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Post-Merger Commercial Bank Performance Trends: A Case of Kenya

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Abstract

Commercial banks face performance challenges since most of them react to these challenges in a fairly standardized manner. This is because most of the commercial banks offer similar products and services. In so doing, they face high competitions and as a result, they engage activities in pursuit of a competitive edge in order to keep their current customers and attract new ones. Some of the strategic activities these companies have engaged in the recent past have been Mergers and acquisitions (M&A). M&A have become an effective strategic tool to consolidate the Banks and Financial Institutions (BFIs) in Kenya to increase their capital base, expand their business, and bring financial stability. However, despite venturing into mergers and acquisitions, evidence from elsewhere indicates that financial performance stability and improvement still remains a challenge forming a good basis for further empirical investigation. This paper provides an assessment of the post-merger commercial bank performance in Kenya over the period 2008 to 2019 using return on equity as a proxy for bank performance. The target population for this study comprised all 13 commercial banks operating in Kenya between the year 2008 and the year 2019. The study used purposive sampling to select thirteen (13) commercial banks that had undergone mergers and acquisitions in Kenya over eleven years (from 2008 to the year 2019). The study finds that the post-merger effect of mergers and acquisitions on financial performance is mixed. Some commercial banks reported improved ROEs while a few reported declining ROEs during the study period. To enhance performance, the study recommended that commercial banks should prioritize M&A opportunities that align with their long-term strategic goals. This might include expanding into new geographic regions, entering new markets, diversifying product offerings, or gaining access to new technologies. Banks should assess the

potential risks associated with the M&A transaction, including credit risk, operational risk, and reputational risk. Develop strategies for mitigating these risks and ensuring a smooth transition.

Keyword: *Mergers, Strategy, Acquisitions, Performance, Return on Equity, S*ynergies, *profitability.*

1.0 Introduction and Background

Commercial banks play an indispensable role in industry productivity and economic growth; they provide a sound medium of exchange and facilitate trading; encourage the mobilization of resources through savings and allocate resources to activities with the highest returns; monitor investments and exert corporate governance; and spread risk by offering a diversity of commercial banks (Chen & Sivakumar, 2021). Furthermore, commercial banks in Kenya provide financial assistance to fulfill the varied needs of enterprises (Lukilah & Wekesa, 2021). Generally, the financial performance of commercial banks in Kenya indicates a decline, especially bearing in mind profitability indicators (Central Bank of Kenya, 2019).

Choi (2001) contends that mergers and acquisitions are corporate strategies usually done between two or more firms whereby the acquiring firm and the acquired firm stand on a merger agreement. The changes in the business environment brought about by changes in customer preferences, globalization, and advancements in information communication and technology have called for a re-strategizing of firms if they are to remain competitive. Merger and acquisition arrangements are strategies that corporations have adopted that have seen several licensed commercial banks merge or one institution take over another's operations (Central Bank of Kenya, 2019). Some of the reasons put forward for mergers and acquisitions are to meet increased levels of share capital, expand distribution networks and market share, and benefit from best global practices, among others (Kaol, 2017). The financial sector in Kenya has experienced an unprecedented level of consolidation, especially since the 1990s (Ndungu & Muturi, 2019). Between 2005 and 2015, eleven mergers and acquisitions were witnessed in Kenya (Mshabaa & Noor, 2017). Despite the fact that mergers and acquisitions remain the most unmistakable system for accomplishing development, their achievement in building long-term investor esteem remains challenged (Mshabaa & Noor, 2017).

Financial performance is a measure of a company's ability to create a profit or the company's ability to manage and control its resources (Fatihudin, 2018). Financial performance is used as a general measure of a firm's overall financial health over a given period (Nuber et al., 2020). Commercial banks' financial performance is considered a very important and necessary mechanism for the survival of the financial sector in any economy in the world. The soundness of a banking system is the most crucial pillar for economic development (Chen et al., 2021). Hence, banks are the most involved commercial banks in the financing of the economy. Getis (2010) contends that in measuring financial performance, several ratios are available to be used, such as return on equity, return on assets, and net interest margin, among others. In this study, return on equity (ROE) was used as a measure of bank financial performance.

Literature on mergers and acquisitions and several other economic theories support the notion that shareholders experience positive abnormal returns as a result of the anticipated value creation post-merger (Halebian, Cynthia, McNamara, Carpenter & Davidson, 2009; Cartwright & Cooper, 1993; Moeller, Schlingemann, & Stulz, 2005). Thus, M&A is expected to create value as a result of firms exploiting economic resources that are both available and implementable,

leading to synergy. The primary objective for any merger or takeover would be to create value for shareholders that will exceed the cost of the acquisition.

1.2 Statement of the Problem

Commercial banks play a crucial role in the economy of Kenya since they provide financial services to individuals, businesses, and the government (World Bank, 2019). Kenya has kept its position as the leading mergers hotspot in East Africa. Analysis predict that the banking sector currently remains the most focus for mergers in year 2024 since there are too many banks (39) which makes it difficult for any single lender to take on financing of large-scale projects due to capital constraints. In the last ten years, about five commercial banks have been placed under receivership because the competition in this sector has intensified. Mergers in this sector have increased over time in comparison to acquisitions, although both have recorded increasing trends.

By the year 2019, CBK reports indicated that since the year 1989, the number of mergers among the commercial banks has been 34 and acquisitions have been 10. In the last 20 years alone, a total of 23 commercial banks that are still operational have undergone mergers and acquisitions, of which 13 are mergers and 10, were acquisitions (CBK, 2019). However, over the years, despite that, the commercial banks' financial performance measured by the ROE has been on the decline; the profit before tax of commercial banks stood at 20.1 percent as of 2012, which declined to 16 percent in 2013. Furthermore, the ROE for commercial banks in Kenya fluctuated over the period (2018–2022).

