitive advantage and to meet the capital adequacy requirements under Basel II. Other reasons that have motivated M&A in Kenya include the need to increase profits through diversification of market share (Joash & Njangiru, 2015). Kenya has witnessed a rise in M&As, especially due to liberalization, globalization and opening up of the economy since 2010. Other factors such as poor economy and the legal statutory requirements have also paved way for the need for M&As in Kenya, especially in the banking sector.

2.3.1 Effect of mergers and acquisitions on return on equity (ROE) of commercial banks in Kenya

Although there are no conclusive results on the effects of M&A on the financial performance of firms, especially in regards to ROE, prior literature of M&A and effects on the ROE have suggested that ROE might influence performance of firms after M&A. In particular, a majority of scholars have utilized different measures in examining the effects of M&A on the financial performance of firms, pointing out different conclusions. For instance, Masud (2015) studied the effects of M&A on the financial performance of banks in Pakistan by investigating both positive and negative effects of M&A in the banking sector. The study focused on the performance of three commercial banks that had merged between 2000 and 2012, finding that there is a general improvement in processes and profitability as a result of M&As in the banking sector.

More specifically, financial performance is a measure of how well an enterprise uses assets to generate revenues. According to Singh and Pandey (2008), financial performance of a

firm can be a measure of the company's overall financial health position within a specific time. Thus, it can be used to estimate and compare companies across a given industry or sector. By evaluating firms' financial performance, it is possible to find out whether the business is viable or not. To measure financial performance of a firm, ratio analysis is mostly used. Accordingly, factors like the ability of the company to pay short-term and long-term claims can be judged through liquidity ratio. Also, firms are usually interested in ascertaining cash flows abilities as well as the ability to service debts over a long period of time. In essence, financial performance of banks can be evaluated through many other ways, including evaluation of the capital structure of the company.

The best measure of the financial performance of a firm is Return on Equity (ROE). In most cases, a firm with higher return on equity is considered as one that can produce liquidity internally compared with those that have lesser ROE. The return on equity is a ratio of income after reduction of taxes, divided by the estimated total equity capital of the company. It is a variable that is used by firms to evaluate how the firm effectively manages its shareholders fund. Jallow, Masazing, & Basit (2017) carried out a study to explore the effects of M&A on financial performance on UK firms. The research was conducted on 40 firms listed under the London Stock Exchange (LSE). Compared with pre-merger performance, the study ascertained that post-merger performance in terms of financial ratios were improved. In particular, by evaluating return on equity for the periods before and after the merger and acquisitions, the research found that return on equity was stronger after M&A.

Usually, a stronger ROE reflects an effective management of shareholders' funds. It also indicates how gainful a firm is by comparing its net income with its normal shareholders' value. According to Mboroto (2012), implementing M&A often leads to an increase in the value of the shareholders between the firms. In addition, a higher proportion rate usually denotes a more effective administration in the use of its value base as well as better returns to shareholders. Furthermore, M&A activities are considered as the prior factors to improve financial performance of a firm. Thus, if a particular company has a higher ROE, it is indicative that the company might create value from within and indicate better profit generation (Mboroto, 2012).

However, Shanmugam and Nair (2004) carried out a study on M&As of banks in Malaysia, concluding that M&As alone cannot achieve strong efficiency and competitiveness in the banking sector. The study, however, claims that when well implemented and supplemented

with other measures such as improving professionals' skills in the banking sector, M&A can achieve more benefits and competitiveness on the banking sector in the context of ever-changing global environment.

2.3.2 Effects of M&A on profitability of commercial banks in Kenya

Mergers and acquisitions are the means used by firms to improve their competitiveness through gaining competitive advantage and synergies over other firms by virtue of increased market share. Alexandridis, Petmezas and Travlos (2010) suggest that M&As may result in a more than average profit levels due to cost reduction and efficient utilization of resources. It means that M&A can directly lead to the creation of value and should be undertaken only when they are deemed to be beneficial to both parties involved. In addition, M&As are based on the assumption that they bring about improvements in efficiency and profitability, which are gained through increased market share, economies of scale, diversification and different sources of synergies.

