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INFLUENCE OF MERGERS ON PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

The objective of this study was to establish the influence of mergers on performance of commercial banks in Kenya. The specific objectives were to evaluate the influence of horizontal merger, vertical merger, lateral merger and conglomerate merger on the way commercial banks in Kenya perform. The study was descriptive research design. The target population for the study was the 231 employees of 32 banks that merged in the period 1994 to 2016 in Kenya. The study sampled 67 respondents out of 231. Stratified random sampling techniques were used to draw the sample. The study collected primary data using questionnaires. Secondary data was gathered from existing credible and recognized sources. Validity and reliability of the questionnaire was determined by performing pilot study. Administration of the questionnaire was done by the researcher using self-administration technique. The Quantitative data collected was analyzed by the use of descriptive statistics using SPSS (Version 21) and presented through percentages, means, standard deviations and frequencies. Content analysis was applied in testing data that was qualitative in nature. The study found that horizontal merger, vertical merger, lateral merger and conglomerate merger had a positive influence on performance of commercial banks in Kenya. The study recommended commercial banks managers to be disciplined in order to ensure that they govern the organization in a good way; they should also encourage development of technology. The management of the institution should also focus on improving the competitiveness of the company as well as their financial performance when entering into a merger and not only their improvement in operations and sustaining their failing operations. The study further recommended management of banks to come up with sound strategies to manage assets as well liabilities.

Key Words: *Organization Merger, Horizontal, Vertical, Lateral, Conglomerate, Commercial Banks*

INTRODUCTION

There are several factors that have led to change of business ownership or merger of businesses, these factors include; change in business environment, competition, existence of many institutions that are licensed mainly being commercial banks. The main reason why merger happens is because businesses want to achieve increased market share, better their performance, attain competitive advantage, and have diversified products (Akinbuli & Kelilume, 2013). It can be clearly noticed that mergers have been on the rise because of the financial crisis experienced worldwide. The reason for organization merger is not just for competition but also to maintain the business being firm in the industry; leading to great change in the landscape of business (Tajalli & Shehzad, 2014).

Growth of a corporation and improved performance are some of the reasons why some of the businesses Organizations are formed. The main element that is used to measure success of a business is its profitability. When the economy is unstable, the growth of business organization is on the threat this is because of the dynamic nature of the business environment (Weston & Copeland, 2013). Shleifer and summers (2012) argued that the main reason that motivates take overs is the fact that they reduce the cost incurred on labour and reduces wages. Acquisition or mergers can have a great impact on the growth of a company in the long run. Despite the fact that acquisition might transform the company that acquires in a very short time, there are some risks that are involved since it has been estimated that only half of the mergers are successful (Tajalli & Shehzad, 2014).

In Kenya the banking sector has faced a lot of developments from the year 1990s. The main foundation of the merger is the belief that they will benefit from the merger. There were a total of 15 mergers experienced from the year 2005 and 2015. This study seeks to establish the influence of mergers and acquisition on performance of commercial banks in Kenya.

Problem Statement

The way commercial banks in Kenya perform has been impressing. During the 1st quarter if the year 2015 the banking industry recorded pretax profits of Ksh. 37.3 billion, which had increased from Ksh. 36.32 billion translating to 2.7% increment from the previous quarter of 2014 (CBK, 2015). Also the profits of the industry increased from Ksh. 33.4 billion to Ksh. 37.3 billion from March of 2014 to March of 2015 (CBK, 2015). The banking sector benefits from merger since there is improved delivery of service, efficiency and performance (Wayland & Cole, 2009). Merger is of great importance in the banking sector since it leads to improved performance (Kamau, 2011).

Mergers have become the main way through which high performance can be attained which is the ultimate goal of every firm, including banks. Many studies carried out in the area of M&A have established inconsistent results. A study by KPMG International found that 75% to 83% mergers do not succeed. When productivity is low, labour unrest, increased level of absenteeism and reduced value of shareholder means that the organization is failing. There are other cases it implies the well-publicized dissolving of the combination. The fact is that it’s much harder to make a deal work than to make the deal itself (Nguyen and Kleiner, 2002). Lev and Mandelker (1972) did a study on 69 companies by having a comparison of the way the merged companies performed by having a comparison of 5 years before merger and 5 years after the merger and reached a conclusion that he market value of those companies that acquired other companies increased by 5.6 percent. Powell and Yawson (2015), did an examination of those acquirers companies in the UK and revealed that some of the companies that merger earn return rates compared to those companies that relied on internal growth. However they weren’t able to determine positive association between profits level and level of merger. Dymski (2013) did an examination of seventeen firms which had merged between the years 1985-1998 and revealed no evidence that companies that are merger intensive have high profit levels than the coverage industry.