Evidence from existing empirical evidence suggests that Mergers and acquisitions provide mixed outcomes with regards to their effect on financial performance. For instance, there is extensive evidence indicating a positive and significant relationship between mergers and acquisitions synergies and financial performance (Tamoor and Tariq (2018) in Pakistan; Shrestha, Thapa and Phuyal (2017) in Nepal; Yanan *et al.* (2016) in USA; Ismail *et al.* (2014) in Egypt; Onutu and Yahaya (2016) in Nigeria; Kimetto (2019) in Kenya). However, none of these studies sought to establish the trend in financial performance over a given period. This study therefore sought to fill the gap that existed and established the post-merger commercial bank performance trends in Kenya during the period 2008 to 2019.

1.5 Scope of the Study

The purpose of the study was to examine the post-merger commercial bank performance trends in Kenya. The study target population comprised all the 46 commercial banks that underwent mergers or acquisitions in Kenya between the year 2008 and 2019. The study purposively selected a total of thirteen (13) commercial banks that underwent mergers and acquisitions in Kenya over eleven years (from 2008 to the year 2019) in view of the Central Bank of Kenya (2020). The choice of the study period was sufficient to capture the post-merger performance trend in the banking sector since Kenya and the world at large witnessed a global economic crisis, post-election violence in Kenya which disrupted business models. During this period, the country witnessed an increase in mergers and acquisitions especially in the banking industry. The inclusion or exclusion criterion was based on three three-year pre and post-merger periods by only selecting M&A that specifically met this criterion in terms of providing complete 3-year data for pre and post-merger periods.

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1.6 Value of the Study

The study outcome is bound to be of value to various stakeholders. These include the management of commercial banks and other financial institutions, policymakers like the Capital Market Authority (CMA) together with the CBK. Other stakeholders to benefit from the study include owners and shareholders of all commercial banks in Kenya and future scholars and academicians. Regulators (such as Capital Markets Authority and CBK) would rely on the study findings to develop the best policies and regulations for any two or more organizations engaged in mergers and acquisitions to emerge stronger with greater synergies for improved performance. The policymakers in the banking industry (The Central Bank of Kenya and the Kenya Bankers Association) benefit from this study by using the conclusions drawn to make good or better regulatory frameworks related to M&As. The study also adds knowledge to the understanding of the importance of mergers in analysing performance by current investors, customers of commercial banks, and other banks in this competitive industry. Finally, future researchers and academicians benefit from the findings of this study, especially those who wish to conduct further research on the same line of study. This research equips researchers with more understanding of the extent to which mergers influence the performance of banks in Kenya. This study adds value to the finance theory.

3.0 Methodology

3.1 Target Population and Sampling Design

The target population for this study comprised all 13 commercial banks operating in Kenya between the year 2008 and the year 2019. The study used judgmental sampling to select thirteen (13) commercial banks that had undergone mergers and acquisitions in Kenya over eleven years (from 2008 to the year 2019) in view of the Central Bank of Kenya (2020). The choice of this window period was sufficient to capture the trend of mergers and acquisitions that have taken place in the country and the financial performance of the selected commercial banks that witnessed mergers.

4.0 Results and Findings

This section presents trend analysis in the form of tables and graphs in addition to interpretations and discussion.

4.1 Trend Analysis

Trend analysis is the process of collecting data from multiple different periods, and entails plotting the data on a line graph for further analysis. This section presents the trend analysis for specific commercial banks during the pre-merger and post-merger period.

4.1.1 Analysis of Return on Equity of Guaranty Trust Bank (Kenya) Limited

In 2010, Fina Bank Ltd. merged with Guaranty Trust Bank Ltd. to form Guaranty Trust Bank (Kenya) Ltd. Figure 4.2 shows the trend movements of the return on equity before and after the merger.

