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MERGERS AND ACQUISITIONS ON THE MARKET PERFORMANCE OF COMMERCIAL BANKS IN KENYA: A CASE STUDY OF THE KENYAN BANKING INDUSTRY

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ABSTRACT

The purpose of this study was to determine the influence of mergers and acquisitions on the market performance of commercial banks in Kenya. Mergers and Acquisition are primarily pursued in effort to strategically position business in a competitive sector. However, the role of mergers and acquisitions on the firm's market position post-merger is less studied thus informing the need for this study. Four market driving factors notably; volume of business transactions, customer base value, capital investment value and competitive advantage were examined in the study in relation to mergers and acquisitions within the banking sector. The study employed descriptive survey technique as the research methodology. Target population included frontline marketing and business development practitioners in the banking sector. All the respondents were employees of listed commercial banks in Kenya, which accounted for 53% of the total market share in the financial services industry. Linear regression analysis was utilised in analysing the data collected from the field survey. The study established that mergers and acquisitions accrued positive effect for commercial banks, recording outcomes such as; increased volume of business transactions, increased customer base value, access to more capital investment and enhanced competitive advantage. The study concluded that successful mergers and acquisition deals result in boosting the firm's market position in all areas of customer value, capital investment and competitive advantage. The study recommended for effective and open communication of information relating to mergers and acquisitions within the banking sector as it impacts on customer confidence and loyalty. The study also recommended for increased investments towards product and services quality improvement post-merger in order to maximise prospects for competitive advantage.

Key Words: *Mergers and Acquisitions, Commercial Banks in Kenya*

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INTRODUCTION

Mergers and acquisitions are common in business practices. This is attributable to the fact that businesses exists in highly competitive and changing environments necessitating strategic changes in its operations which includes mergers and acquisitions. Though used interchangeably, mergers and acquisitions are different in its definition. Mergers refers to the situation where two companies fuse and operate as one business entity. According to Koi-Akrofi (2016), mergers occurs when one company acquires the whole assets of another company. Conversely, acquisitions refers to purchase of part of the assets by one company from another business entity. In the scenario of acquisitions, the firms may continue to operate as separate entity but one firm can have a majority shareholding or have the controlling stake (Koi-Akrofi, 2016). Accordingly , mergers can be horizontal, vertical or conglomerate which is backed by a unique purpose that an organization wants to achieve.

Mergers and acquisitions in business can be traced back to 1890s in the United States (Junni and Teerikangas, 2019). During the early periods, the mergers took the horizontal form which leads to the creation of big manufacturing firms. A report by Pricewaterhouse Coopers, PwC, (2020) noted that mergers and acquisitions have traditionally occurred in waves fuelled by a certain prevailing circumstance in the market. For instance, mergers and acquisitions (M & A) occurring at the turn of the new millennium were fuelled by internet boom while those occurring between 2004 and 2007 occurred because of cheap credit available in Asia. Other factors like globalization played a major role in the current M&A trends in the world.

Mergers and acquisitions are complex and challenging activities with some degree of risk. If not executed well, M&A is bound to fail (Junni and Teerikangas, 2019; PwC, 2020). Consequently, management of organizations should treat M&A activities as a top priority (Galpin, 2018). The move allows the firms to prepare adequately for the M&A process and allocate sufficient resources to the process. According to Okofo-Dartey (2019), firms should employ competent human resources to oversee the M&A process to minimize the risks of failure.

Several scholars have explored the best practices in M&A execution process. Galpin (2019) proposed seven steps that firms should follow when carrying the M&A exercise. The steps stresses on identifying appropriate partners, drawing up a road map for implementation, resource allocation, coordination between teams overseeing the process, developing a plan of action, prepare a plan for the change, and carrying out continual modifications to the process when necessary. On the other hand, Okofo-Dartey (2019), pointed out that M&A should abide by prudent management practices, proper research, and allocation of resources to arrive at successful implementation of M&A. Also, banks shall appoint competent investment managers or consultancy firms to oversee the M&A process.