Empirical studied done include, a study by Marembo (2011) that looked at the impact of mergers and acquisition on the financial performance of 32 commercial banks in Kenya. Adebayo and Olalekan (2012 investigated the impact of merger and acquisition on commercial banks performance in Nigeria. Muia & Fidelis (2012) examined some of the markets and industry variables as variables determining merger and acquisition and how they affect the growth of companies; a case of Kenya. Despite there being several studies done on mergers, the findings from the study conflict with each other on how the mergers affect businesses in Kenya. This study thus sought to fill this gap, by investigating the influence of merger on performance of commercial banks in Kenya'.

Research Objective

- To evaluate the influence of horizontal merger on performance of commercial banks in Kenya
- To assess the influence of vertical merger on performance of commercial banks in Kenya
- To determine the influence of lateral merger on performance of commercial banks in Kenya
- To establish the influence of conglomerate merger on performance of commercial banks in Kenya

METHODOLOGY

This study used descriptive research design. This type of design uses various techniques and procedures in describing a variable. I this design the following are involved; collecting information which describes a particular event, tabulating it, depicting and describing it. This type of research design explains a variable by providing answers to "who, what, and how" questions (Babbie, 2009). This study sought descriptive research design because it involved use of questionnaires. Yin (2013) recommended descriptive design because it allows the researcher to describe, record, analyze and report a phenomenon as it is.

On model specification and for the variables under investigation, it was fit to have the following model to help explain the relationship between the explanatory variables and the main response variable.

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon,}$$

Where; Y= Performance, β_0= constant (coefficient of intercept), X_1= Horizontal merger; X_2= vertical merger; X_3= lateral merger; X_4= conglomerate merger; ε = error term;

RESULTS

Inferential Statistics

The study made use of correlation analysis and multiple regression analysis in testing the effect among the independent variables. Coding, entering, and computation of the measures of regression analysis were done using SPSS Version 21.

Correlation Analysis

The relationship between the predictor and response variables were analysed using correlation analysis. The study applied Pearson Moment Correlation in determininh the association of horizontal merger, vertical merger, lateral merger, conglomerate merger with performance of commercial banks in Kenya. The results were as shown in Table 1.

The results revealed that horizontal merger and performance of commercial banks in Kenya had a strong and positive correlation with r = 0.852, and p = 0.001<0.01; vertical merger and performance of commercial banks in Kenya had a strong positive correlation with r = 0.821, and p = 0.003; lateral merger and performance of commercial banks in

Kenya had strong positive correlation indicated by r= 0.827, and significance at p = 0.003; conglomerate merger and performance of commercial banks in Kenya had a strong positive correlation with r = 0.867, and p = 0.000. This implies that horizontal merger, vertical merger, lateral merger, conglomerate merger affects performance of commercial banks in Kenya.

Table 1: Correlations Coefficient

		Performance	Horizontal merger	Vertical merger	Lateral merger	Conglomerate merger
Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	64				
Horizontal merger	Pearson Correlation	.852**	1			
	Sig. (2-tailed)	.001				
	N	64	64			
Vertical merger	Pearson Correlation	.821**	.214	1		
	Sig. (2-tailed)	.003	.000			
	N	64	64	64		
Lateral merger	Pearson Correlation	.827**	.203	.195	1	
	Sig. (2-tailed)	.003	.000	.000		
	N	64	64	64	64	
Conglomerate merger	Pearson Correlation	.867**	.211	.213	.197	1
	Sig. (2-tailed)	.000	.000	.000	.000	
	N	64	64	64	64	64

**. Correlation is significant at the 0.001 level (2-tailed).

Multiple Regression Analysis

Model Summary

The variation of the response variable due to predictor variables was analysed using the model summary. The study analyzed the variations of performance of commercial banks due to the changes of horizontal merger, vertical merger, lateral merger, conglomerate merger. Adjusted R^2 was 0.779 implying that there was 77.9% variation of performance of commercial banks due to the changes of horizontal merger, vertical merger, lateral merger, conglomerate merger. There were other factors that affected the way commercial banks in Kenya performed but were not discussed in thus research; this was because the variables did not explain 100% of the performance of the bank implying there were other factors that affected the performance by 22.1%. The association existing between the study variables was indicated by R which was the correlation coefficient. The variables were found to be strongly related as shown by R value of 0.886.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.886	0.785	0.779	0.135

Analysis of Variance

To establish if the data used in the study was significant, ANOVA was computed. The findings showed that the processed data had significance level of 0.001 because the value was less than 0.05, it implied that the data was suitable to conclude on the population's parameter. The value of F critical was found to be less than that of F calculated (77.766 > 2.528), implying that horizontal merger, vertical merger, lateral merger and conglomerate merger significantly influence the performance of commercial banks.