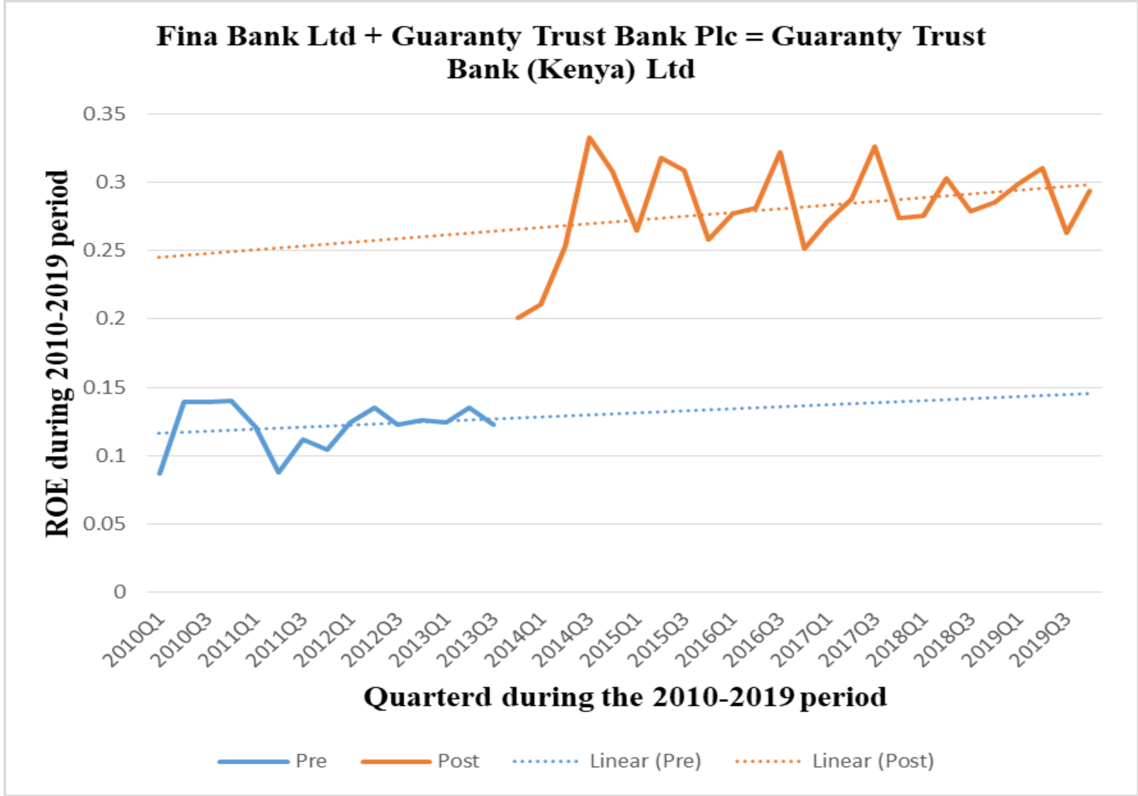

Figure 1: Analysis of Return on Equity of Guaranty Trust Bank (Kenya) Ltd

Source: Study Data (2024)

Figure 1 shows the 10-year averages from 2010 to 2019. This shows that there were variations in the return on equity over the years. Year 2011 had the lowest return on equity of 8.7% while the year 2014 had the highest average of 33.3%. The increase in the return on equity can be associated with the merger with Fina Bank Ltd that increased the banks' net income.

4.1.2 Analysis of Return on Equity of I&M Bank Limited

In 2017, I&M Bank acquired Giro Commercial Bank Ltd. Figure 2 depicts the trend movements of return on equity before the merger and after the merger.

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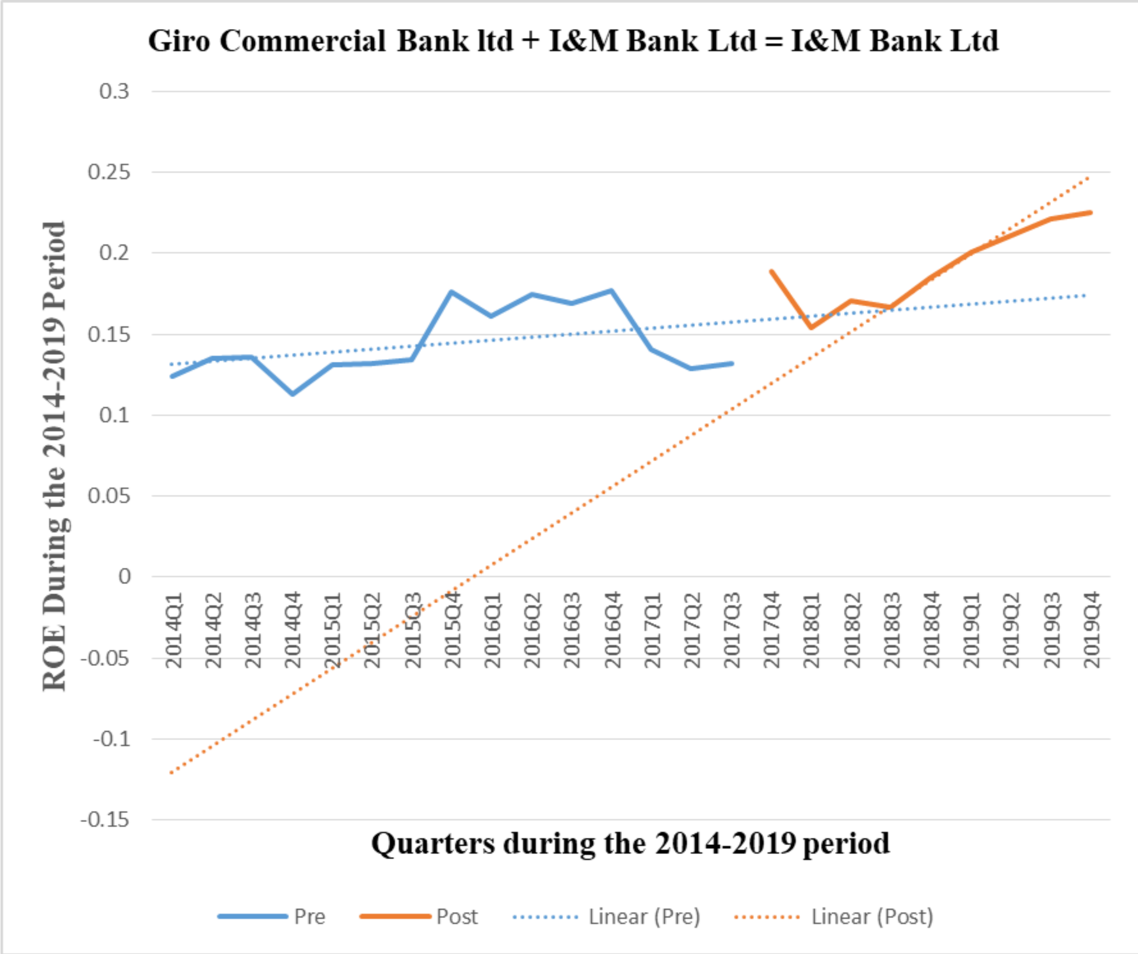

Figure 2: Analysis of Return on Equity of I&M Bank Ltd

Source: Study Data (2023)

Figure 2 shows the 6-year averages from 2014 to 2019. This shows that there were variations in the return on equity over the years. The fourth quarter of 2014 had the lowest return on equity of 11.3% while the fourth quarter of 2019 had the highest average of 22.5%. The increase in the return on equity can be attributed to the increase in net income after the acquisition of Giro Commercial Bank Ltd in 2017.

