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Mergers and Acquisitions and the Effect on Financial Performance of Commercial Banks in Kenya

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Abstract

This study looked at the Pre and post mergers and acquisitions and financial performance of commercial banks in Kenya for the period 2000 to 2018. The specific objectives were to determine effects of: mergers and acquisitions on Capital adequacy on the financial performance of commercial banks in Kenya, mergers and acquisitions on Asset Quality on the financial performance of commercial banks in Kenya, effects of mergers and acquisitions on Earnings on the commercial banks in Kenya, effects of mergers and acquisitions on Liquidity on the commercial banks in Kenya, mergers and acquisitions on the Sensitivity to market risk of the commercial banks in Kenya. The study used a descriptive research, employing both the use of multiple regression analysis and test of equality of two means with target population of 16 banks that had been involved in a merger/acquisition for the period 2000 to 2018. Based on availability of data for five years before and five years after the merger, 5 banks were picked to form the sample. Secondary data was collected from the financial statements available on the banks' websites and supplemented with macroeconomic data from the central bank of Kenya banking supervisory reports for the period under study. Data was analyzed using both descriptive and inferential statistics. The results showed that merged banked improved in ROA and liquidity but in the process they became more sensitive to market risk. The study concluded that mergers/acquisitions improved ROA and bank liquidity and that capital adequacy of the merged banks did not improve, nor did the asset quality, nor the earnings and that sensitivity to market risk greatly increased for the merged banks. The study recommended that for banks seeking to improve on ROA and Liquidity a merger/acquisition would be one of the options to consider.

Keywords: *Pre-mergers, Post-mergers, Acquisitions, Financial, Performance, Commercial banks, Kenya.*

1.1 Background to the Study

Businesses are constantly evolving with only the innovative once surviving. Those losing out to competition are often eliminated either through mergers, acquisitions, takeover or any other form of restructuring. Mergers and Acquisitions (M&As) are considered to be the most common ways businesses can restructure themselves and have played significant roles in the external development of a good number of global firms. M&A's form an important change agent (Depamphilis, 2010). Mergers and Acquisitions have been very popular event since the 20th century. The main reason for Mergers and Acquisitions is that they are used in creating value to shareholders of the target and acquiring firms. Therefore, Mergers and Acquisitions are an essential tool for growth in the corporate world with most companies engaging in it as a growth strategy. According to Chatarjee and Banerjee (2013) growth can be best achieved through Mergers and Acquisitions. It can however be noted that various companies are motivated by different factors other than just growth.

Some Mergers and Acquisitions are simply motivated by the need to gain monopoly in a certain market or simply gain operational efficiency. It should however be noted that the determinants of Mergers and Acquisitions are not mutually exclusive, and a company may engage in one for various reasons. In developed nations, the number of Mergers and Acquisitions is higher compared to those developing including Kenya. However, Kimani (2014) noted that in the first seven months of 2012, the Kenya recorded a sharp rise in the number of Mergers and Acquisitions deals. This trend has continued to be witnessed as more and more companies get involved in M&A's. The banking industry in Kenya has experienced an unprecedented level of consolidation especially since the 1990s. The combination is predominantly based on the belief that gains will accrue from consolidation. Between the year 2005 and 2019 sixteen mergers and acquisitions were witnessed, with the last being that between Commercial bank and NIC ltd that merged to NCBA.

Reasons for their adopting mergers and acquisitions vary and theoretically it is assumed that Mergers and Acquisitions are motivated by the need for firms to meet the increased levels of share capital, to acquire synergies, increased market power through expansion of distribution network and market share, enhanced profitability, risk diversification and to benefit from best global practices among others (Kiarie, 2014).

Financial performance refers to the measure of how well a firm can use assets from its primary mode of business and generate revenues. Financial Performance is essentially a measure of an organizations financial health over a given period of time. It is used to compare similar firms across the same industry or to compare industries or sectors in aggregation. In Mergers and Acquisitions, financial performance of firms is determined by evaluating the following; profitability, liquidity and solvency. Profitability shows the extent to which a company has been efficient in its operations or gauges a company's operating success over a given period of time. Liquidity measures the ability of a firm to meet its short-term obligations in due course. Solvency indicates a company's ability to meet long-term obligations when due and measures the long term financial strength of a firm.

Financial performance is the level of performance of a business over a specified period, expressed in terms of overall profits and losses during that time. Evaluating the financial performance of a business allows decision makers to judge the results of business strategies and activities in objective monetary terms. It can be measured by use of financial ratios that depict the company's ability to generate economic value and improve its operations. It has been noted by many researchers such as Altunbas and Marques (2007); Kemal (2011); Ullah et al. (2010), the fact that mergers have a significant impact on performance of banks and many factors such as liquidity, leverage, capital adequacy and size influence this performance.

Studies depict a different picture on the results of mergers involving failures and poor financial returns. Even conservative estimates place mergers failure rates at approximately 50% or higher for nearly four decades (Coffey et al, 2003).

Mergers and Acquisitions are techniques which can be used to establish inter-firm linkages whereby firms purchase either a section or control interest of a different firm. A merger refers the joining of two or more firms into one while an acquisition is the act of an organization buying another with the aim of maintaining control (Hitt, Harrison & Ireland, 2003). Similarly, Lee and Lieberman (2010) define acquisition as an act of taking over which is characterised by a change of control of an organization from a specific group of shareholders to another. The organization which makes the move to acquire or merge with another is termed as an acquiring company while the one being solicited by the acquiring company is known as target company (Machiraju, 2007).

Mergers and Acquisitions are used in improving company's competitiveness and gaining competitive advantage over other firms through gaining greater market share, broadening the portfolio to reduce business risk, entering new markets and geographies, and capitalizing on economies of scale (Saboo & Gopi, 2009). Forcello et al. (2002) are in support of the theory that Mergers and Acquisitions act as ways to which reinforcement can be applied on the existing capabilities as well as having access to new set of valuable capabilities, considered to be difficult to imitate but can be integrated within an invisible section of a different firm. According to Luypaert (2008) Mergers and Acquisitions are perhaps the most common way in which corporate restructuring or business combination, which have played an important role in the external growth of a number of leading firms in the world and it is the fastest way to grow as value chains of the target firm already exist and operational. Other than growth, different authors have concluded different motives behind Mergers and Acquisitions. Mergers and Acquisitions have not had the same success story in Kenya after numerous cases being witnessed of failures especially in the banking sector. As much as this has been the case, there are also reported incidents of Mergers and Acquisitions giving positive performances. As a result, most stakeholders have been left confused on whether to agree to Mergers and Acquisitions or not (Muniu, 2012).

The successful mergers can be attributed to the fact that carefully thought out post- merger policies have been adopted after a significant amount of time being dedicated to courtship (Very & Schweiger, 2001). The study is built on the premise that the success of M&A's depends on the extent to which the motives are achieved. The performance of the Mergers and Acquisitions are measured in terms of the motives or the theories behind the formation of mergers and the level of achievability post-merger. Mergers and Acquisitions refer to the change in ownership, business mix, assets mix and alliance with the view to maximize shareholders' value and improve firm performance. One of the main elements of improving company performance is the boom in mergers and acquisitions (Pazarkis et al, 2006). Gaughan (2011) defines a merger as the process in which two firms combine and only one endures and the merged entity cease to exist. Nakamura (2005) asserts that an acquisition takes place when a company attains all or part of the target company's assets and the target remains as a legal entity after the transaction whereas in a share acquisition a company buys a certain share of stocks in the target company in order to influence the management of the target company.

According to Gaughan 2011, mergers and acquisitions are important as they lead to combining corporate resources, but only if it results in a competitive advantage. Some of the benefits are, rapid access to technology and products, an extended customer base, an enhanced market position and a stronger financial position (Ghosh, 2001). Another importance of mergers and acquisitions is access to an expanded installed base of customers. This not only provides an

opportunity for sales of existing products to a larger group of customers, but also provides a greater base for future product sales. In addition, consolidated companies can own a greater share of market, which gives them a substantial competitive advantage. Mergers and acquisitions also benefit companies wanting to reposition themselves in the market. By adding capabilities to their product offerings, companies can rapidly expand their market coverage and modify their market position (Harford, 2005).