Meanwhile, another study by Onyango (2015) set out to investigate the determinants of choice for firms to consider M&As, and whether such choices would translate to profitability. In particular, his study sought to establish profitability of M&As by comparing selected companies' pre and post-merger profitability outcomes. From the study, Onyango (2015) realized that M&A indeed increased profitability of some companies in the long run due to the knowledge transfer and management from one company to another, resource deployment and revenue-based synergies, among other factors. Furthermore, Onyango (2015) considers that capitalized banks often face a lower need to external funding as well as lower bankruptcy and funding costs. Similarly, these factors facilitate realization of profitability, hence increased financial performance of the banks. At the same time, it is distinct that with more capital, banks can be more resistant to failure. In this case, capital funding is important in facilitating profitability of a firm, especially where there is more capital funding and less risk-taking activities. Still, this provision is realized when firms enter into M&A than when they operate separately.

Meanwhile, a study by Afza and Nazir (2008) concluded that there is a negative correlation between profitability and an enterprise's degree of aggressiveness in managing working capital, whether merged or operating separately. Their study also found out that companies with more aggressive working capital policies seemed to be more efficient although they did not necessarily generate more profits. It could mean that although M&A facilitate profitability, firms must manage their working capital in order to achieve profitability.

In a study to evaluate the effects of M&A on financial performance of companies listed at the NSE, Ndung'u (2011) concluded that M&As have the ability of improving performance of companies listed at the NSE. The findings of the study were valid as it reinforced the theory of efficiency wherein M&As are executed to accomplish net gains from synergies or coming together of two firms. In addition, the efficiency gains tend to accrue from operating synergies, which can be accomplished through the transfer of economies of scale as well as economies of scope from one firm to another. Overall, Ndung'u's (2011) study is relevant in this context since it postulates that through M&A, firms' overall profitability is also improved.

2.3.3 Effects of M&A on the market share of commercial banks in Kenya

Increased globalization and competition have led to the rise of mergers and acquisitions for firms seeking competitive advantage in their respective industries. Competitive advantage means that, the firms can extend their margins and market share worldwide. The general objective of this study was to determine the effects of mergers and acquisitions on the financial performance of commercial banks in Kenya. The specific objectives were: to determine the effect of asset management on financial performance; to establish the effect of shareholder's equity on financial performance and to investigate the effect of financial stability on financial performance.

Many companies use M&A not only to grow but also to establish their asset value as well as to increase their market share. Different studies have confirmed that through M&A, firms can particularly increase market share and compete fairly in given market environments. For banks, especially in Kenya, M&A have been used to destroy competition and establish critical mass in some cases. In such cases, M&A activities might increase the bargaining power of the firm, particularly with suppliers and customers. In addition, M&A can generate economies of scale in the process hence facilitate expansion of products and services of a firm.

In a study carried out by Ndora (2010), it was clear that firms considered M&A had better financial performance, especially in terms of market share and competitiveness in the insurance sector in Kenya. By measuring the financial performance ratios of firms that entered into mergers and acquisitions, the researcher found that such firms that considered M&A had improved post-merger performances in terms of market share compared to the pre-merge period. Thus, the study concluded that M&A can result in increased market

share of an insurance company.

Mishra and Chandra (2010) also carried out a study of M&As on the growth of commercial banks in Kenya, considering banks that had merged between 2000 and 2010. From the study, it was clear that by comparing the impacts of mergers on growth of assets and shareholders' value, the period of post-merger indicated that there was an overall improvement. The results also indicated that most banks undertook mergers not only to grow shareholders' value but also to increase market share. Banks that indicated growth and development in terms of market share achieved these objectives as a result of M&A.

2.4 Research Gap

Performance is a measure of a firm's ability to sustain income, stability as well as to grow and survive in the market. Since performance is a measure of relative investment, and can be relative to factors such as assets, availability of capital, or liability, it is critical that financial performance of financial institutions consider these factors to further understand how M&A affect financial performance of banks in Kenya. At the same time, M&As do not automatically create value for shareholders of companies or firms since not all M&As succeed. In particular, failure of M&As can occur and further deteriorate the wealth of the shareholders in cases where there is no proper integration of the processes involved in M&As.

Regardless of the many international and local studies on M&As, there are still some notable conflicting findings on the impacts of M&A on the financial performance of commercial banks, especially in Kenya. Ndungu (2011) in a research on companies listed in the NSE as a result of M&As concluded that M&As have the ability to improve performance of companies listed in the NSE. Another study conducted by Onyango (2015) to investigate the choice of firms to consider during mergers and whether the choices translated into profitability. From the study he concludes that indeed mergers and acquisitions increased profitability in the long run of organizations due to knowledge transfer, resource deployment and revenue-based synergies among others. Internationally, Masud (2015) studied the impacts of M&As on financial performance of banks in Pakistan by evaluating both the positive and negative effects of M&As. In his study he considered three banks that had merged and found out that there was an improvement in the banking processes and profitability of the merged banks.