4.1.3 Analysis of Return on Equity of Prime Bank Limited

In 2008, Prime Bank Ltd. merged with Prime Capital Ltd. to form Prime Bank Ltd. Figure 3 shows the trend movements of return on equity before the merger and after the merger.

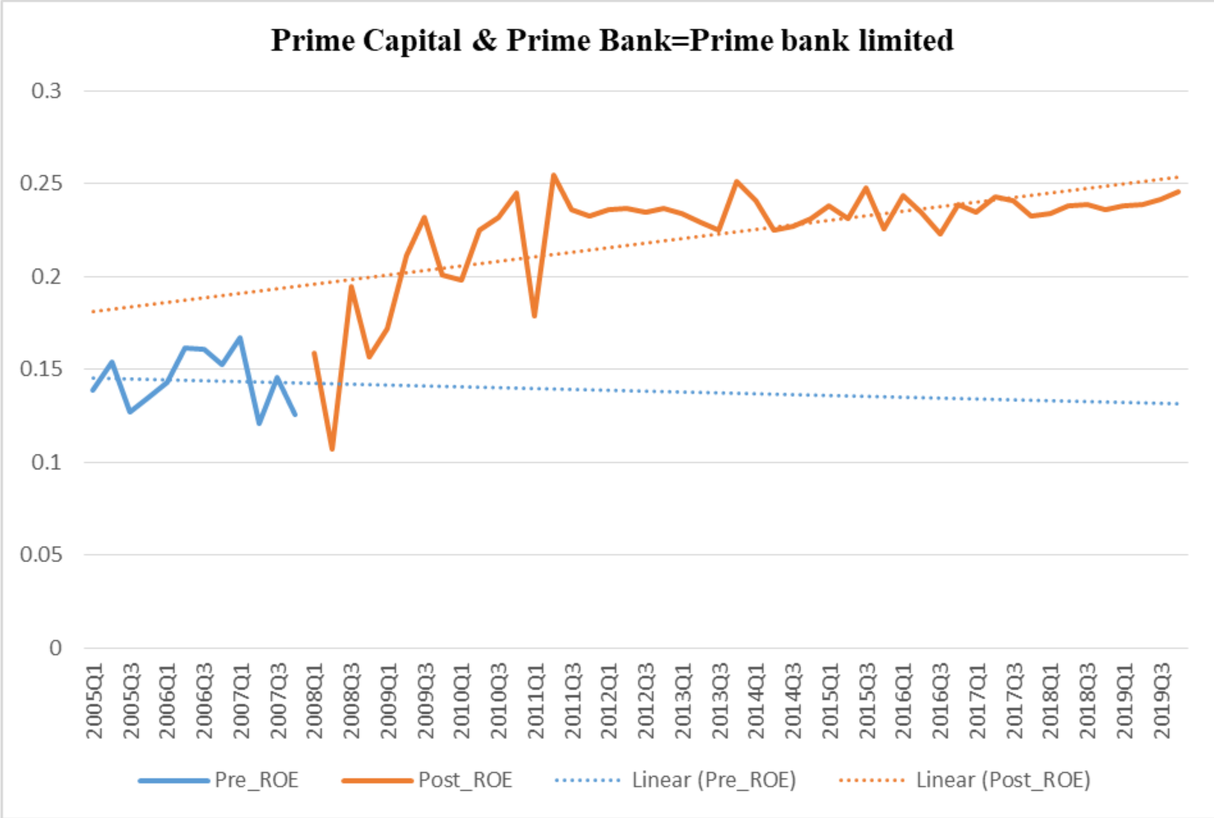

Figure 3: Analysis of Return on Equity of Prime Bank Ltd

Source: Study Data (2024)

Figure 3 shows the 15-year averages from 2005 to 2019. This shows that there were variations in the return on equity over the years. The fourth quarter of 2007 had the lowest return on equity of 12.1% while the second quarter of 2011 had the highest average of 25.5%. The increase in the return on equity can be attributed to the increase in net income after the merger with Prime Capital Ltd in 2008.

4.1.4 Analysis of Return on Equity of SBM Bank Kenya Limited

In 2017, SBM Kenya Bank Ltd. acquired SBM Bank Ltd. Figure 4.4 shows the trend movements of the return on equity before the merger and after the merger.