According to Machiraju (2007), there are three major types of mergers and acquisitions. The first one is the horizontal merger, where firms that produce and sell the same product merges. In this case, the merger occurs between two competing firms whose products are viewed by buyers as the same and therefore their cross elasticity of demand and supply is high. The second type of merger is the vertical merger. This is a merger between firms operating at different stages of production. It happens between firms that have a successive functional link between their products, i.e. the output of one firm is an input for another firm at a higher stage of production. The third type of merger is the conglomerate merger. This is a merger between firms operating at different stages of production.

Mergers have hit headlines from the past as much as the present. They are being talked of and promoted the world over. Studies carried shows that merger and acquisition activities on a wide range of sectors including banking and insurance, oil, gas, electricity among others. Many companies aim at their financial performance after merger. Many of the studies show that merger and acquisitions lead to better financial performance of companies. Contrary to this, Ghosh (2001) show results at odds with the view that mergers and acquisitions improve performance.

1.2 Statement of the Problem

Mergers and Acquisitions has been one of the popular trends for business expansion in developed countries and is increasing in developing countries as well (Al-Sharkas, Hassan & Lawrence, 2008). There has been a recent upsurge in M&A activity within the Kenyan banking industry. The frequent increase in the minimum capital requirements by the CBK made it difficult for the small banks to survive. Thus they opted for M & A, particularly in the late 1990s and onwards. This creates an essential need to investigate the effects of M & A on the performances of the merged banks so that other banks can make more informed decision. Therefore, the current study is undertaken to evaluate the effects of M & A on the post-merger operating performances of the acquirer banks in Kenya. This study will focus on the Camels ratings used by the banks to measure the performance, i.e. Capital Adequacy, Asset quality, Earnings, Liquidity and Sensitivity to market risks. The study will seek to compare the financial performance before and after the merger.

1.3 Objectives of the Study

i. To compare pre- and post-merger/acquisition Capital adequacy of commercial banks in Kenya.
ii. To examine the relationship between pre- and post – merger/acquisitions Asset Quality of commercial banks in Kenya.
iii. To find out if pre-and post- merger/acquisition Earnings are different for commercial banks in Kenya. .
iv. To compare pre-and post-merger/acquisition Liquidity for commercial banks in Kenya.
v. To determine if mergers and acquisitions improve Sensitivity to market risk of the commercial banks in Kenya.

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1.4 Research Hypotheses

H_{01}: Post merger capital adequacy is different from pre-merger capital adequacy for commercial banks in Kenya.

H_{02}: Post merger Asset Quality is different from pre-merger Asset Quality for commercial banks in Kenya.

H_{03}: Post merger Earnings is different from pre-merger Earnings for commercial banks in Kenya.

H_{04}: Post merger Liquidity is different from pre-merger Liquidity for commercial banks in Kenya.

H_{05}: Post merger Sensitivity to market risk is different from pre-merger Sensitivity to market risk for commercial banks in Kenya.

1.5 Conceptual Framework

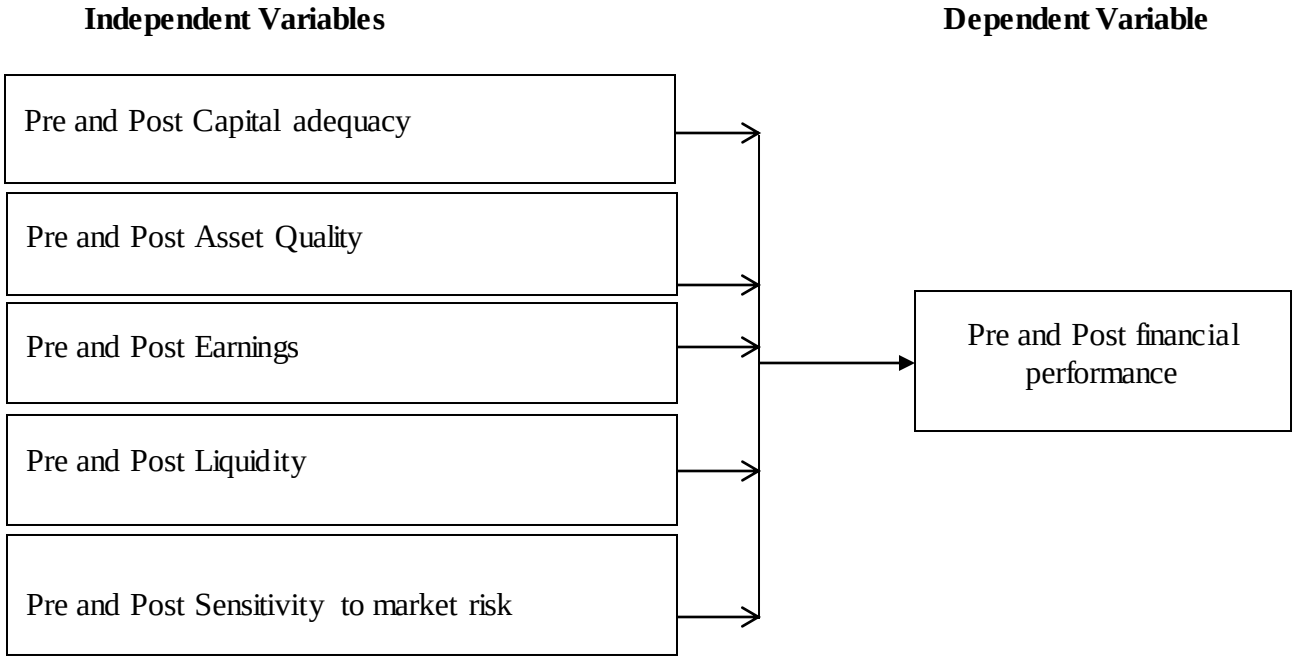

Figure 1: Conceptual Framework

Source: Own formulation based on the literature

2.0 Literature Review

2.1 Theoretical Review

2.1.1 Synergy Theory

Synergistic theory suggests that the bidder firm can achieve efficiency gains by combining an efficient target with their businesses thereby improving the target's performance. Bidder firms often recognize specific complementarities between their businesses and that of the target; therefore, even though the target is already performing well, it should perform even better when

it is combined with its complementary counterpart, the bidder firm. The theory suggests that targets perform well both before and after the merger (Chatterjee, 2010; Altunbas & Ibanez, 2008; Hankir, Rauch & Umber, 2011). The implication of this is that operating synergies are achievable in horizontal, vertical and even conglomerate mergers. The synergy theory makes the assumption that economies of scale exists in the industry and that before the merger, the firms are merely operating at levels of activity that fall short of achieving the economies of scale (Chatterjee, 1986; Weston, Chung, & Hoag, 2003; Altunbas & Ibanez, 2008; Hankir et al., 2011).

Operating synergy can be implemented through revenue enhancement or cost reducing measures. Potential sources of revenue enhancements might come from sharing of marketing opportunities by cross-marketing each merger partner´s product (Gaughan, 2011). The main source of operating synergy however comes from cost reductions. Cost reductions may be the result of economies of scale; thus the decreases in unit cost that result from an increase in the size or scale of company´s operations, elimination of duplicate functions and back office operations. Hellgren, Lowstedt and Werr (2011); Hankir et al. (2011) explain the possibilities for increased revenues resulting from cross selling, and cost reduction arising from efficiency gains.

The financial synergy theory on the other hand is based on the proposition that nontrivial transaction costs associated with raising capital externally as well as the differential tax treatment of dividends; may constitute a condition for more efficient allocation of capital through mergers from low to high marginal returns, production activities, and possibly offer a rationale for the pursuit of conglomerate mergers (Weston et al., 2003). The theory also states that when the cash flow rate of the acquirer is greater than that of the acquired firm, capital is relocated to the acquired firm and its investment opportunities improve. According to (Gaughan, 2011); financial synergy refers to the impact of a corporate merger or acquisition on the costs of capital to the acquiring firm or the merging partners. The extent to which financial synergy exists in corporate combinations, the costs of capital should be lowered. Another widely discussed proposition is that the debt capacity of the combined firm can be greater than the sum of the two firms 'capacities before the merger, and this provides tax savings on investment income (Weston et al., 2003). Mergers contribute to lower cost of capital in that companies substantially increase their sizes as a result of a merger will have more assets hence higher debt capacity. A company with investment opportunities and another with cash slack may combine to achieve financial synergy (Gaughan, 2011).