Other than the above-mentioned studies that have supported M&As on grounds of positive financial performance, several other studies have found that M&A deals have had negative

effects on financial position of merged or acquired companies. For instance, in a study to examine the effects of M&A deals on Jordanian industrial firms, Al-Hroot (2016) revealed that overall financial performance had no significant improvement in post-merger period, meaning that the impact of M&As on firms is negative. Likewise, in another research, Abbas, Hunjra, Azam, Ijaz, and Zahid (2014) M&As only provided a temporary solution to the issue of financial distress that affects most financial institutions, and no direct link to the all other operating challenges that these firms face. Moreover, a study by Fatima and Shehzad (2014) only shed light on ROE as the only factor that affects M&A in Kenya.

From the review of empirical studies, it is clear that there are different inconclusive results on financial performance of firm's pre and post M&A activities. There are conflicting findings, especially regarding whether M&As have positive or negative effects on financial performance of banks. From the review, it is evident that there is a big gap that need to be filled. The relevant literature is also not comprehensive enough as available studies failed to analyze M&As of non-financial firms. In Kenya, M&A activities in the Kenyan banking sector are expected to increase because of the recent regulatory measures that the government has put to encourage M&As. Thus, there is a need to also understand how these factors will affect M&A operations and their subsequent effects on the performance of commercial banks in Kenya. This study seeks to fill these aforementioned gaps, by investigating the effect of M&As on the financial performance of commercial banks in Kenya. The findings will add to the body of knowledge in the effect of M&A on financial performance of banks, and will consequently seek to reduce the conflicting findings on this topic.

2.5 Conceptual Framework

The concept provides the details of both independent variables and the dependent variables. Independent variables are the variables which can cause other variables to change and the researcher cannot control them. The independent variables are represented by the financial performance of mergers and acquisitions as shown in the concept table in the next page.

The dependent variable reflects the effect of altering the independent variables. The dependent variables include the profitability, return on equity and the market share to show financial performance currently and before merges of the commercial banks which will be measured by liquidity, profitability, efficiency ratios and capital adequacy ratios these variables are able to produce either positive or negative financial performance in the long

run. The conceptual framework for this study is summarized in Figure 1.1

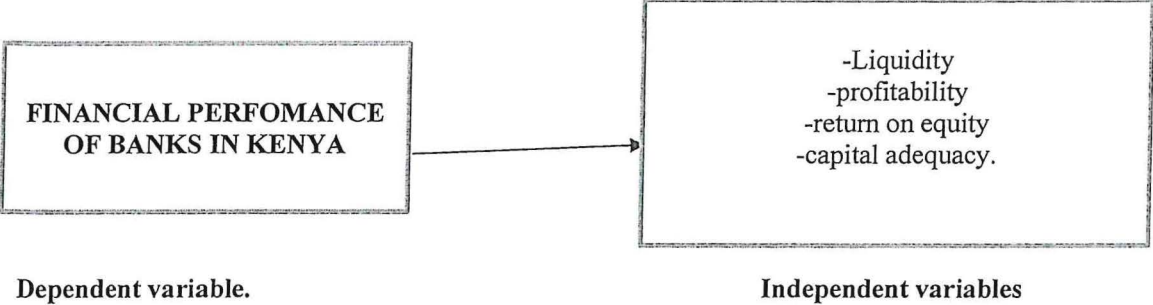


Figure 2.1 Conceptual framework

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter will discuss the key research procedures and data collection methods to give direction to how this study has been conducted. The chapter will also describe how the survey has been conducted and how data interpretation has been carried out, as well as present recommendation of findings.

3.2 Research Design

A research design explains the specific methods as well as procedures used in a study to collect and analyze required data for the research. In other words, a research design provides a framework for researchers to collect and analyze data for the given study (Zikmund, Carr, Babin, & Griffin, 2013). This study has adopted a qualitative research approach, using descriptive and explanatory research design to establish the causal effect of M&As on the financial performance of commercial banks in Kenya. This means that only secondary data has been used in this study.

More specifically data has been collected from secondary sources or existing literature covering M&As, especially the effects of mergers and acquisitions on financial performance of banks in Kenya. Data collected has then be screened for correct answering of questions by the research supervisor before analysis and interpretation. The research design undertaken in the study is consistent with the research objectives and questions, that is, to find out the effects of M&As on financial performance of commercial banks in Kenya.