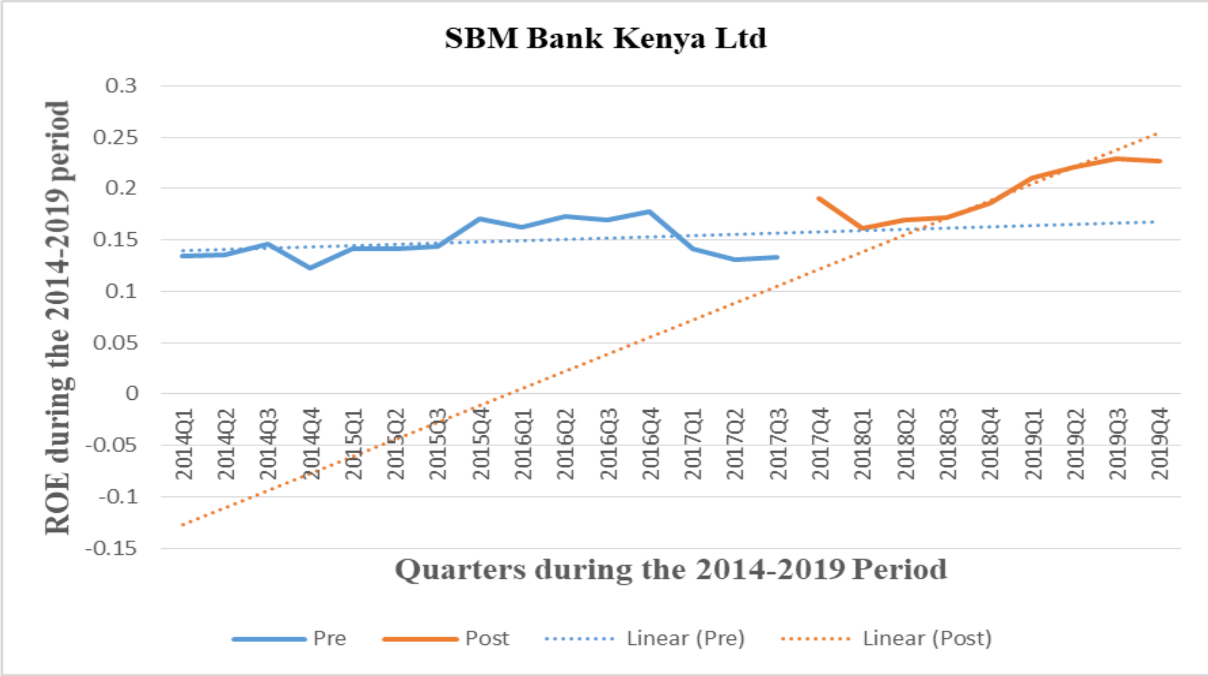

Figure 4: Analysis of Return on Equity of SBM Bank Kenya Limited

Source: Study Data (2024)

Figure 4.4 shows the 6-year averages from 2014 to 2019. This shows that there were variations in the return on equity over the years. The third quarter of 2016 had the lowest return on equity of 17% while the fourth quarter of 2019 had the highest average of 22.7%. The increase in the return on equity can be attributed to the increase in net income after the acquisition of SBM Bank Ltd.

4.1.4 Analysis of Return on Equity of Equatorial Commercial Bank Limited

In the year 2010, Equatorial Bank Ltd. merged with Southern Credit Ltd. to form Equatorial Commercial Bank Ltd., and later in 2014, it acquired Mwalimu SACCO Society Ltd. Figure 5 shows the trend movements of ROE before the merger and after the merger.

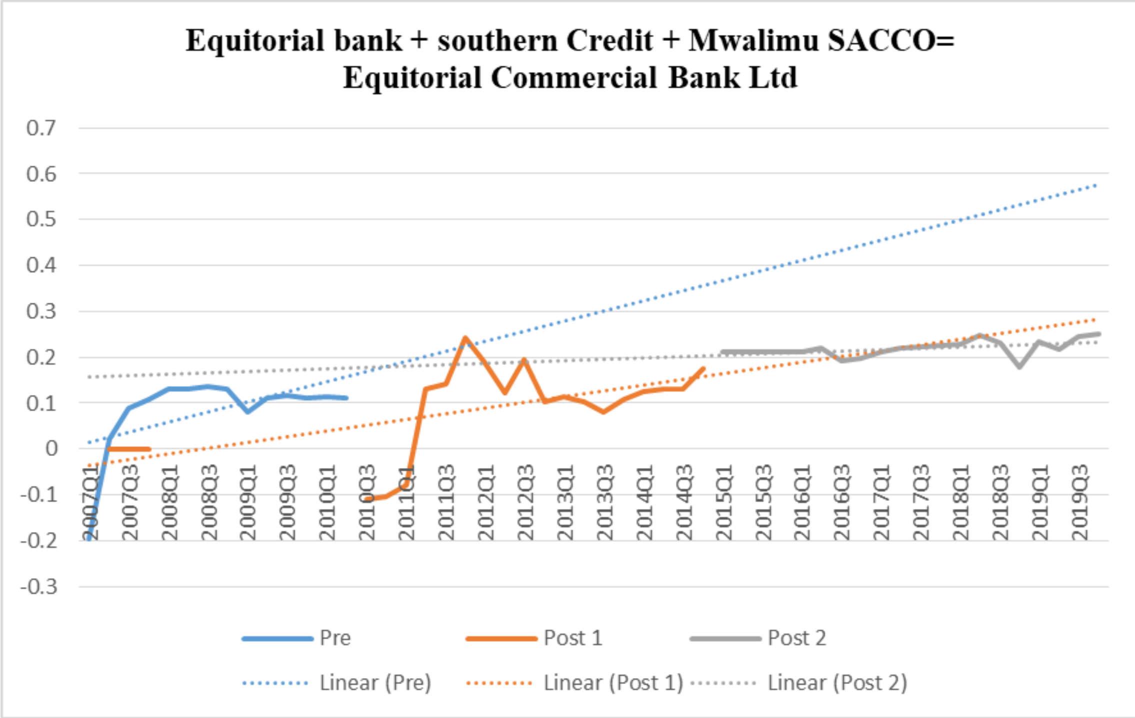

Figure 4: Analysis of Return on Equity of Equatorial Commercial Bank Limited

Source: Study Data (2024)

Figure 5 shows the 13-year averages from 2007 to 2019. This shows that there were variations in the return on equity over the years. The first quarter of 2007 had the lowest return on equity of negative 19.7% indicating the bank was making loses. After the merger with Southern Credit Ltd, the fourth quarter recorded the highest return on equity of 24.1%. The last quarter of 2019 had the highest return on equity of 25.1%. The increase in the return on equity can be attributed to the increase in net income after the acquisition of Mwalimu SACCO Society Ltd in 2014.

4.1.5 Analysis of Return on Equity of Eco-bank Kenya Limited

In 2008, Ecobank Kenya Ltd. merged with ABS Bank Ltd. to form Ecobank Kenya Ltd. Figure 6 shows the trend movements of ROE before the merger and after the merger.