Mergers and acquisitions are common in the banking sector. Factors like globalization and financial liberation plays an important role in pushing for strategic alliances in the global banking industry. Globally, banks use the strategic alliance to improve the bank's competitive edge, penetrate new markets, and improve their profitability. According to Ghosh and Dutta (2016), banks in India realized economic benefits from M&A activities since the strategic alliances granted banks in India a slight advantage in the industry. However, the scholars noted that M&A affected the share prices of the banks involved in the strategic alliances in the end. In the short term, a study carried out on banks in the Middle East and North Africa by Sindi et al (2015), established that announcements of M&A have a profound effect on the profitability of organizations due to the behaviour of the shareholders in anticipation of the impending change. A study by Goglio and Kalmi (2017), noted that whereas banks used strategic alliances like M&A to cut costs and reduce risks, banks in Europe did not realize economies of scale from their M&A

activities. Rao-Nicholson and Salaber (2016), in their study of the effect of financial predicaments on M&A, noted that cross border strategic alliances among banks grew during the financial crisis in the 90s as well as the period of 2007 to 2013.

The studies carried out in the global setting revealed, that the M&A in the global banking sector has risen considerably in the last four decades. This resulted from the changes and developments in the global financial sector that necessitated the need for strategic alliances. Various pieces of the literature suggest that M&A in the global banking industry pose some benefits to stakeholders while some aspects like stock prices experience negative growth.

Regarding the regional level, M&A in the banking industry in the African continent has increased considerably in the recent past. The trend appears to follow the happenings in the global banking industry where factors like globalization as well as financial freedom mediated the need for strategic alliances. A study by Hassan and Lukman (2020), noted that risks, poor governance, and inefficiencies in the Nigeria banking industry triggered M&A with the blessings of the Nigerian Central bank. Also on the Nigerian banking industry, a study by Abdulazeez, Suleiman, and Yahaya (2016), noted that the reforms in the Nigerian banking sector forced the realignment and structural changes of banks in the country thus giving rise to strategic alliances in the sector.

On the other hand, the South African banking sector appears unique since oligopolies control almost 90% of the banking industry (Wanke, Maredza, and Gupta, 2017). Presence of oligopolies in the industry indicates the existence of M&A activities in the sector. However, according to Wanke et al (2017), the presence of oligopolies in the South African banking sector presents a problem in determining the economies of scale of such a strategic alliance. Other studies indicate that the growth and development of the African banking sector relys heavily on the regional economic blocks like ECOWAS and EAC (Wilson and Bala, 2019). This means that the cross border M&A in Africa occurs within the confines of the laws governing M&A in the trade block.

The mergers and acquisitions in the Kenyan banking sector peaked in the last decade. These events generated a lot of interest in the academic and business communities as they tried to establish the motivation behind the strategic manoeuvres adopted by the Kenyan banks. A study by Ombaka and Jagongo (2018), determined that the need to spread risks, improve economic prospects, and acquire new markets drove M&A in Kenya. Mugo (2017), noted that both financial and non-financial needs drove banks to form strategic alliances. For instance, in the Kenyan market, banks are driven by the need to acquire more portfolios to undertake M&A to improve their survival chances in the market. However, to protect small firms from being crowded out of the market, Mugo (2019), noted out that M&A in Kenya is conducted strictly according to the law and subject to the approval of the National treasury and other industry regulators. Mwangi (2018), pointed out that a large firm has a better chance of profitability than small business entities. The scholar suggests that banks in Kenya, in search of profitability and better economic prospects engage in M&A.

Problem Statement

Most studies carried out on M&A in the banking industry fail to yield consistent results on the performance of banks. Various studies carried out globally on the effects of M&A on the business indicate that strategic alliances fail to realize economic benefits to the firms that engage in it. A report from PwC (2020), indicates that 50% to 80% of the business entities that merge or acquire part of the assets of another company end up failing or performing dismally in the market in the long run. Additionally, a study carried out in Pakistan by Rhaman, Ali, and Jebran (2016), observed that M&A in the banking industry yielded negative returns to the firms engaged in the strategic transaction.