3.3 Target Population

A study population includes all the individuals or cases with similar observable trends or characteristics used in a study (Mugenda & Mugenda, 2003). This research has considered all the financial bank institutions that have been involved in M&A in the past ten years that is between 2008 -2018. They include M&As that have resulted due to policies set out by the regulatory body, CBK, in the past ten years and other relevant factors.

In particular, the study has considered mergers between Savings and Loan (K) Limited and Kenya Commercial Bank Limited that formed Kenya Commercial Bank Limited, merger between City Finance Bank Ltd and Jamii Bora Kenya Ltd that created Jamii Bora Kenya

Ltd, and merger between Equatorial Commercial Bank Ltd and Southern Credit Banking Corporation Ltd that formed Equatorial Commercial Bank Ltd. Likewise, the study has taken into account acquisitions such as Fina Bank Ltd by Guaranty Trust Bank Plc, K-Rep Bank Ltd by Centum Ltd and Kenya's East African Building Society (EABS) Bank acquired by Ecobank Transnational Incorporated.

3.4 Data Collection

The descriptive study involves collection of secondary data obtained from respective financial statements of pertinent banks that have entered into mergers and acquisitions. Collecting secondary data was key to this study, especially to establish dynamics involved in M&As. Thus, sources of this kind of data will include annual financial and fiscal reports, CBK reports on M&As as well as published data on banks. Such information has also been accessed through the respective bank websites and the NSE. In addition, data from financial statements, including assets, liabilities and net worth, among other details has helped in analyzing the financial performance of banks before and after M&As.

3.5 Data Analysis

The secondary data collected for this study has been analyzed through financial ratio analysis method to determine the correlation ratio between dependent and independent variables. Meanwhile, Excel has also been used to analyze and present data in tables and graphs as well as understand distributions over given periods. Further, the analyzed data has been compared in terms of pre and post-merger performance ratios to observe significant changes in the performance of firms before and after M&As. These methods have assisted in estimating different parameters of the regression models well as for testing the level of significance. Ultimately, by comparing the coefficients of the regression model and standard errors for each of the coefficients, along with the value of the threshold of significance, this study has come up with precise findings to depict the relationship of financial performance based on M&As.

CHAPTER FOUR

DATA COLLECTION AND ANALYSIS

4.0. Introduction

This area is about analysis, presentation and interpretation of collected data. The information gathered has been presented in table format. The information analyzed was interpreted in relation to the research objectives to ensure that it provided answers to the research questions. The general objective of this study was to investigate the effect of mergers and acquisitions on financial performance of banks in Kenya. This chapter discusses the findings of the data collected in chapter three for the individual institutions under study. The chapter gives a summary results of all the institution, then discusses results of each specific objective as follows: effect of return on equity on financial performance of merged commercial banks; effect of profitability on financial performance of merged commercial banks in Kenya and effect of market share on financial performance of merged commercial banks in Kenya

4.1. General Information

This section contains the Mean (M) of return on equity (ROE), profitability and market share index (MSI) for each of the sampled bank in the study.

4.1.1. Kenya Commercial Bank Merger in 2010

Table 4.1 KCB and Savings and Loan Ltd Merger

KCB AND SAVINGS AND LOAN MERGER (2010)										
PRE-MERGER PERIOD										
Institution	Kenya Commercial Bank									
Measure/Year	2007	2008	2009							Mean
Profitability	3.1	3	3.57							3.22
ROE	30.07	26.9	28.69							28.55
MSI	12.57	13.21	14.21							13.33
Institution	Savings and Loan Limited									
Measure/Year	2007	2008	2009							Mean
Profitability	3.3	3.9	5.14							4.11
ROE	31.79	46.8	50							42.86
MSI	0.99	1.02	1.12							1.04
POST-MERGER PERIOD										
Measure/ Year	2010	2011	2013	201 4	201 5	201 6	201 7	201 8	Mean	
PROFIT ABILITY	5.17	4.98	5.2	5.0	4.17	5.98	3.2	5.6	4.2	
ROE	28.23	31.18	29.8	27.8	32.2 3	41.1 8	22.8	30.8	30.4	
MSI	13.98	14.52	13.5 4	12.5 4	15.9 8	16.5 2	13.5 4	16.5 4	14.6	

Pre-merger profitability mean for KCB was 3.22 while Savings and Loan Ltd was 4.11, after the merger this rose to a mean of 4.2. ROE mean for KCB before the merger was 28.55 while that of Savings and Loan Ltd was 42.86, after the merger the mean ROE was at 30.4. Pre-merger mean MSI index for KCB was 13.33 while Savings and Loan Ltd was 1.04. After the merger the value rose to 14.6 as shown on table 4.1.