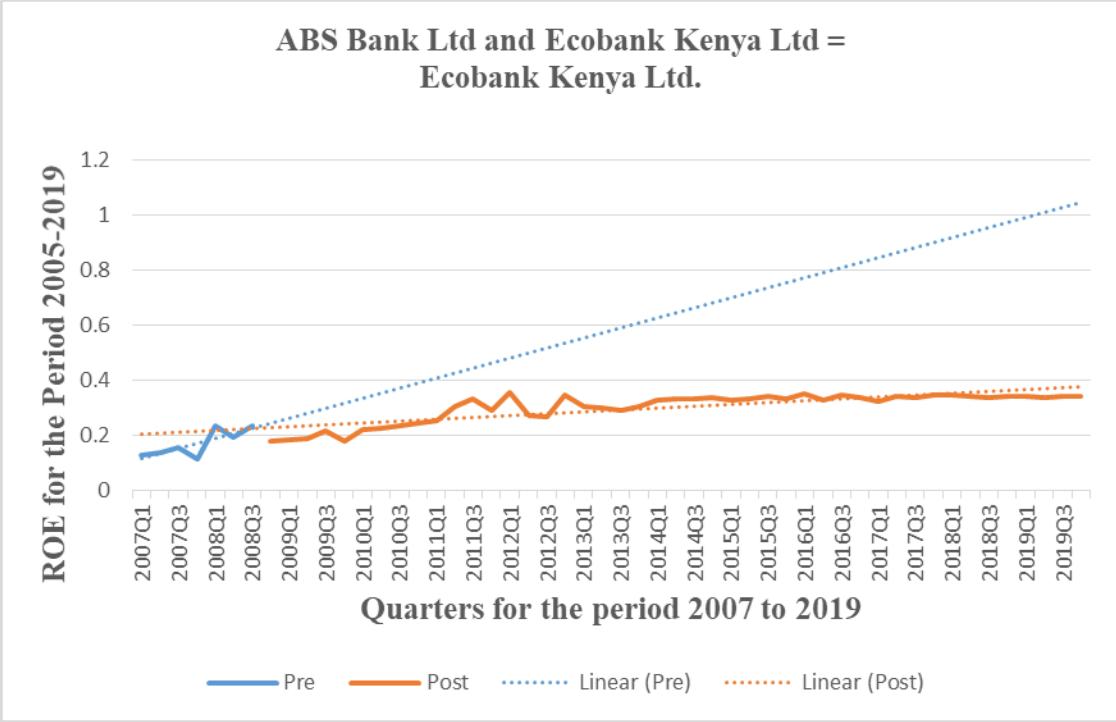

Figure 5: Analysis of Return on Equity of Eco-bank Kenya Limited

Source: Study Data (2024)

Figure 6 shows the 13-year averages from 2007 to 2019. This shows that there were variations in the return on equity over the years. The first quarter of 2007 before the merger had the lowest return on equity of 12.6% while the first quarter of 2016 had the highest return on equity of 34.8%. The increase in the return on equity can be attributed to the increase in net income after the merger with ABS Bank Ltd in 2008.

4.1.6 Analysis of Return on Equity of Diamond Trust Bank Kenya Limited

In the year 2017, Diamond Trust Bank Kenya Ltd acquired Habib Bank Kenya Ltd. Figure 7 shows the trend movements of ROE before the merger and after the merger.