Yet other studies indicated that M&A is profitable in the short term especially when M&A

announcements are made to the shareholders by the acquiring firms. This introduces some degree of doubt on the effectiveness of M&A as a business strategy and warrants a deeper analysis to reveal how strategic alliances affect the performance of the organization. Studies carried out on a global scale indicates that M&A is becoming a popular business strategy that is being adopted by business entities across many industries. The banking industry has not been left behind in this respect.

In the Kenyan banking sector, M&A has been rampant in the last decade. Although several studies have been carried out on the effects of M&A on the performance of the firms in the banking sector, the findings of the studies were inconclusive enough to answer the study questions for this study. Furthermore, the past studies included microfinance banks and other financial institutions in the ample size hence the need to carry out a study that is lean and targets only the commercial banks in the Kenyan banking industry.

LITERATURE REVIEW

Modern Portfolio Theory on Mergers and Acquisitions

Modern Portfolio theory was proposed by Markowitz in 1952, and thereafter been generalized by the scholars and applied to various aspects of finance. According to Maier-Paape and Zhu (2018), portfolio theory holds the premise that organizations should pay more attention to the benefits of carrying out a business transaction having factored in the risks and the expected returns. Esfahani, Sobhiyah, and Yousefi (2016), explained that portfolio theory allows the firms to implement a certain business strategy for a certain expected return based on certain amount of risks. Lee, Cheng, and Chang (2015), pointed out that the modern portfolio theory seeks to maximize returns or minimize risks from an investments transaction. This implies that, firms should expect a certain amount of risks when implementing business strategies like M&A as long as the risks fall below the expected returns. Additionally, Esfahami et al (2016), pointed out that an appropriate trade-off requires the organization to carefully select the factors of a portfolio. In this regard, Bodnar, Mazur, and Pdgorski (2015), noted that Markowitz proposed a mathematical model appropriate for the section of the elements of the portfolio. The mathematical formula proposed assigning of weights on the components of a portfolio using historical data.

The modern portfolio theory applies to this study. This is because; M&A is an investment decision that must be made by an organization. In so doing, an acquiring organization must carefully select the desirable elements in a portfolio and assign weights to them based on the historical data available. This practice is supported by various scholars who proposed that an organization aiming to acquire the whole or part of the assets of another organization should carry out due diligence (Okofo-Dartey, 2019; Galpin, 2019). Additionally, firms should gauge the benefits of a possible merger or acquisition transaction given the existing risks. This move is fully supported by the modern portfolio theory. Therefore, modern portfolio theory applies to this study.

Mergers and Acquisitions and Market Performance

The volume of Business Transactions

Business entities record a heightened number of business transactions during the announcement of M&A. This is attributed to the realignments that shareholders undertake due to the expected economic impact of strategic alliances. However, the increasing numbers of transactions are short term and slow down a few days after the acquiring firm has announced M&A activities being undertaken by the firm (Heuver, 2019). A study by Tao, Liu, and Gao (2017), on the Chinese banking industry confirmed that the volume of business transaction reduced post-Merger and acquisition. The study by Tao et al (2016), confirmed a study by Yaghoubi et al (2015), that sales decreased slightly after M&A. Another study conducted on the Indian banking sector by Ghosh and Dutta (2016), established that net sales increased after M&A

which can be a strong indicator that volume of transactions went up after the strategic alliance. Existing studies do not explain conclusively the reducing number of transactions after M&A.

In Kenya's banking industry, the volume of business transactions vary from firm to firm and therefore a conclusive finding cannot be drawn from the past studies (Mugo, 2017). A study conducted by Muchoki and Njuguna (2020), supported the view that the volume of business transaction realized by firms after merger and acquisition depended on the marketing strategies put in place by the acquiring firms. The arguments by the scholars indicate that the volume of transactions resulted from the individual efforts of the firms and was not necessarily influenced by the M&A transactions.

Customer Base Value

Mergers and acquisitions lead to a larger customer base for the organizations involved. According to a study carried out by Ghosh and Dutta (2016), on Indian banking firms noted that banks that merge enjoy the benefits of having a larger customer base than banks than have not gone through M&A. Besides the increasing number of customers, M&A led to an increase in the number of bank branches as well as access to new markets. Additionally, M&A in the banking industry has been found to boost customer confidence in the banking sector. A study conducted in Nigeria targeting the effects of M&A on banks financial performance determined that more customers expressed confidence in the banking sector on account of integrations (Abdulazeez, Suleiman, and Yahaya, 2016).