2.1.2 Agency Motive Theory

Under the agency motive, managers may get acquisitions against the attention of the shareholders. Amihud and Lev (1981) depict that managers engage in conglomerate mergers in order to spread activities of the firm and smooth out earnings, thereby securing their jobs but this is against shareholder interest as they can diversify at their own at a very little cost. Jenson (1986) in his theory of free cash flow, explains that managers with admittance to spare cash, favor in engaging favorite projects and unbeneficial or unsuccessful acquisitions instead of giving back to shareholders. This is sign of agency conflict between owners and managers. For two reasons. Firstly, payments to the executive are often connected to firm size, so that the managers have the first choice for growing the firm ever larger. As paying cash to shareholders lessens firm size and their discretion, managers tend to involve in negative Net Present Value investments. Secondly, it is simply more esteemed to head huge organizations therefore Chief Executive Officers who in fact believe in their abilities to build and craft value, are seeking more supremacy against shareholder interests. Thus prospects of lofty and towering

remuneration and the kudos of running large firm's top management into making acquisitions even if the deal is unfavorable, harmful or unprofitable to the firm value.

2.1.3 Market for Corporate Control Theory

According to this view, managers compete for the right to manage the resources of company. The poorly performing managers are threatened to become a victim of takeover (Jensen, 1988). After takeover, the incumbent inefficient management team is replaced by value maximizing managers. The acquirer assumes that economic gains can be achieved by replacing inefficient incumbent management with more efficient persons. In an efficient merger, the theory of corporate control provides a third justification beyond simply synergistic gains for why mergers must create value. The theory suggests that there is always another firm or management team willing to acquire an underperforming firm, to remove those managers who have failed to capitalize on the opportunities to create synergies, and thus to improve the performance of its assets (Weston, Mitchell & Mulherin, 2006). It also suggests that managers who offer the highest value to the owners will take over the right to manage the firm until they themselves are replaced by another team that discovers an even higher value for its assets. Manne (2005) explains that inefficient managers will supply the market for corporate control and managers that do not maximize profits will not survive, even if the competitive forces on their product and input markets fails to eliminate them. The authors emphasize that hostile takeovers can, as a result, be observed amongst poorly performing firms, and amongst those whose internal corporate governance mechanisms have failed to discipline their managers.

2.1.4 Hybris Theory

The hybris hypothesis by Roll (1986) suggests that managers make mistakes in estimating the value of target firms. The theory states that managers wrongly believe that they are quite better enough as compared to the rest of the management to control and supervise different firms. That is, they are arrogant and self-centered in their decision-making aptitude and conclude by paying more for target which turns the bidder firm to drop. It has been established that the hubris result is similar to the winner's curse that occur in frequent value auctions where bidders pay more for the auctioned item. The highest bidder would yield highest positive valuation error (reflecting his boldness) and is successful in winning the target. The bidder management is equally likely to overestimate or underestimate the synergy to be achieved by acquiring some listed company. The bidder knows that the current market price is the lowest price that a target company shareholder can accept. When bidder's valuation is below the market price, an offer is not made. If bidder believes that there are potential synergies but actually there are not, the takeover premium is a mistake made by the bidder.

2.1.5 Managerial Discretion Theory

Managerial discretion theory claims that it is not over-confidence that drives unproductive acquisitions, but rather the presence of excess liquidity, or free cash flow (Jensen, 1986). The author suggests that firms whose internal funds are in excess of the investments required to fund positive net present value projects are more likely to make quick strategic decisions, and are more likely to engage in large-scale strategic actions with less analysis than their cash-strapped peers. High levels of liquidity increase managerial discretion, making it increasingly possible for managers to choose poor acquisitions when they run out of good ones (Martynova & Renneboog, 2008). Rau and Vermaelen (1998) suggest that the other stakeholders in the firm will be more likely to give management the benefit of the doubt in such situations, and to approve acquisition plans on the basis of fuzzy and subjective concepts such as managerial 'instincts', 'gut feelings' and 'intuition', based on high past and current cash flows. Thus, like the hubris theory, the theory of free cash flow suggests that otherwise well-intentioned

managers make bad decisions, not out of malice, but simply because the quality of their decisions are less challenged than they would be in the absence of excess liquidity.

2.2 Empirical Review

Mergers and Acquisitions and Return on Asset

Geoffrey Meeks (1997) explores the gains from merger for a sample of transactions in the United Kingdom between 1964 and 1971. This study examines a relatively large sample of 233 observations and looks at the change in return on total assets (ROA) of the buyer compared to the change in the ROA of the industry. Meeks' (1997) findings reveal a decline in ROA of the acquirers following the transaction, with performance reaching the bottom after five years. For nearly two-thirds of acquirers, the performance is below the standards of the industry. He concludes that the mergers in the sample suffered a decline in profitability.

Ramaswamy and Waegelein (2013) examined the financial position using financial data of 162 merged firms and industry adjusted cash flow returns as performance criterion taking 5-year pre and post-merger period. They found that after merger, performance was negatively related with size of target firm and have positive relationship with long-term motivation recompense plans. Firms that were in different industries also showed improvement in financial performance. They used regression analysis to conclude whether there was any improvement in performance after merger as compare to the financial performance before merger. They found improvement in after merger operating and financial position calculated by industry-adjusted return on assets for selected sample.

Mergers and Acquisitions and Capital Adequacy

A study by Pasiouras and Kosmidou (2012) on indicators of the best or the most competitive banks, employed trend analysis on the financial ratios for a period of time, they argue that the best performing banks are those who maintain a high equity level relative to their assets. Highly capitalized banks are stable and assured to be profitable even during economically difficult times. Furthermore, a lower risk increases a bank's creditworthiness and reduces its funding cost. In addition, banks with higher equity to assets ratios will normally have a lower need of external funding, which has a positive effect on their profitability. From this point of view, a higher capital ratio has a positive effect on profitability. Hence, mergers and acquisitions increase the capital adequacy leading to good financial performance of commercial banks.

A study by Olalekan (2012) on inference of merger and acquisition of commercial banks in Nigeria on their profitability and other related measures of performance found out that there is noteworthy relationship between pre and post-merger and acquisition on capital base of commercial banks and profitability level. Merger and acquisitions have also increased the capitalization of commercial banks as evidenced in company's share ownership, increase in the cost of services and changes in bank lending rates. Based on these findings, arrived at conclusion, that the merger and acquisition activity improved the in general performance of banks significantly and also has contributed immensely to the growth of the real estate sector for sustainable growth and development.

Javaid (2011) conducted a study on factors affecting profitability of Commercial banks. By use of regression analysis in analyzing his data, he observed that the capital muscle of a bank is of paramount importance in affecting its profitability. A well-capitalized bank is perceived to be of lower risk and such benefit is converted to profitability. He adds that a well-capitalized bank faces lower expected costs of financial distress and such advantage is reflected into high profitability. Merged firms have more access to financial markets that were not available initially to one or both of the said firms. The cost of capital reduces below premerger levels.

For example, the combined firm may have a lower probability of bankruptcy than the two separate firms if the cash flows of the two firms are not perfectly positively correlated. (Bruckner, 2015) did a study on the impact of mergers on bank performance and observed that mergers and acquisitions of commercial banks had accordingly increased the capital base of banks and that increase in capital base of commercial banks does not only enhance revenue generation but acts as a hedge against future losses, economic slow-down and to secure the capital of shareholders.

Mergers and Acquisitions Asset Quality

Evaluation of assets to estimate their credit risk is asset quality. The asset quality of commercial banks directly has an effect on their financial and operational as well as the national financial soundness. According to Yin (2012), a drop in the value of asset quality due to commercial banks not keen on loan quality is likely a severe cause of future crisis. Michael (2013), on the other hand argues that the most prime determinant of the quality 21 of asset is the loan portfolio value and the banks control of credit management. Loans and securities are forms of commercial banks assets but they pose the highest threat in amount of risks. Moreover, other assets such as real estate's, off balance sheet items and cash also affect asset quality of a commercial bank.

According to Levine (2015), asset strongly determines the financial performance of any sectoral institution since it increases interest income and leads to a fall in the cost burden of bad debt management at the same time. Legally, banks are expected to keep aside cash deductible as an expense so as to cushion the bank against bad debts and other loan defaults. The higher the NPS ratio to the gross/net asset, the lower the asset quality. This therefore implies a negative trade-off between asset quality and the bank's financial performance (Ombaba, 2013).