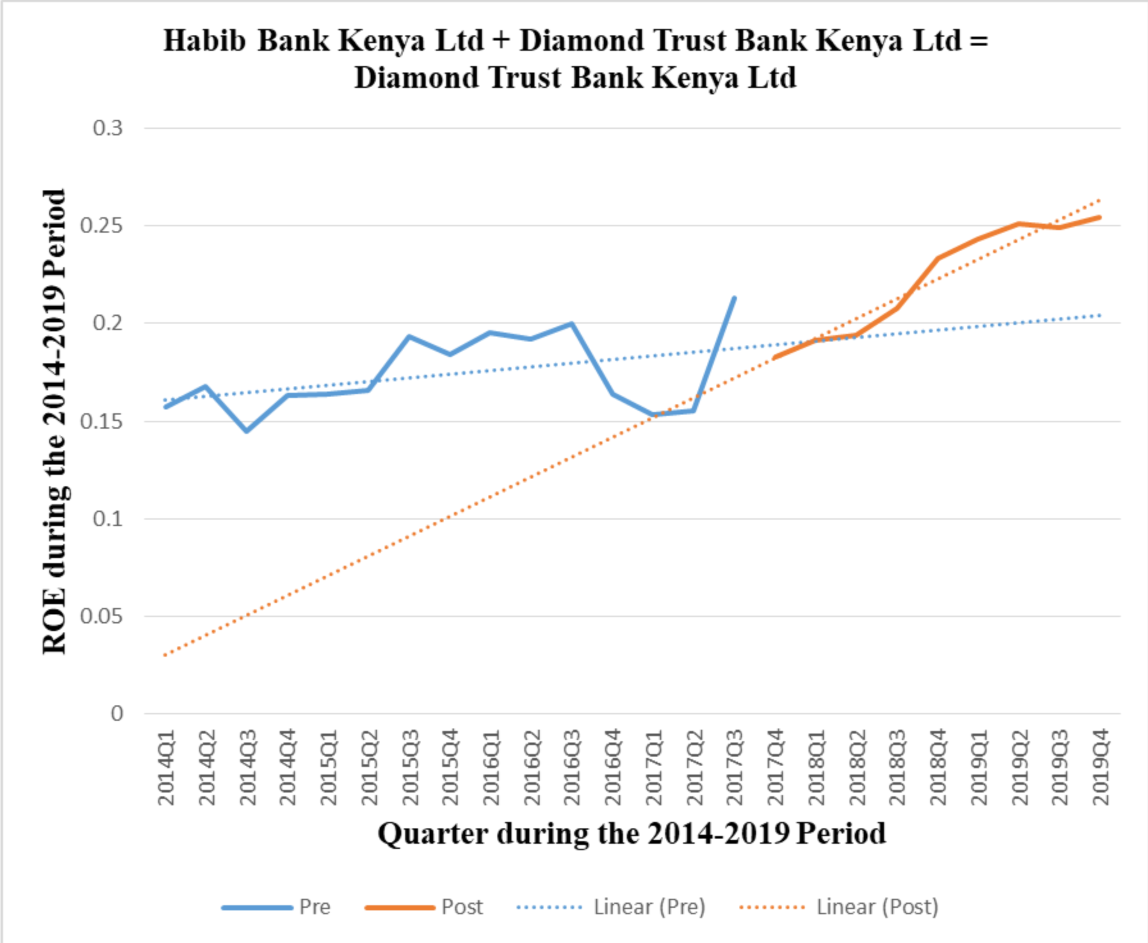

Figure 6: Analysis of Return on Equity of Diamond Trust Bank Kenya Ltd

Source: Study Data (2024)

Figure 7 shows the 6-year averages from 2014 to 2019. The trend analysis indicates that there were variations in the return on equity over the years. The third quarter of 2014 before the merger had the lowest return on equity of 14.5% while the fourth quarter of 2019 had the highest return on equity of 25.4%. The increase in the return on equity can be attributed to the increase in net income after the acquisition of Habib Bank Kenya Ltd in 2017.

4.1.7 Analysis of Return on Equity of the Commercial Banks

The dependent variable of the study is financial performance. Measured as a ratio of net income to shareholders' equity. The computed ratios for the commercial banks, industry aggregates, and 13-year annual averages are presented in Table 1 and 2).

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Table 1: Individual banks' Return on Equity during the 2007 to 2019

Bank	Mean	Std. Dev	Median	Min	Max	Skewness	Kurtosis
1	.23895	.0454781	.3405	.254	.304	0.3771	0.2649
2	.2234	.028708	.321	.284	.369	0.7738	0.0269
3	.3809	.0494442	.3825	.293	.454	0.6982	0.2913
4	.2526	.029215	.35	.297	.396	0.7889	0.2686
5	.25545	.030828	.35	.297	.401	0.7809	0.2796
6	.27185	.0309163	.346	.286	.407	0.8833	0.9743
7	.22935	.0257973	.34	.287	.375	0.6723	0.3719
8	.2308	.0276207	.3395	.273	.363	0.0865	0.9059
9	.3467	.0387829	.339	.264	.407	0.6040	0.9428
10	.24665	.040605	.3425	.273	.444	0.3495	0.3111
11	.25675	.0299418	.346	.286	.407	0.7693	0.6170
12	.2152	.0381391	.3215	.287	.404	0.3144	0.0967
13	.20425	.0385526	.314	.254	.407	0.1703	0.6641
Industry Aggregate	**0.2579**	**0.0349**	**0.34096**	**0.280**	**0.395**	**0.5591**	**0.4627**

Table 1, gives the various descriptive statistics for ROE in all the 13 commercial banks that were studied for the period 2007–2019. The total mean of ROE for the period 2007–2019 was 0.2597. This indicates that on average, the proportion of total quarterly net income to the total shareholder's equity was good over that period as the variation was relatively low, as evidenced by a standard deviation of 0.0349, indicating small variability in ROEs over time. The minimum and maximum values of operational synergies over the same period of time were 0.280 and 0.395, respectively. There was a great variation in ROE, as evidenced by the fact that the minimum observed ROE was 0.280 while the maximum was 0.395. This implies that some commercial banks were able to increase their net incomes over the period.

ROE represents the bank's ratio measured as a ratio of net income to shareholders' equity. Table 1b) shows that commercial bank #9 had the highest ROE with a mean of 34.67 percent, while commercial bank #13 had the lowest average ROE of 20.425%. The industry aggregate for ROE was 25.79%, with a standard deviation of 0.0349, a minimum of 28.0%, a maximum of 39.5%, and a positive skewness of 0.4627. This showed there was great variation in ROEs within the industry. The commercial banks had positive ROEs throughout the period.

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Table 2: Pre and Post mergers and acquisitions Industry Quarterly Average ROE