4.1.2. Prime Bank Ltd Merger in 2008

Table 4.2: Prime Bank Merger in 2008

PRIME BANK LTD MERGER IN 2008									
PRE-MERGER PERIOD									
Institution	PRIME BANK LTD								
Measure/Year	2007	2008	2009	Mean					
Profitability	3.1	3	3.57	3.22					
ROE	30.07	26.9	28.69	28.55					
MSI	12.57	13.21	14.21	13.33					
Institution	CREDIT BANK LTD								
Measure/Year	2007	2008	2009	Mean					
Profitability	1.4	1.5	2.2	1.7					
ROE	17.32	14.51	16.45	16.09					
MSI	15.59	13	14.94	14.51					
POST-MERGER PERIOD									
Measure/Year	2010	2011	2013	2014	2015	2016	2017	2018	Mean
PROFITABILITY	2.3	2.33	2.37	3.07	2.3	2.45	2.1	3.07	2.5
ROE	15	18.09	19.74	28.88	15	19.01	18.4	27.7	20.22
MSI	2.31	2.41	1.8	1.64	2.41	1.8	1.64	2.41	2.05

Prime Bank pre-merger profitability mean was 1.70, this rose to a mean of 2.5 after the merger. Pre-merger ROE mean was at 16.09, which rose to a post-merger mean of 20.2. MSI had a pre-merger mean of 1.97 that rose to 2.05 after the merger as shown on table 4.2 above.

4.1.3. CFC Stanbic Bank Ltd merger in 2008

Table 4.3: CFC Stanbic Bank Ltd merger in 2008

CFC STANBIC BANK LTD MERGER IN 2008													
PRE-MERGER PERIOD													
Institution		CFC Bank											
Measure/Year		2005	2006	2007									Mean
Profitability		1.54	2.1	3.1									2.25
ROE		15.36	22.7	27.59									21.88
MSI		3.81	3.69	3.43									3.64
Institution		Stanbic Bank											
Measure/Year		2005	2006	2007									Mean
Profitability		2.5	2.9	3.4									2.93
ROE		21.64	33.48	35.57									30.23
MSI		3.01	3.90	3.70									3.54
POST-MERGER PERIOD													
Measure/Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Mean	
PROFITABILITY	1.5	1.35	1.96	2.23	1.6	1.5	2.01	2.74	1.85	1.2	2.5	2.035	
ROE	18.4	16.3	20.96	30.82	18.4	17.3	25.86	29.2	21.3	13.7	32.6	24.45	
MSI	7.62	6.05	5.31	5.10	7.12	7.72	6.31	5.65	8.54	4.90	7.43	7.16	

The profitability mean of CFC Bank Limited before its merger with Stanbic Bank was 2.25 for CFC bank and 2.93 for Stanbic bank, these values were higher than the profitability

mean after the merger which was at 2.35. Pre-merger ROE mean for CFC Bank was 21.88 and that of Stanbic Bank Kenya was 30.23. After the merger the value was at 24.45. MSI pre-merger mean for CFC Bank was 3.64 and that of Stanbic bank was 3.54. After the merger the MSI mean rose to a mean of 7.16 as shown on table 4.3 above.

4.1.4. Jamii Bora Bank acquisition in 2010

Table 4.4: Jamii Bora Bank acquisition in 2010

JAMII BORA BANK ACQUISITION IN 2010										
PRE-MERGER PERIOD										
Institution	Jamii Bora Bank									
Measure/Year	2007	2008	2009							Mean
Profitability	-3.1	-0.5	-1.26							-1.62
ROE	-8.74	-0.9	-0.02							-3.22
MSI	0.53	0.52	0.52							0.52
POST-MERGER PERIOD										
Measure/ Year	2010	2011	2013	2014	2015	2016	2017	2018	Mean	
PROFITABILITY	-4.85	-1.79	1.5	1.3	1.85	2.01	2.2	2.45	1.19	
ROE	-8.19	-2.43	2.5	4	2.9	3.43	3.7	5.01	2.38	
MSI	0.21	0.24	0.27	0.32	0.39	0.55	0.77	1.01	0.44	

Before the acquisition in 2010 City Finance Bank Ltd, currently known as Jamii Bora Bank had a mean profitability of -1.62, this rose to a mean of 1.19 after the acquisition. The ROE means before the acquisition was -3.22, which rose to 2.38 after the acquisition. MSI pre-merger mean was 0.52 which slightly rose to a mean of 0.44 after the merger as shown on table 4.4. above.