The quality of current and potential credit risks reflects the asset quality ratings indicate the quality and this is highly intertwined with the loan investment portfolios, real estates and off-balance sheet transactions. This also reflects the bank's ability to identify and manage credit risks. According to (Abata, 2014), asset quality evaluation should be emphasized on how adequate the Allowance for Loan and Lease Losses (ALLL) are, the intensity of disclosure to counter-party, the issuer or borrower default under actual or implied contractual agreements. However, there are other factors and risks to consider which actually stand to affect the bank's assets value or marketability, including, but not limited to; operating, market, reputation, strategic and compliance risks should be considered.

Earning and Mergers and Acquisitions

Poornima and Subhashini (2013) using paired sample t-test examined the performance of 33 merged companies for the time period 2009–2010 for India. They examined the profitability ratio, the leverage ratio, the liquidity ratio, and the managerial Earning ratio to carry out their empirical analysis to compare the pre and post-merger performance. They found that there is no significant improvement in Earning of the firms after being acquired. They also reported that other financial ratios also do not show any significant change after the merger deal.

Liquidity and Merger and Acquisitions

Chang and Tsai (2012) studied the long-run performances of 4288 merged firms during the period 1990–2007 in the USA. Their results depicted a declining performance of acquirer firms. They further examined superior stock performance of acquiring firms before occurrence of merger. They found that investors might anticipate earlier good performance and that the long-run returns correct the overestimation as result of announcements of merger decision.

Likewise, Kemal (2011) analyzed the four year (2006–2009) post-merger financial statements of Royal Bank of Scotland (RBS) in Pakistan by taking 20 fundamental ratios. The result of his case study showed that merger deal did not improve the financial position of RBS in terms of profitability, liquidity, cash flows, and asset management.

Kemal (2011) analyzed the four year (2006–2009) post-merger financial statements of Royal Bank of Scotland (RBS) in Pakistan by taking 20 fundamental ratios. The result of his case study showed that merger deal did not improve the financial position of RBS in terms of profitability, liquidity, cash flows, and asset management.

Sensitivity to market risk and Merger and Acquisitions

Aruwa and Musa (2014) examined the effects of the various risk components like credit risk, interest rate risk and operational risk on the financial performance of Deposit Money Banks in Nigeria. The study used the whole number of banks that have existed in Nigeria from the year 1997 to 2011. The data was analysed using descriptive statistic and ordinary least square regression. In this study the researchers established that a strong relationship exists between risk components and the financial performance of the banks in Nigeria as was indicated by the r-squared value of 91%. However, variables that represent credit risk and the rate of capital to total weighted risk asset have positive relationship. Operational and interest rate risk affects the profitability of the banks negatively. This research covered a wider range of risks that are encountered in financial institutions.

Al-Tamimi et al., (2015) examined the relationship between financial risk and performance of Gulf Cooperation Council Islamic banks and the relative importance of the most common types of risk. The study covered 11 of the 47 Islamic banks of the Gulf Cooperation Council region from 2000 to 2012. Data was obtained from the Bank scope database. ROA and ROE were used as measures for bank performance. Four types of financial risk were used, namely credit risk, liquidity risk, operational risk, and capital risk. Regression analysis indicated that there exists a significant negative relationship between the Gulf Cooperation Council Islamic banks' performance, capital risk and operational risk. The results also confirm a significant negative relationship between Gulf Cooperation Council Islamic banks' performance. Capital risk was the most important type of risk and then followed by operational risk.

3.0 Research Methodology

The study employed a descriptive research design as it sought to obtain information regarding the variables. Specifically, the study employed a multiple linear regression analysis and the test of equality between two means to compare per-and post-merger bank performance. The objective of the descriptive research design was to describe the way things are or the way in which they exist in a particular time. The target population for this study was all the commercial banks in Kenya that were involved in merger and acquisition in the period between 2000 and 2018. According to data available for the central bank of Kenya, 16 mergers/acquisitions took place between the year 2000 and 2018. With regard to the effect of M & A's on financial performance of commercial banks in Kenya, the study used secondary data. Secondary data was collected from the banks' financial statements. The banks included in the sample were those that were involved in a merger/acquisition on or before 2013 so that the researcher would afford to pick data for 5 years before and after the merger/acquisition. Using this criteria 5 banks, namely CFC-Stanbic, GT bank, Sidian (formerly K-rep bank, Spire bank (formerly Equatorial bank and KCB were picked to constitute the sample.

For the pre-merger/acquisition period, ratios for both the acquirers and the targets examined to get an indication of the relative financial performance of the acquirer and the target. For the post-merger period, the focus of the analysis was on the combined institution. Pre-merger

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average data (y1) was compared with the post-merger average data (y2) to determine what changes occurred in financial performance following the merger or the acquisition. In this study, 6 financial performance indicators were used: profitability ratio (ROA), CA, AQ, E, LQ, and SMR.

The researcher then conducted a multivariate regression analysis to establish the relationship between the dependent and independent variables. The dependent variables being the financial performance as denoted by ROA_{it-1}= against the independent variables being the CA.AQ, E, LQ and SMR as denoted by CA_{it-1}, $AQ_{it-1}, E_{it-1}, LQ_{it-1}$ and SMR_{it-1} respectively.

Data analysis was done through a comparison of pre-merger and post-merger regression analyses and via the test of the difference between two means.

Pre- merger data analysis

The following model was used to test the effect of the pre-merger independent variables on the performance of the banks

$$ROA_{it-1} = \beta_0 + \beta_1 CA_{it-1} + \beta_2 AQ_{it-1} + \beta_3 E_{it-1} + \beta_4 LQ_{it-1} + \beta_5 SMR_{it-1} + \varepsilon_{it-1}$$

Where,

ROA_{it-1} = Premerger Return on assets for bank i and time t

CA_{it-1} = Premerger capital adequacy for bank i and time t

AQ_{it-1} = Premerger asset quality for bank i and time t

E_{it-1} = Premerger earnings for bank i and time t

LQ_{it-1} = Premerger Liquidity for bank i and time t

SMR_{it-1} = Premerger sensitivity to market risk for bank i and time t

ε_{it-1} = Premerger error term

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = Pre-merger regression coefficients

Post- merger data analysis

The following model was used to test the effect of the post-merger independent variables on the performance of the banks

$$ROA_{it+1} = \beta_{00} + \beta_{11} CA_{it+1} + \beta_{22} AQ_{it+1} + \beta_{33} E_{it+1} + \beta_{44} LQ_{it+1} + \beta_{55} SMR_{it+1} + \varepsilon_{it+1}$$

Where,

ROA_{it+1}=Post-merger return on assets for bank *i* and time *t*

CA_{it+1}=Post-merger return on assets for bank i and time t

AQ_{it+1}=Post-merger asset quality for bank i and time t

E_{it+1}=Post-merger earnings for bank i and time t

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LQ_{it+1}=Post-merger liquidity for bank i and time t

SMR_{it+1}=Post-merger sensitivity to market risk for bank i and time t

ε_{it+1}=Post-merger regression error term

$\beta_{00}, \beta_{11}, \beta_{22}, \beta_{33}, \beta_{44}, \beta_{55}$=Post-merger regression coefficients

Analysis of Variance between means

The study employed descriptive analysis and statistical inference in data analysis. The descriptive analysis include, mean, median, minimum, maximum, standard deviation, kurtosis. The statistical inference focused on the test hypothesis of the difference between two means of pre-acquisition and post-acquisition. The key null hypothesis to be tested in the study was that there was no difference between the mean of the financial performance before and after the merger. To establish the strength of the model, the researcher has conducted an ANOVA test. This has help to establish whether the model is significant in explaining the relationship between mergers and acquisition on the financial performance of commercial banks in Kenya. A significance test at 1% and confidence level shall be conducted at 99% to measure the significance of the factors in explaining the changes in the dependent variable.

Return on assets, $ROA = \frac{PAT}{TA}$, where PAT = profit after tax, TA = Total assets

Capital adequacy, $CA = \frac{TC}{TRWA}$, where Tc = total capital, TRWA = Total risk weighted assets

Asset Quality, $AQ = \frac{NPL}{TA}$, where NPL = non-performing loans, TA = total assets

Earnings, $E = \frac{PAT}{TC}$, where PAT = profit after tax, TC= total capital

Liquidity, $LQ = \frac{TLiab}{TD}$ where TLiab = Total liabilities, TD = total deposits,

Sensitivity to market risk, $SMR = \frac{TC}{IR}$, wher TC = total capital, IR = commercial lending rates.