In the Kenyan situation, the number of customers for a particular bank improved due to the effects of M&A. Various studies conducted on the Kenyan banking industry revealed that acquiring firms derived customer base value from the M&A activities. Muchoki and Njuguna (2020), explained that firms need to put in place prudent customer management activities aimed at recruiting and maintaining the existing customer base, post-merger and acquisition. Organizations that succeed to convince the customers to buy more of their products are likely to drive more value from the customer base. Njambi and Kariuki (2018), pointed out that the level of customer conversion rate to bring active business to amalgamated firms determines the financial position of the company in the long run.

The finding of the studies analyzed in this section demonstrate that M&A increase the customer base of the acquiring organization, however, the specific strategies employed by the firms will determine the value that they reap from the huge customer base. On the other hand, the customer must derive value from the banks they are associated with and will cease their engagements with the bank if they realize no benefit. This implies that M&A is vital in expanding the customer base but the value is a dependent variable.

Capital Investments Value

The capital base has a significant impact on the market performance of banks across the world. In a study targeting the effects of M&A on the Nigerian banking sector, Abdulazeez and Yahaya (2016), noted that Nigerian banks used M&A to achieve the appropriate capital base to sustain their operations. However, the connection between capital investments and market performance is not elucidated in the study. Additionally, Küçükkocaoğlu and Bozkurt (2018), analysis on the effects of M&A on the performance of Turkish financial institutions established that cross border M&A led banks to obtain foreign capital investments thus strengthening their operations in the market. This gave the firms the necessary financial strength to out maneuver the competitors in the market.

In the Kenyan banking industry, Muchoki and Njuguna (2020), while conducting a study of the effect of M&A on financial performance noted that firms use strategic alliances to gain more capital investments value. The net effects of such a move means that firms gain more capital to run their operations and obtain the necessary cushion against financial turbulence that threaten the survival of smaller firms. Additionally, the capital structure of an organization determines its ability to

be a candidate for M&A. In this respect, Ombaka and Jagongo (2018), noted that banking firms seeking to acquire part or whole of the assets of another bank carry out extensive research in the capital form of the targeted organization to find out its eligibility for M&A.

The study analyzed in this section reveal that banks use M&A as a vehicle for obtaining more capital investments. However, the values derivable from the capital investments depend on the bank's ability to put in place prudent financial management practices. Additionally, the study reveals that the capital structure of a firm enables the firm to be a potential candidate for a takeover. However, the study does not conclusively demonstrate how the market performance of a firm can be improved due to M&A.

Business Competitiveness Value

Mergers and acquisitions have a profound effect on the competitiveness of the acquiring firm. For instance, the study by Abdulazeez and Yahaya (2016), on the Nigerian banking sector noted that M&A improved the competitive edge of the banks in the country. This finding is not isolated since various researchers support this outcome. Heuver (2019), noted that M&A allowed firms to gain critical assets that allowed it to become competitive in the market. Küçükkocaoğlu and Bozkurt (2018), established that firms increased their competitiveness in the market once the merger and acquisitions occurred. This was strengthened by the fact that firms that got involved in M&A acquired more customers, assets, and capital investments hence improving their competitiveness in the market. In yet another study, Shah and Khan (2017), observed that M&A improved the market share of the financial institutions by doing away with the competition.

However, this type of M&A appeared to affect the competitiveness of the firm, in the study conducted by Heuver (2019), vertical mergers led to profitability due to stability of the market while horizontal mergers were more profitable when the market was unstable. Furthermore, on this respect, Shah and Khan (2017), noted that horizontal mergers led to decrease in the operational performance of the firm due to decreasing competitiveness in the market.