4.1.5. Equatorial Commercial Bank merged in 2010

Table 4.5: Equatorial Commercial Bank and Southern Credit Banking Corporation Merger

EQUATORIAL COMMERCIAL BANK AND SOUTHERN CREDIT BANKING CORPORATION MERGER IN 2010									
PRE-MERGER PERIOD									
Institution	Equatorial Commercial Bank								
Measure/Year	2007	2008	2009	Mean					
Profitability	1.4	-0.2	1.69	0.96					
ROE	10.89	-1.2	10.51	6.73					
MSI	1.08	0.92	0.85	0.95					
Institution	Southern Credit Banking Corporation								
Measure/Year	2007	2008	2009	Mean					
Profitability	0.6	0.1	-14.7	-4.67					
ROE	7.36	1.1	-0.15	2.77					
MSI	1.11	0.98	0.93	1.01					
POST-MERGER PERIOD									
Measure/ Year	2010	2011	2013	2014	2015	2016	2017	2018	Mean
PROFITABILITY	-0.32	0.55	-4.65	1	-0.5	0.75	-3.65	1.2	-0.85
ROE	-3.7	5.91	-90.8	11.1	-93.7	6.01	-99.8	16.05	-33.1
MSI	0.53	0.57	0.52	0.53	0.63	0.78	0.32	0.98	0.5

Equatorial Commercial Bank pre-merger profitability mean was 0.96, while that of Southern Credit Banking Corporation was - 4.67, after their merger the value fell to a mean of -0.85. Pre-merger ROE mean was 6.73 and 2.77 for Equatorial Commercial Bank and Southern Credit banking corporation respectively. After the merger the mean fell to a value of -33.1. Pre-merger MSI was 0.95 and 1.01 for Equatorial and Southern Credit respectively. This fell to 0.5 after the merger. These findings are shown below on table 4.5 above.

4.1.6. K-Rep Bank acquisition in 2014

Table 4.6: K-Rep Bank acquisition in 2014

K-REP BANK ACQUISITION IN 2014						
PRE-MERGER PERIOD						
Institution	K-REP BANK					
Measure/Year	2011	2012	2013	Mean		
Profitability	2.75	3.21	4.22	3.39		
ROE	19.23	20.1	29.81	23.05		
MSI	0.47	0.42	0.47	0.45		
POST-MERGER PERIOD						
Measure/Year	2014	2015	2016	2017	2018	Mean
PROFITABILITY	4.61	2.72	0.30	3.13	4.10	2.97
ROE	29.98	13.54	1.60	25.12	27.4	19.52
MSI	0.51	0.60	0.60	0.41	0.49	0.522

Centum Ltd acquired K-Rep bank in 2014. The bank is currently known as Sidian Bank. The profitability mean before the merger was 3.39 which fell to a value of 2.97 after the acquisition. The mean ROE before the acquisition was 23.05, this fell to a low of 19.52 after the acquisition. Pre-acquisition MSI was 0.45 rose to 0.522 after the acquisition as shown on table 4.6.

4.1.7. Fina Bank acquisition in 2013

Table 4.7: Fina Bank acquisition in 2013

FINA BANK ACQUISITION IN 2013							
PRE-MERGER PERIOD							
Institution	FINA BANK						
Measure/Year	2010	2011	2012	Mean			
Profitability	1.07	2.12	2.00	1.73			
ROE	11.32	20.22	13.9	15.15			
MSI	0.76	0.69	0.74	0.73			
POST-MERGER PERIOD							
Measure/Year	2013	2014	2015	2016	2017	2018	Mean
PROFITABILITY	1.17	1.07	2.23	2.7	2.07	2.52	1.96
ROE	7.43	5.6	7.90	8.55	6.6	8.10	7.37
MSI	1.07	0.97	0.90	1.99	0.87	1.10	1.15

Fina Bank Limited was acquired by Guaranty Trust Bank Plc in 2013. The profitability mean before the acquisition was 1.73 which rose to a value of 1.96 after the acquisition. The mean ROE before the acquisition was 15.15, this fell to 7.37 after the acquisition. Pre-acquisition MSI was 0.73 and rose to 1.15 after the acquisition as shown on table 4.7 above.