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4.0 Results and Discussions

4.1 Descriptive Statistics

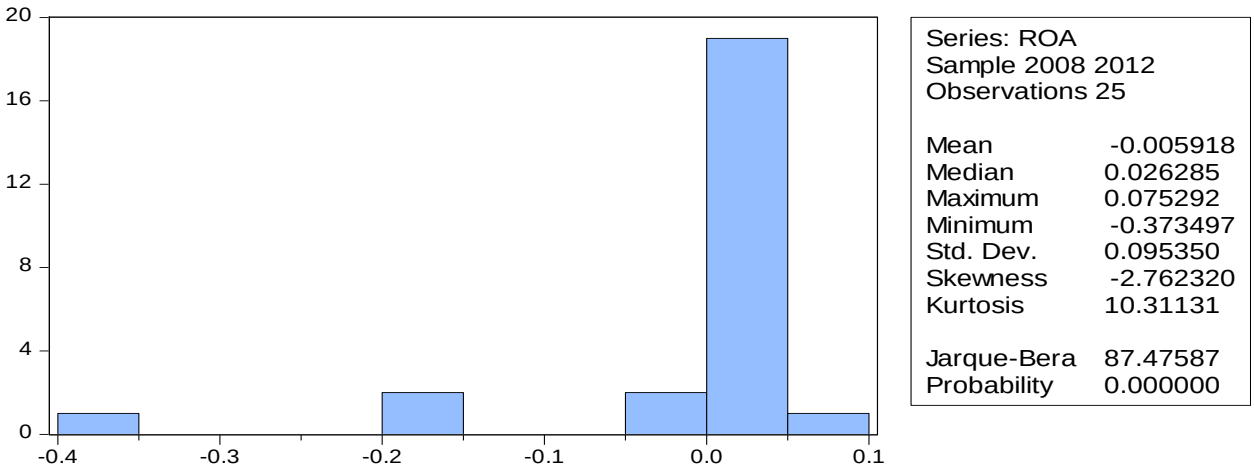

Figure 2: Pre-Merger ROA Descriptive Statistics

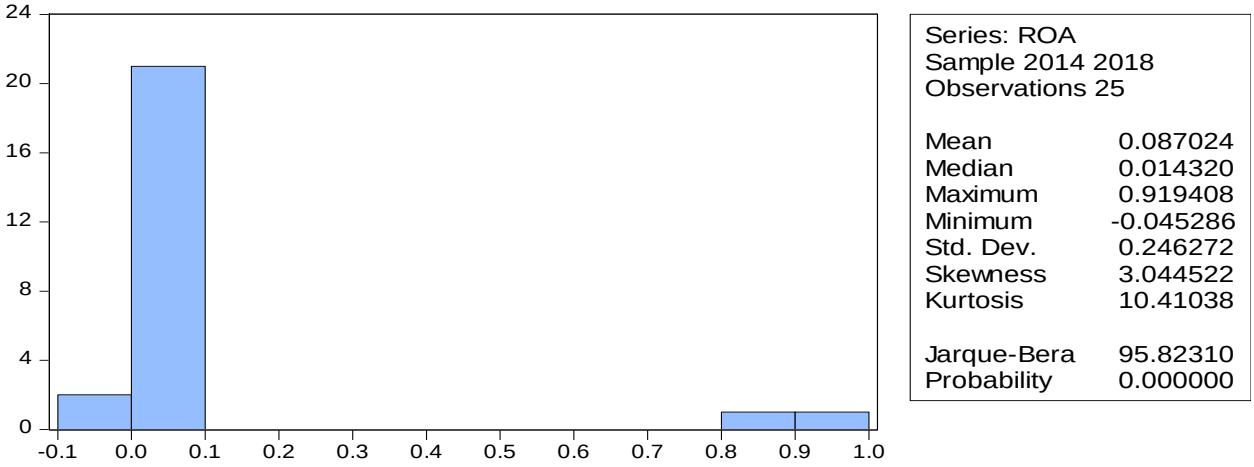

Figure 3: Post-merger ROA Descriptive statistics

Figures 2 and 3 show the descriptive statistics for pre-merge and post-merger ROA respectively. The mean pre-merger ROA was negative while post- merger mean was positive. This implied that that there was an improvement in the performance in terms of ROA after the merger – a fact that is supported by the ANOVA test for ROA. The median ROA was higher in pre-merger compared to after –merger. Both the maximum and minimum values of ROA were higher was after the merger. Variability in terms of standard deviation was higher after the merger. The ROA data was negatively skewed before the merger and positively skewed after the merger. Post-merger Kurtosis was slightly higher than pre-merger Kurtosis. The pre-merger and post-merger Jarque-Bera test statistics 87.47587 and 95.82310 respectively both with probabilities of 0.000 implying that the null hypothesis of a normality distributed pre-and post-merger ROA would be rejected and a conclusion made that the pre-and post-merger ROA series were significantly different from normal. However, according to Ooko, Githui and Omurwa (2018), a series that has a skewness and Kurtosis values of $|3|$ and $|10|$ respectively are considered to be approximately normal and can thus be subjected to parametric statistical analysis.

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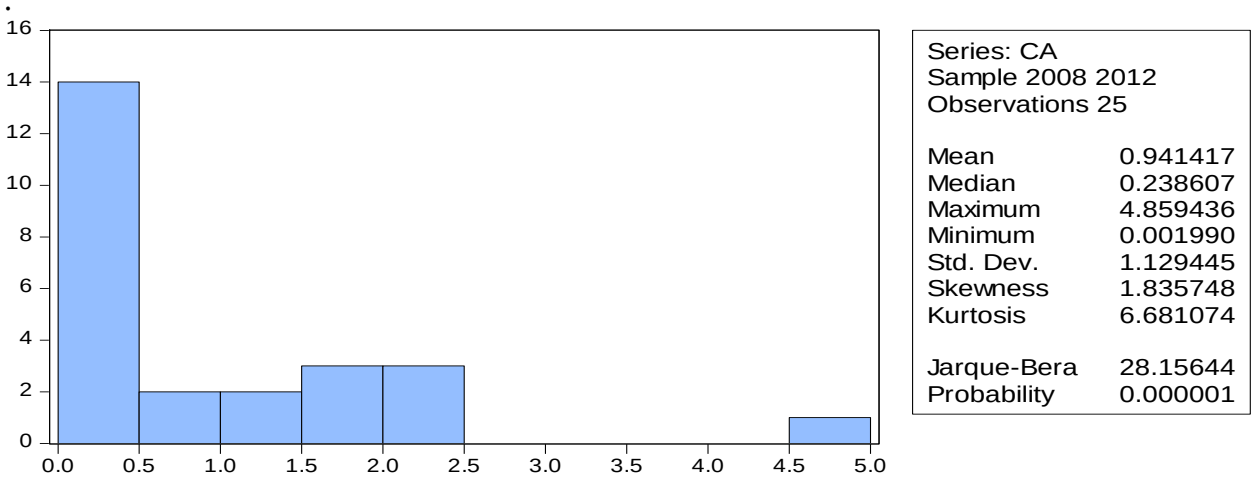