In the local setting, competitiveness appears to be a driving factor behind business consolidation and strategic alliances. According to Njambi and Kariuki (2018), banking industry in Kenya considered M&A as a strategy to overcome competition in the market. Conversely, Muchoki and Njuguna (2020), noted that players in the Kenyan banking industry consider M&A as a tool for overcoming competition since the process accord firms the competitive edge in the market. The success of the strategy of competitive value as a reason for M&A in the Kenyan commercial banking industry is not clear and more studies are needed to deeply examine the matter.

METHODOLOGY

The study employed descriptive survey design as the technique for conducting research process. Target population for the study included frontline banking staff drawn from 6 listed commercial banks that control over 53% of total market (Ndambiri, 2019). Business development and marketing strategies experts working within the Kenyan banking ecosystem formed the main stakeholders with sufficient understanding on the topic of study. As such, banking staff attached to business development division and marketing departments were the main respondents of the study. The staff were drawn from the 6 listed commercial banks which include; Kenya Commercial Bank (KCB), Equity Bank, Cooperative Bank, Standard Chartered Bank (K), Absa Bank of Kenya and CFC Stanbic Bank. The study employed random sampling to identify the respondents of the study. A sample size of 109 people was calculated for the study. A structured close-ended questionnaire was the preferred tool for data collection. Content validity was employed in this study to aid on extracting main determinants of mergers and acquisitions within the purview of market performance. Determinants of the study that are relative to the performance of the study

include; volume of business transactions, customer base value, capital investments value, business competitiveness value. The study employed regression analysis techniques in evaluating the data collected from the field survey. Linear regression model integrating all the variables of the study was presented highlighting the existing levels of association between the independent variables notably; volume of business transactions, customer base value, capital investment s value, business competitiveness value and dependent variable market performance.

FINDINGS

Multivariate linear regression test was carried out evaluating the influence of independent variables mergers and acquisitions notably; volume of business transactions, customer base value, capital investments value and business competitiveness value against the dependent variable market performance.

The results in table 1 presented the model summary of the test which records r-value of 0.833 and r-squared value of 0.694. These results implied that a strong positive correlation (R=.83) exists between mergers and acquisitions and market performance in the banking sector. Furthermore the results implied that, M&A factors including volume of business transactions, customer base value, capital investments value and business competitiveness value account for 69.4% ($R^2 = 0.694$) of variability in market performance within banking industry. Also, the findings showed that 30.6% of variability in market performance for banking industry is attributed to factors external to mergers and acquisitions.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.833[a]	.694	.680	1.26136
a. Predictors: (Constant), volume of business transactions, customer base value, capital investment value, business competiveness value				

The results in table 2 presented the analysis of variance results for the regression test. The test deduces, F-statistic value, $F(5, 103) = 46.808$, with a p-value of 0.000 ($P < 0.01$). The findings implied that recorded variances for both the dependent and independent variables are different hence can be included in the model. The results also implied that there exists a significant statistical association between mergers and acquisitions factors notably; volume of business transactions, customer base value, capital investments value, business competitiveness value and market performance and significant at 0.01 significance level.

Table 2: ANOVA for the Regression Test

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	372.363	5	74.473	46.808	.000[b]
	Residual	163.875	103	1.591		
	Total	536.239	108			
a. Dependent Variable: Market performance						
b. Predictors: (Constant), volume of business transactions, customer base value, capital investment value, business competiveness value						

The results in table 3 presented the coefficients for the linear regression test between mergers and acquisition factor versus market performance. The unstandardized beta coefficients presented the value of influence for each independent variable on the dependent variable (market performance) and can be drawn in the model.

The model equation for the study is:

Y (market performance) = $\beta_0X_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \acute{\varepsilon}$ where; β_0X_0 = constant, X_1 = volume of business transactions, X_2 = customer base value, X_3 = capital investment value, X_4 = competitive advantage, $\beta_{1,2,3,4}$ = beta coefficients and $\acute{\varepsilon}$ = error term.

Therefore the deduced regression equation for the study will be:

Market performance = 4.424 + 0.134* volume of business transactions + 0.016* customer base value +0.193*capital investment value + 0.093* competitive advantage.