4.1.8. Eco Bank acquisition in 2013

Table 4.8: Eco Bank acquisition in 2013

ECO BANK ACQUISITION IN 2013							
PRE-MERGER PERIOD							
Institution	Kenya's East African Building Society						
Measure/Year	2010	2011	2012	Mean			
Profitability	0.07	0.40	1.00	0.49			
ROE	0.56	3.01	6.94	3.50			
MSI	1.93	1.71	1.16	1.60			
POST-MERGER PERIOD							
Measure/Year	2013	2014	2015	2016	2017	2018	Mean
PROFITABILITY	0.5	-7.13	0.7	0.45	0.7	-6.45	1.87
ROE	3.8	-0.54	3.76	7.03	4.2	-0.75	2.91
MSI	1.47	1.58	1.59	1.02	1.99	1.88	1.59

Kenya's East African Building Society (EABS) Bank was acquired by Ecobank Transnational Incorporated (ETI) in 2008. The profitability mean for EABS bank before the acquisition was 0.49 which rose to 1.87 after the acquisition. The mean ROE before the acquisition was 3.50, this fell to a value of 2.91 after the acquisition. Pre-acquisition MSI was 1.60 and fell to 1.59 after the acquisition as shown on table 4.8 above.

CHAPTER FIVE

DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.0. Introduction

This chapter presents the summary of the study, discussion of the results and makes conclusions from the findings. Recommendations for improvement and further studies have also been discussed.

5.1. Summary

The general objective of this study was to determine the effects of mergers and acquisitions on the financial performance of commercial banks in Kenya. The study was guided by the following specific objectives: to determine the effect of return on equity on financial performance of merged commercial banks in Kenya, to determine the effect of profitability on financial performance of merged commercial banks in Kenya and to investigate effect of market share on financial performance of merged commercial banks in Kenya. The study adopted a descriptive research design which focused on determining the relationship between mergers and acquisitions and the financial performance of the commercial banks between 2008 and 2018. The population of the study consisted of financial institutions in Kenya that had either merged or undergone acquisitions from 2000 to 2018 as approved by the Central Bank of Kenya. The sample was selected using the purposive method which involved studying ten commercial banks that had merged between the years 2008 to 2018. Secondary data, three years before and three years after the event was retrieved from audited financial statements, annual reports published by Central Bank of Kenya and the respective bank websites.

Profitability in this study was used to measure return on assets of commercial banks in Kenya. The results revealed a positive relationship between profitability and financial performance. This meant that profitability as a determinant of financial performance of Kenyan commercial banks positively influenced mergers and acquisitions. The more the mergers or acquisition institutions acquire assets, the better they perform. Return on Equity was used to measure the effects of mergers and acquisitions on shareholder's equity of commercial banks in Kenya. The findings also revealed a positive relationship between return on equity and performance. This implied that institutions that had either merged or undergone acquisition with higher shareholder's value also had a higher financial

performance and hence, a higher market share.

5.2. Discussion

Five out of the ten banks under study had a decrease in return on assets after the merger or acquisition event. The banks included CFC Stanbic Bank, Equatorial Commercial Bank, K-Rep Bank, Fina Bank and Ecobank. This could be an indication of failure by management to use its resources efficiently of the sampled banks. This signified that the companies were able to earn higher profits in relation to their overall resources after the merger or acquisition. Akenga and Olang (2017) presented a similar study on the effects of asset growth on financial performance of commercial banks. They tested the hypothesis that asset growth had no significant effect on financial performance using a t-test analysis. Asset growth was measured using change in value of assets which resulted to a significant value of 0.002 which was below the 0.05 significance level. The results led to the rejection of the null hypothesis that asset growth had no significant effect on financial performance of commercial banks.

The findings indicated that the banks under study achieved a higher mean return on return on equity after the event except for Equatorial Commercial Bank and K-Rep Bank. Descriptive results however indicated that there was a fall in the mean values for the return on equity from 17.0548 before the merger to 9.6146 after merger owing to the two banks whereby, one recorded a negative result, while the other had a decrease in the mean value after the merger. Similar studies have resulted into contradicting results for example Mugambi (2014) whose findings indicated an increase in mean return on equity after merger or acquisition depicted by an increase in the mean from 2.079 on pre-merger period to 3.965 on the post-merger period.