Figure 4: Pre-merger CA Series Descriptive Statistics

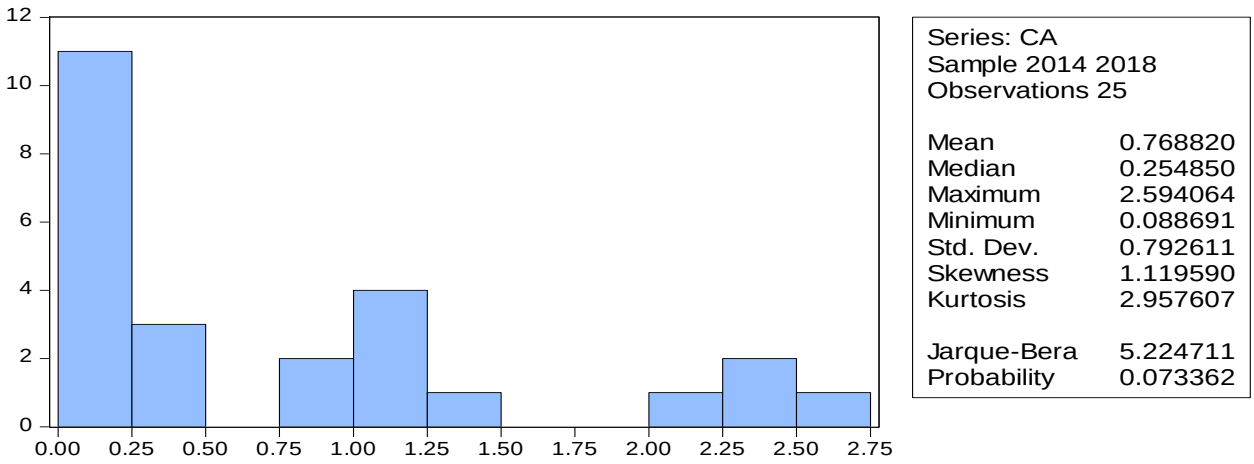

Figure 5: Post-merger CA Series Descriptive Statistics

Figures 4 and 5 show the descriptive statistics for pre-merge and post-merger CA respectively. The mean pre-merger CA was higher the post-merger CA. This implied that that there was deterioration in CA after the merger though this was shown to be significant by the ANOVA test. The median CA was higher in pre-merger compared to after –merger. Both the maximum and minimum values of CA were higher after the merger. Variability in terms of standard deviation was lower after the merger. The CA data was positively skewed both before and after the merger. Post-merger Kurtosis was slightly lower than pre-merger Kurtosis. The pre and post-merger Jarque-Bera test statistics were 28.15644 and 5.224711 with respective probabilities of probabilities of 0.000001 and 0.073362 implying that the null hypothesis of a normality distributed pre-merger CA would be rejected at all levels of significance and a null hypothesis of a normality distributed post-merger CA would be not be rejected at 5% significance level and based on the suggestions by Ooko, Githui and Omurwa (2018) for the pre-merger CA and a conclusion of a normally distributed post-merger CA parametric statistical analysis would be applied the both the pre-and post-merger CA.

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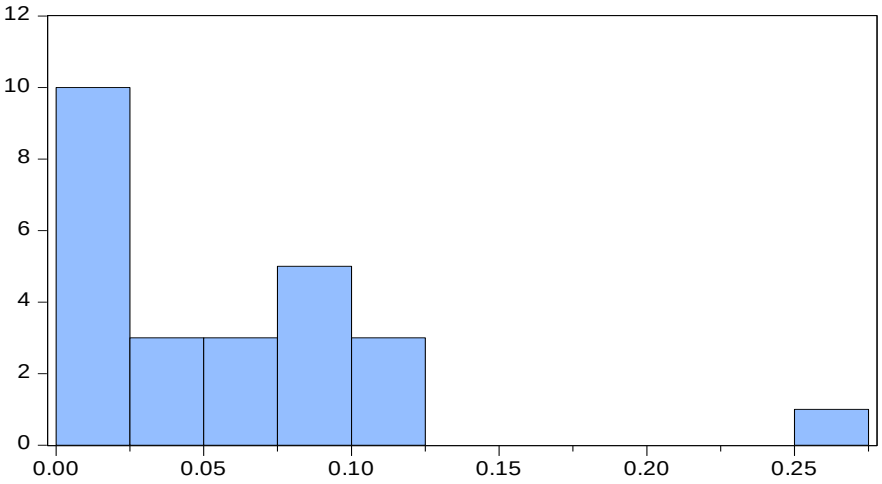
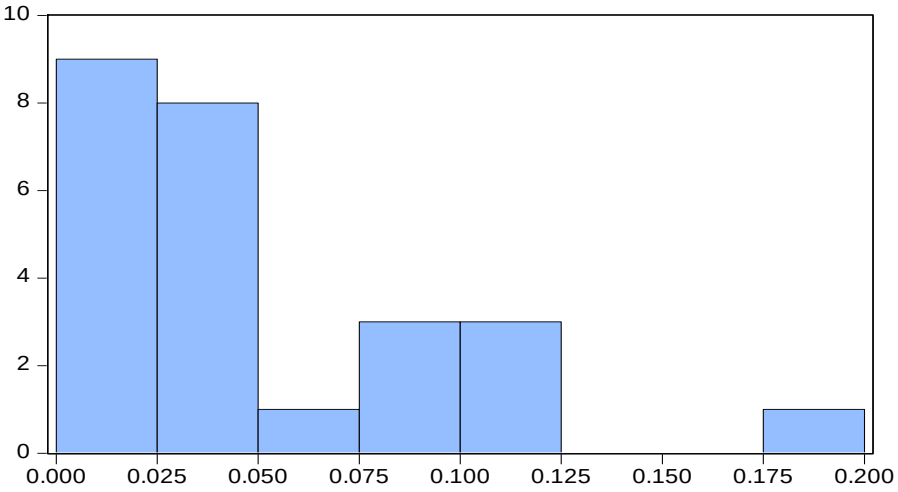


Series: AQ	
Sample 2008 2012	
Observations 25	
Mean	0.056052
Median	0.040554
Maximum	0.269168
Minimum	0.002519
Std. Dev.	0.058636
Skewness	1.898418
Kurtosis	7.875761
Jarque-Bera	39.78022
Probability	0.000000

Figure 6: Pre-merger AQ descriptive Statistics



Series: AQ	
Sample 2014 2018	
Observations 25	
Mean	0.048506
Median	0.040150
Maximum	0.191605
Minimum	0.002298
Std. Dev.	0.047867
Skewness	1.183607
Kurtosis	4.201705
Jarque-Bera	7.341456
Probability	0.025458

Figure 7:Post-merger AQ descriptive Statistics

Figures 6 and 7 show the descriptive statistics for pre-merge and post-merger AQ respectively. The mean pre-merger AQ was higher the post-merger AQ. This implied that that there was deterioration in AQ after the merger and this was shown to be significant by the ANOVA test. The median AQ was higher in pre-merger compared to after –merger. Both the maximum and minimum values of AQ were higher after the merger. Variability in terms of standard deviation was lower after the merger. The AQ data was positively skewed both before and after the merger. Post-merger Kurtosis was slightly lower than pre-merger Kurtosis. The pre-merger Jarque-Bera test statistic was 39.78022 with a probability of 0.000 implying that the null hypothesis of a normally distributed per-merger AQ would be rejected and a conclusion made that the pre-merger AQ was significantly different from normal but invoking the results by Ooko, Githui and Omurwa (2018) parametric testing would be done on the data. The post-merger Jarque-Bera test statistics was 7.341456 with a probability of 0.025458 implying that the null hypothesis of a normality distributed AQ would be rejected at 5 % significance level and a conclusion made that the AQ series was different from normal distribution.

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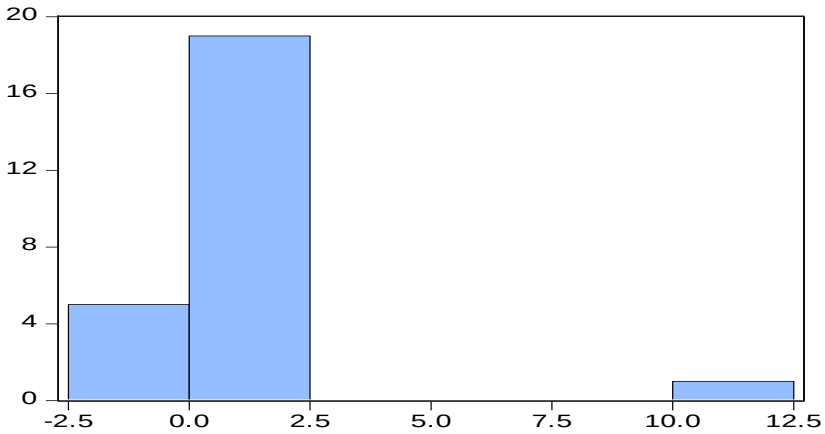