Quarterly basis	Mean	Std. Dev	Median	Min	Max	Skewness	Kurtosis
2007Q1	.3039	.021091	.344	.259	.335	0.2505	0.9416
2007Q2	.2804	.0292276	.328	.227	.324	0.3384	0.2286
2007Q3	.2713	.0236934	.335	.233	.308	0.6364	0.0349
2007Q4	.2883	.0357493	.328	.235	.336	0.7645	0.0028
2008Q1	.30065	.026168	.325	.248	.339	0.6413	0.3964
2008Q1	.2689	.0321982	.323	.202	.331	0.8156	0.8847
2008Q1	.27415	.0240554	.367	.225	.315	0.7461	0.5442
2008Q1	.2103	.0271954	.369	.214	.313	. 0.8116	. 0.4893
2009Q1	.323	.0397254	.348	.257	.377	0.3895	0.0500
2009Q2	.3192	.0213359	.341	.279	.367	0.6310	0.4798
2009Q3	.28565	.0285183	.36	.227	.335	0.3666	0.8874
2009Q4	.28205	.0284077	.329	.233	.324	0.4073	0.0768
2010Q1	.3425269	.0384175	.334	.254	.454	0.1382	0.8435
2010Q2	.3493846	.0304864	.332	.307	.4	0.5255	0.4746
2010Q3	.3503077	.0359244	.371	.286	.407	0.9194	0.7611
2010Q4	.3496154	.0390289	.361	.293	.404	0.8202	0.0671
2011Q1	.3416923	.0293297	.341	.286	.377	0.3706	0.5096
2011Q2	.3283846	.0296635	.324	.285	.375	0.9399	0.4135
2011Q3	.3403077	.0249245	.326	.309	.4	0.0786	0.1917
2011Q4	.3386923	.0349819	.336	.273	.407	0.7081	0.4982
2012Q1	.3475385	.0494716	.339	.254	.451	0.7092	0.3764
2012Q2	.3297692	.0458751	.318	.273	.401	0.4065	0.3336
2012Q3	.3440769	.047259	.315	.266	.451	0.3556	0.3029
2012Q4	.3342308	.040235	.335	.273	.425	0.3966	0.3185
2013Q1	.3518462	.0373583	.324	.314	.451	0.0075	0.0316
2013Q2	.3513846	.0361353	.248	.298	.4	0.9724	0.1119
2013Q3	.3359231	.0585213	.202	.254	.451	0.3533	0.7219
2013Q4	.3449231	.0410781	.225	.281	.425	0.6780	0.9791
2014Q1	.3434615	.0460916	.234	.266	.404	0.8987	0.2488
2014Q2	.3478462	.0372913	.227	.273	.407	0.7112	0.2379
2014Q3	.3483077	.0317422	.233	.307	.401	0.5388	0.2297
2014Q4	.3260769	.0346397	.235	.264	.378	0.5723	0.4788
2015Q1	.2881	.0336212	.234	.202	.377	0.9081	0.0740
2015Q2	.2986154	.0330871	.318	.233	.344	0.4216	0.5874
2015Q3	.2867692	.0275625	.323	.243	.328	0.7650	0.2082
2015Q4	.2997692	.0199506	.327	.277	.335	0.2239	0.4915
2016Q1	.2894615	.0335624	.336	.233	.328	0.3305	0.3189
2016Q2	.2867692	.0325171	.335	.232	.325	0.2966	0.5426
2016Q3	.2782308	.0290435	.324	.23	.323	0.8341	0.2837
2016Q4	.2857692	.0385641	.338	.227	.367	0.3428	0.6406
2017Q1	.2906923	.0341867	.332	.245	.377	0.0560	0.0801
2017Q2	.2812308	.0395225	.331	.223	.354	0.3509	0.9381
2017Q3	.2840769	.0414638	.335	.218	.369	0.4113	0.7802
2017Q4	.2963846	.034413	.324	.253	.348	0.8295	0.0058
2018Q1	.2853077	.0360957	.327	.239	.341	0.6426	0.0965
2018Q2	.2908462	.042583	.326	.214	.36	0.6354	0.6716
2018Q3	.2911538	.0318691	.333	.234	.329	0.4405	0.3888

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2018Q4	.2808462	.0339677	.312	.233	.334	0.9649	0.2937
2019Q1	.2839231	.0299846	.331	.24	.332	0.7630	0.2743
2019Q2	.2958462	.0386821	.245	.227	.371	0.8029	0.6870
2019Q3	.2772308	.0412839	.235	.202	.361	0.8754	0.5236
2019Q4	.2851538	.0307784	.24	.225	.341	0.6443	0.7672
Mean	**0.30789**	**0.0344**	**0.313**	**0.252**	**0.370**	**0.56132**	**0.41787**

Table 1b) gives the various descriptive statistics for ROE during the study period of 2007–2019. The mean ROE for the period 2007–2019 was 30.789%. This indicates that on average, the proportion of total quarterly net income to the total shareholder's equity was good over that period as the variation was relatively low, as evidenced by a standard deviation of 0.0344, indicating small variability in ROEs over time. The minimum and maximum values of operational synergies over the same period were 25.2% and 37.0%, respectively. There was a great variation in ROE, as evidenced by the fact that the minimum observed ROE was 25.2 percent while the maximum was 37.0%. This implies that some commercial banks were able to increase their net incomes over the period. The results show that there was great variation in ROEs within the industry during the study period.

5.0 Conclusions

The study makes conclusions in view of key findings. Mergers have become an effective strategy to reduce the growing number of banks and financial institutions in Kenya, although it has become less effective in commercial banks. Most commercial banks adopted M&A as a strategic tool to increase their capital base and expand their business. This study aimed to evaluate the post-merger commercial bank performance trends in Kenya. Hence, the study concludes that the overall financial performance of the commercial banks under study has mixed results in the pre-post-merger period. The results indicated that profitability ratio (ROE) declined and improved significantly during the study period.

6.0 Recommendations

A study recommendation is a proposed course of action or suggestion derived from the findings and conclusions of a research study. The findings of this research encourage commercial banks to become involved with M&A with other commercial banks rather than the weaker development banks and finance companies to gain synergy benefits, cost efficiency, risk diversification, and are more competitive. On the other hand, this research concludes that the merger associated with commercial banks does not benefit from the weaker bank and financial institutions. Therefore, the CBK should encourage commercial banks to find the right partners and force them to merge with stronger commercial banks rather than two weaker and smaller commercial banks.

To improve their performance, commercial banks should prioritize M&A opportunities that align with their long-term strategic goals. This might include expanding into new geographic regions, entering new markets, diversifying product offerings, or gaining access to new technologies. Banks should assess the potential risks associated with the M&A transaction, including credit risk, operational risk, and reputational risk. Develop strategies for mitigating these risks and ensuring a smooth transition.

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