5.3. Conclusion

The results on profitability had the highest variation explaining performance after the merger event. Despite this, the banks under study had mixed results some recording an increase while others recording a decrease in return on assets after the merger or acquisition. In conclusion there is a positive significant relationship between profitability and performance of institutions that had either merged or undergone through acquisitions. The findings show that most of the sampled banks had an increase in return on equity after the merger or acquisition hence showing a significant relationship between financial performance and return on equity of institutions that

had either merged or undergone through acquisitions.

5.4. Recommendations

A low profitability signifies that a company is not making adequate profits or is overinvested in assets that are not profitable. Management can work on reducing the bank's operational cost by downsizing facilities and by relocating to affordable premises. They can also sell off fixed assets that are not being used. Management should strive to efficiently utilize the shareholders' funds at their disposal. This will encourage the shareholder to invest more in the banks. The banks can increase return on equity by increasing the amount of debt capital relative to its equity capital, increase the overall bank's profit relative to its equity and reduce the excess cash on the balance sheet by paying out dividends to its shareholders. An increase in the market share index confirms that a bank can meet its liabilities and other obligations as and when they are due and be able to absorb more losses in case of default loans by customers.

5.5 Suggestions for Further Research

Further studies should be carried out on the effect of mergers and acquisitions on financial performance from time to time to establish trends for longer periods and to capture new opportunities that have recently emerged in Kenya. Since the study can use various variables to measure performance, both quantitative and qualitative variables should be included in the studies to come up with more comprehensive conclusions.

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APPENDICES

APPENDIX I: Secondary Data Collection Template

Period	Year	Financial Institution	PROFIT ABILITY	ROE	CAR	MSI
Year 1						
Year 2						
Year 3						
Merger/Acquisition						
Year 1						
Year 2						
Year 3						

A. Effect of Profitability on Financial Performance of Merged Commercial Banks in Kenya checklist

Financial Institution	Profitability						
	Year 1	Year 2	Year 3	Merger	Year 1	Year 2	Year 3
KCB							
S&L ltd							
Prime Bank							
CFC Bank							
Stanbic							
Jamii bora							
Equatorial							
Southern Credit							
Sidian							
Guarantee Trust Bank							
Ecobank							

B. Effect of Return on Equity on Financial Performance of Merged Commercial Banks in Kenya checklist

Financial Institution	ROE						
	Year 1	Year 2	Year 3	Merger	Year 1	Year 2	Year 3
KCB							
S&L ltd							
Prime Bank							
CFC Bank							
Stanbic							
Jamii bora							
Equatorial							
Southern Credit							
Sidian							
Guarantee Trust Bank							
Ecobank							

C. Effect of Market share on Financial Performance of Merged Commercial Banks in Kenya checklist

Financial Institution	MSI						
	Year 1	Year 2	Year 3	Merger	Year 1	Year 2	Year 3
KCB							
S&L ltd							
Prime Bank							
CFC Bank							
Stanbic							
Jamii bora							
Equatorial							
Southern Credit							
Sidian							
Guarantee Trust Bank							

Ecobank							
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APPENDIX II: List of Commercial Bank Mergers and acquisitions in Kenya from 2008 – 2018

Mergers

Institution	Merged with	Current Name	Date approved by CBK
Prime Capital & Credit Ltd	Prime Bank Ltd	Prime Bank Ltd	01.01.2008
CFC Bank Ltd	Stanbic Bank Ltd	CFC Stanbic Bank Ltd	01.06.2008
Savings and Loan (K) Limited	Kenya Commercial Bank Limited	Kenya Commercial Bank Limited	01.02.2010
City Finance Bank Ltd	Jamii Bora Kenya Ltd	Jamii Bora Bank Ltd	11.02.2010
Equatorial Commercial Bank Ltd	Southern Credit Banking Corporation Ltd	Equatorial Commercial Bank Ltd	01.06.2010

Acquisitions

Institution	Acquired by	Current Name	Date approved by CBK
EABS Bank Ltd	Ecobank Kenya Ltd	Ecobank Ltd	16.06.2008
Fina Bank Ltd	Guaranty Trust Bank Plc	Guaranty Trust Bank (Kenya) Ltd	08.11.2013
K-Rep Bank Ltd	Centum Ltd	K-Rep Bank Ltd	29.10.2014
Equatorial Commercial Bank Ltd	Mwalimu Sacco Society Ltd	Equatorial Commercial Bank Ltd	31.12.2014
Giro Commercial Bank Ltd	I&M Bank Ltd	I&M Bank Ltd	13.02.2016

Source: Central Bank of Kenya

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