Figure 8: Pre-merger E Series Descriptive Statistics

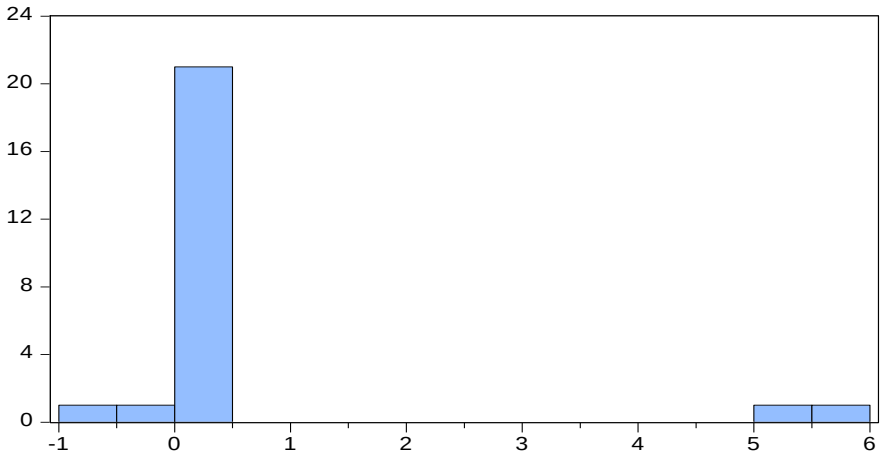

Figure 9: Post-merger E Series Descriptive Statistics

Figures 8 and 9 show the descriptive statistics for pre-merge and post-merger E respectively. The mean pre-merger E was higher the post-merger E. This implied that that there was deterioration in E after the merger and this was shown to be significant by the ANOVA test. The median E was higher in pre-merger compared to after –merger. Both the maximum and minimum values of E were higher after the merger. Variability in terms of standard deviation was lower after the merger. The E data was positively skewed both before and after the merger. Post-merger Kurtosis was slightly lower than pre-merger Kurtosis. The pre-merger and post-merger Jarque -Bera test statistics were 458.888 and 92.8064 both with probabilities of 0.00 implying that the null hypothesis of a normality distributed E would be rejected at all levels of significance and a conclusion made that the E series was different from normal distribution but invoking the suggestions by Ooko, Githui and Omurwa (2018), the series would be subjected to parametric statistical analysis.

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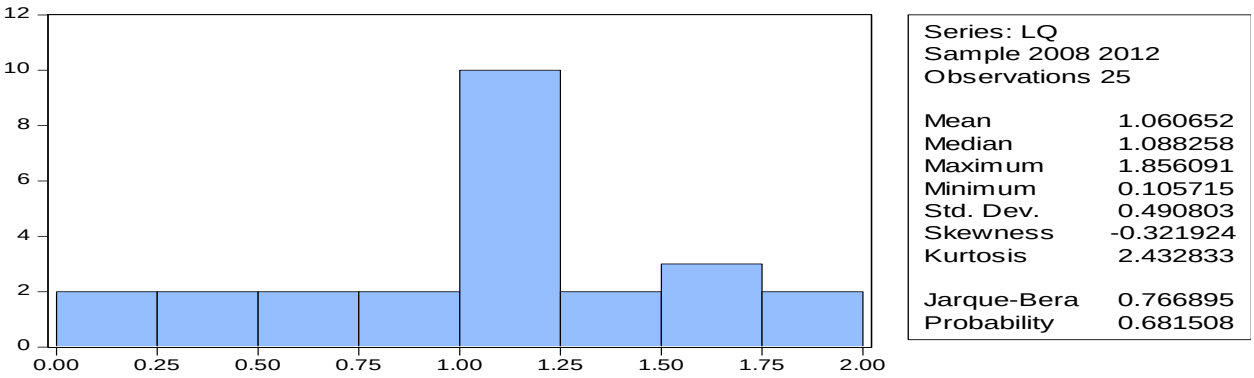
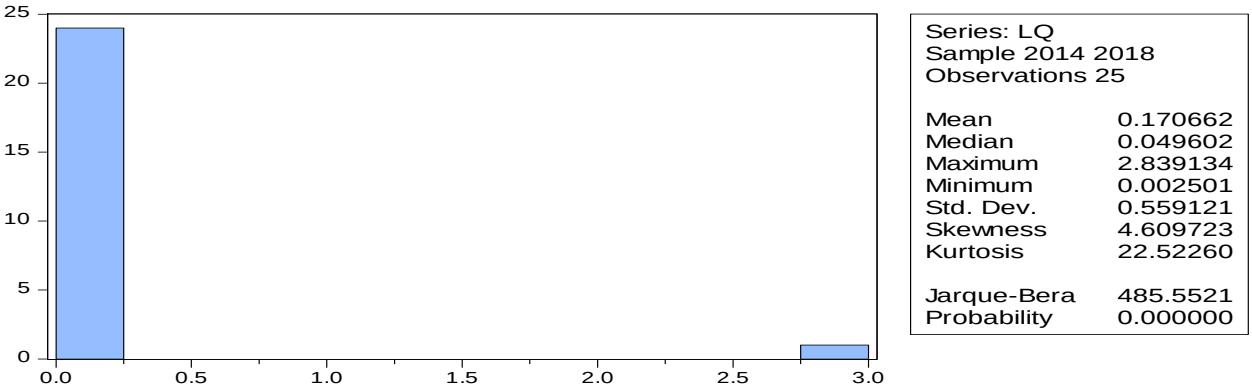


Figure 10: Pre-merger LQ Series Descriptive Statistics



Figures 11: Post-merger LQ Series Descriptive Statistics

Figures 10 and 11 show the descriptive statistics for pre-merge and post-merger LQ respectively. The mean pre-merger LQ was higher the post-merger LQ. This implied that that there was deterioration in LQ after the merger and this was shown to be significant by the ANOVA test. The median LQ was higher in pre-merger compared to after –merger. The maximum values of LQ were higher after the merger but the minimum value was lower after the merger. Variability in terms of standard deviation was higher after the merger. The LQ data was negatively skewed before the merger and positively skewed after the merger. Post-merger Kurtosis was lower in pre-merger compared to post-merger. The pre-merger Jarque-Bera test statistics was 0.766895 with a probability of 0.681508 indicating that the pre-merger LQ was normally distributed and would be subjected to parametric testing. The post-merger LQ had a Jarque – Bera test statistic of 92.8064 both with probabilities of 0.00 implying that the null hypothesis of a normality distributed LQ would be rejected at all levels of significance and a conclusion made that the LQ series was different from normal distribution. This implied that the results of parametric testing may not be accurate.

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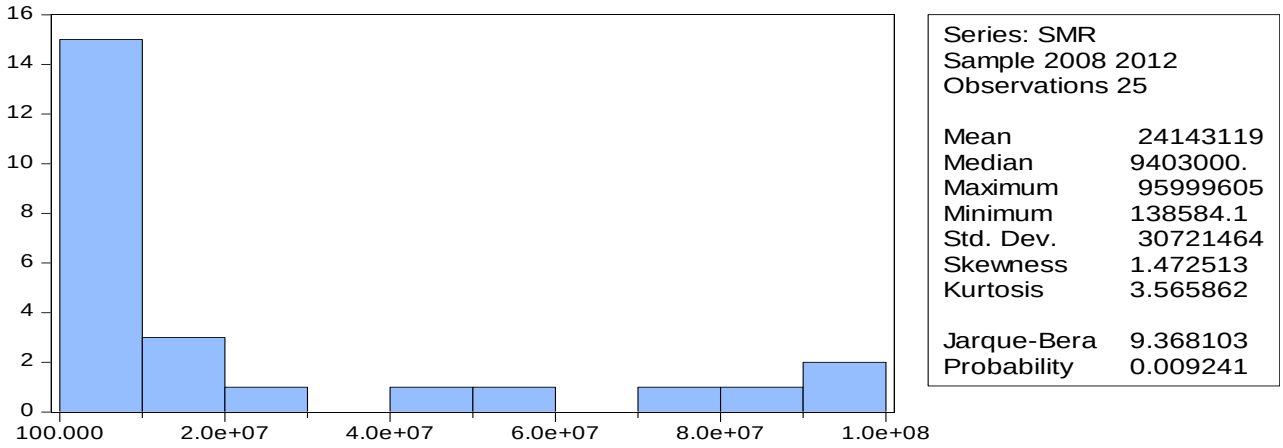