The results of the equation deduced implies that, upon execution of a merger and acquisition deal; for every unit change recorded for volume of business transactions it triggers a 0.134 units change in market performance, for every unit change recorded for customer base value triggers a 0.016 units change in market performance, for every unit change recorded for capital investments value, it records a 0.193 units change in market performance and finally, for every unit change in competitive advantage, results in a 0.093 units change in market performance.

Table 3: Coefficients for the regression test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.424	1.398		3.165	.002
	Volume of business transactions	.134	.041	.240	3.259	.002
	Customer base value	.016	.045	.027	1.357	.001
	Capital investment value	.193	.057	.306	3.405	.001
	Business competiveness value	.093	.051	.164	1.813	.073
a. **Dependent Variable**: Market performance						

Discussion

The study established that mergers and acquisitions contributed positively towards boosting the cumulative value of transaction volumes for business activities. The results showed that combined business value in case of a merger or a business acquisition, contributed towards rallying the amount of recorded transactions in the aftermath. These findings agree with submissions of Ghosh and Dutta (2016), who found that net sales increased post M&A. Similarly the findings are in line with Muchoki and Njuguna (2020), who established that M&A wielded a significant factor on the overall business volumes.

The study found that mergers and acquisitions directly impacted on the customer base. Upon the commencement of operations post M&A period, the organizations involved accrued an equivalent share of customers corresponding to the particular firm whose business assets have been acquired. In banking industry, M&A results in more prospects for expanding the customer base who are critical in determining the market value of M&A deals. These findings are consistent with Abdulazeez et al.

(2016), who explained that M&A boosted business performance attributed to increased customer activity and loyalty to the firm services post-merger. Also, the findings in this study were echoed in Njambi and Kariuki (2018), who submission of conversion rate of customers was valuable in the post-merger phase towards boosting the overall financial performance.

The study established that mergers and acquisitions formed a good model for raising business capital. Findings showed that, M&A deals were characterized by injection of new capital in order to raise and enhance business operations post-merger. Also, badly performing businesses due to declining cash-flow and operational capital were better placed with pursuing a partnerships or M&A deals in effort to boost business confidence. These findings are consistent with Abdulazeez and Yahaya (2016), who found that M&A deals in the banking sector created an avenue for boosting access to new capital injection.

The study made a finding that mergers and acquisitions wield a positive effect in the market position. Increasing stake in market share was directly reflected in the business performance which formed the primary motivation of businesses to embrace M&A deals. Further, increased market foothold was attributed to competitive advantage acquired in the process of business assets acquisition phase. These findings are supported in studies by Heuver (2019), and, Küçükkocaoğlu and Bozkurt (2018), who all established that M&A contributed positively towards boosting firm's competitive advantage in post-merger phase.

CONCLUSION AND RECOMMENDATIONS

The study concluded that the success of mergers and acquisitions in the banking sector is pegged on the incremental value within the scope of business transactions. Firms pursuing M&A deals seek to explore positive growth in business operations which is fundamental towards boosting the financial performance of the business.

The study also concluded that the expansion of customer base forms a key determinant in the success of M&A deals in the banking industry. Existence of a strong foundation for customer base determines the future growth prospects of banking firms involved in a merger or acquisition.

The study concluded that access to capital forms a critical determinant and driver of M&A deals. Success of M&A is pegged on capital injection towards boosting operational front and funding business expansion efforts.

The study concluded that mergers and acquisitions in banking sector wields an effect on the competitive advantage of the firms involved. Therefore, M&A factors for boosting business competitiveness in a highly competitive industry increases prospects of more M&A deals within the banking industry.

The study made the following recommendations;

- Mergers and Acquisitions deals should seek to combine operational congruence. Firms that have similar operational and business models are better placed in recording positive operational success post M&A.
- Mergers and Acquisitions deals should be designed with the intentions of boosting business value for firm's customers. Creating value for customers plays a critical role in driving operational and financial success.
- Information related to mergers and acquisitions deals should be made public and be accompanied by official public launch in order to project confidence and maintain public trust. This is critical in effort to maintain customer confidence and loyalty post-merger.
- Mergers and Acquisitions deals should be flowed by capital injection in the post-merger phase which should be channeled towards enhancing product quality and product innovation. This is critical in boosting market presence and upholding market competitiveness.

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