Figure 12: Pre-merger SMR Series Descriptive Statistics

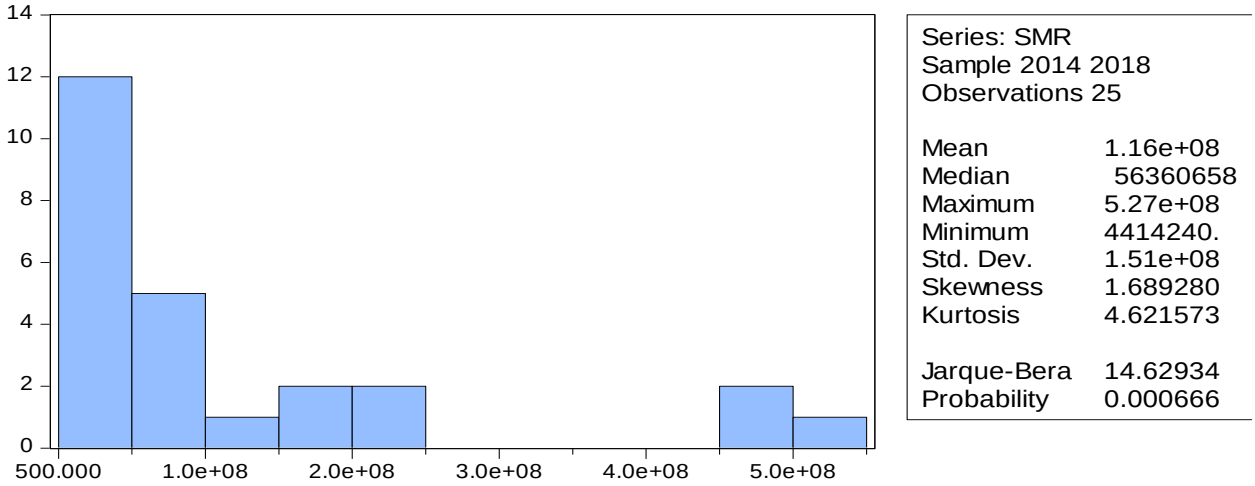

Figure 13: Post-merger SMR Series Descriptive Statistics

Figures 12 and 13 show the descriptive statistics for pre-merge and post-merger SMR respectively. The mean pre-merger SMR was lower than the post-merger SMR and this result was statistically significant as confirmed by the ANOVA test. The median SMR was higher in pre-merger compared to after –merger. The maximum values of SMR were higher after the merger but the minimum value was also higher after the merger. Variability in terms of standard deviation was higher after the merger. The SMR data was more positively skewed compared to pre-merger period. Post-merger Kurtosis was higher compared to post-merger. The pre-merger Jarque-Bera test statistics was 9.368103 with a probability of 0.009241 indicating that the pre-merger SMR was not normally distributed. The post-merger SMR had a Jarque – Bera test statistic of 14.62934 with a probability of 0.000666 implying that the null hypothesis of a normality distributed SMR would be rejected at all levels of significance and a conclusion made that the SMR series was different from normal distribution. This implied that the results of parametric testing may not be accurate.

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4.2 Regression Analysis

Table 1: Pre-Merger Regression Analysis

Dependent Variable: ROA

Variable	Coefficient	Std. Error	Prob.
C	-0.193647	0.055605	0.0025
CA	-0.000444	0.019506	0.9821
AQ	0.662147	0.554031	0.2467
E	0.008611	0.011806	0.4747
LQ	0.122769	0.040008	0.0063
SMR	6.54E-10	6.76E-10	0.3455
R-squared	0.470484		
Adjusted R-squared	0.331138		
F-statistic	3.376371		
Prob(F-statistic)	0.023791		

Coefficient of determination explains the extent to which changes in the dependent variable (Return on asset) can be explained by the change in the independent variables or the percentage of variation in the dependent variable that is explained by all the three independent variables (CA,AQ,E,L AND SM).The Pre-merger results show that CA, AQ, E and SMR were not significant in explaining bank performance according to ROA whereas LQ was statistically significant in explaining pre-merger bank performance. The five independent variables that were studied, contribute 33.1% of the effects of mergers and acquisition on the financial performance of commercial banks prior to the merger/acquisition as represented by the R^2. This therefore means that there are other factors not studied in this research which contributes 66.9% of the impact of mergers and acquisition on the financial performance of commercial banks in Kenya. Therefore, further research should be conducted to investigate these factors affecting (66.9%) the changes noted in the financial performance of commercial banks following the merger/acquisitions.

The model had a low explanatory power with an adjusted R-squared of 33.1% but significant as whole since the F-statistic of 3.37371 had a probability (F-statistic) of 0.023791 implying significance at 5%.

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Table 2: Post-Merger Regression Analysis

Dependent Variable: ROA

Variable	Coefficient	Std. Error	Prob.
C	0.001843	0.009581	0.8495
CA	-0.003285	0.005953	0.5875
AQ	0.081215	0.110164	0.4700
E	0.161318	0.003185	0.0000
LQ	-0.001342	0.008667	0.8786
SMR	-3.49E-11	2.97E-11	0.2544
R-squared	0.993985		
Adjusted R-squared	0.992402		
F-statistic	627.9487		
Prob(F-statistic)	0.000000		

The Post-merger results show that CA, AQ, LQ and SMR were not significant in explaining bank performance according to ROA whereas E was statistically significant in explaining post-merger bank performance. The model had a high explanatory power with an adjusted R-squared of 99.2402% and significant as whole since the F-statistic of 627.9487 had a prob (F-statistic) of 0.00000 implying significance at all levels of significance.

Table 3: Test for Equality of Means of ROA

Method	df	Value	Probability
Anova F-test	(2, 47)	363.9073	0.0000

In terms of the overall performance, the null hypothesis was that there was no difference between the pre- and post-merger return on assets. The results, in table 3, showed that the F-test value of 363.9073 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger return on assets was different from pre-merger return on assets for commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger return on assets was higher than pre-merger return on assets.

Table 4: Test for Equality of Means of CA

Method	df	Value	Probability
Anova F-test	(3, 46)	206.2354	0.0000

Concerning the capital adequacy, the null hypothesis was that there was no difference between the pre- and post-merger capital adequacy. The results, in table 4, showed that the F-test value

of 206.2354 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger capital adequacy was different from pre-merger capital adequacy commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger capital adequacy was lower than pre-merger capital adequacy.

Table 5: Test for Equality of Means of AQ

Method	df	Value	Probability
Anova F-test	(2, 47)	43.05369	0.0000

Concerning the Asset Quality, the null hypothesis was that there was no difference between the pre- and post-merger asset quality. The results, in table 5, showed that the F-test value of 43.05369 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger asset quality was different from pre-merger asset quality for commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger asset quality was lower than pre-merger asset quality.

Table 6: Test for Equality of Means of E

Method	df	Value	Probability
Anova F-test	(3, 46)	1987.087	0.0000

Concerning the earnings, the null hypothesis was that there was no difference between the pre- and post-merger earnings. The results, in table 6, showed that the F-test value of 1987.087 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger earnings was different from pre-merger earnings for commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger earnings were lower than pre-merger earnings.

Table 7: Test for Equality of Means of LQ

Method	df	Value	Probability
Anova F-test	(2, 47)	149.9994	0.0000

On liquidity, the null hypothesis was that there was no difference between the pre- and post-merger liquidity. The results, in table 7, showed that the F-test value of 149.9994 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger liquidity was different from pre-merger liquidity for commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger liquidity was higher than pre-merger liquidity.

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Table 8: Test for Equality of Means of SMR

Method	df	Value	Probability
Anova F-test	(2, 47)	176.2593	0.0000

On sensitivity to market risk, the null hypothesis was that there was no difference between the pre- and post-merger sensitivity to market risk. The results, in table 8, showed that the F-test value of 176.2593 was significant with a p-value of 0.000. This led to the rejection of the null and acceptance of the alternate hypothesis that post - merger sensitivity to market risk was different from pre-merger sensitivity to market risk for commercial banks in Kenya. The mean obtained from descriptive statistics showed that the post-merger sensitivity to market risk was higher than pre-merger sensitivity to market risk.

5.0 Conclusions

Concerning the overall objective of comparing pre-merger with post-merger bank performance and if return on assets (ROA) were the only aspect of performance that was interest then it would be concluded that the post-merger was higher that pre-merger ROA indicating that that merged/acquired banks had improved in performance. This study measures the effects of M & A on the operating performances of acquirer banks in Kenya over a period of 5years i.e. 2002-2011. The pre- and post-merger performances are compared and the degree of change is tested with regression analysis. It was observed that overall objective of comparing pre-merger with post-merger bank performance and if return on assets (ROA) were the only aspect of performance that was interest then it would be concluded that the post-merger was higher that pre-merger ROA indicating that that merged/acquired banks had improved in performance. When other measures of financial performance were incorporated based on the CAMEL and leaving out "M" since M is more of a HR issue, it would be concluded that the capital adequacy of the merged banks did not improve, nor did the asset quality, nor the earnings but liquidity and sensitivity to market risk greatly increased for the merged banks.

6.0 Recommendation

From the findings on the testing of the significance of the independent variable before and after merger, the study found that there was improvement in financial performance, in terms of ROA and liquidity. However, sensitivity to market risk greatly increased after bank merger/acquisition.

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