Table 3: Analysis Of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	57.689	4	14.422	77.956	.001[b]
	Residual	10.942	59	0.185		
	Total	76.631	63			

Beta Coefficients of the study Variables

The regression equation was:

$Y = 1.334 + 0.689X_1 + 0.546X_2 + 0.487X_3 + 0.591 X_4 + \varepsilon$

The equation above revealed that horizontal merger, vertical merger, lateral merger and conglomerate merger constant, the variables significantly influence performance of commercial banks as shown by constant =1.334. Horizontal merger was statistically significant to performance of commercial banks in Kenya as shown by (β = 0.689, P = 0.005). This showed that horizontal merger had a significant and positive association with commercial banks in Kenya in terms of their performance. This was an indication that increase in horizontal merger led to increase in the way commercial banks perform. Vertical merger was statistically significant to performance of commercial banks in Kenya as shown by (β = 0.546, p = 0.005). This indicated that vertical merger was significantly and positively related with how commercial banks in Kenya perform. This suggested that increase in vertical merger will lead to increase in the way commercial banks perform.

Lateral merger was statistically significant to performance of commercial banks in Kenya as shown by (β = 0.487, p = 0.001). This implied that lateral merger was significantly and positively related with how commercial banks in Kenya perform. This suggested that increase in lateral merger will lead to increase in the way commercial banks perform.

Conglomerate merger was statistically significant to performance of commercial banks in Kenya as shown by (β = 0.591, p = 0.010). This showed that conglomerate merger was significantly and positively related with how commercial banks in Kenya perform. This suggested that increase in conglomerate merger will lead to increase in the way commercial banks perform.

Table 4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	**(Constant)**	1.334	0.198		6.737	0.000
	Horizontal merger	0.689	0.211	0.671	3.265	0.005
	Vertical merger	0.546	0.173	0.497	3.156	0.005
	Lateral merger	0.487	0.107	0.450	4.551	0.001
	Conglomerate merger	0.591	0.216	0.535	2.736	0.010

DISCUSSION

There are several ways in which a company benefits from horizontal type of merger. Some of the benefits are; equal sharing of resources, it ensures improved organizational production by ensuring the production process is efficient and effective, it also reduces the cost incurred by the company during production process therefore increasing the revenue of the company through provision of a vast range of products to the already existing. By the company taking in horizontal merger it enables it to attain their economies of scale through amalgamation of facilities that are used in production which ensures that the resources are well utilized.

The study also established that horizontal merger and performance of commercial banks were strongly and positively correlated. Horizontal merger is significantly and positively related with performance of commercial banks in Kenya.

For those companies that are involved in vertical merger, raw materials are always available to them; this is because the raw materials are consistently supplied. Another advantage brought about by vertical merger is that the company is able to acquire raw materials at a low cost, which reduces the cost of production leading to higher profits. It also enhances the company production hence increasing market share.

Vertical merger is positively correlated with performance of commercial banks in Kenya. Also, vertical merger with performance of commercial banks in Kenya were significantly and positively associated.

Lateral merger ensures smooth organizational operations by ensuring fast decision making and reducing any conflict that may arise during the decision making process. Lateral merger also ensures that hared operations are done more efficiently. This type of merger also helps achieve strategic objectives through various ways such as expanding products and markets or other objectives that are related with the strategies in place. It also provides competitive environment which enhances how flexible the management is regarding future operations of the organization.

Lateral merger and performance of commercial banks in Kenya were positively correlated. Lateral merger with performance of commercial banks in Kenya were significantly and positively associated; implying that performance of commercial banks is affected by lateral merger.

Conglomerate merger ensures diversification of the company which increases customer base of the company. Because of the increased number of customers, the company will experience increased sales in their key products which results to increased profitability of the organization. Conglomerate merger also provides investment opportunities for idle cash and therefore there will be an increase in the organization expenses. This type of merger is also referred to as diversification strategy because it enables the company to diversify its business which is very important because it helps the business to overcome the risks related with the vulnerable market.

Conglomerate merger is positively correlated with performance of commercial banks in Kenya; this implies that performance of commercial banks is affected by conglomerate merger. It was also established that conglomerate merger had a significant and positive association with performance of commercial banks in Kenya implying that increasing conglomerate merger will lead to improved performance of commercial banks.

Recommendations

It is important that the management be disciplined in order to ensure that their governance is good; promote the use of technology and raise their paid up capital regardless of the statutory requirements in order to ensure that the existence of the company is not affected by the merger. The management of the institution should also focus on improving the competitiveness of the company as well as their financial performance when entering into a merger and not focus only on their improvement in operations and sustaining their failing operations. The management need to come up with effective strategy to be applied in managing asset and liabilities in order to avoid the issue of investments that fail to match and also better the quality of assets. The management need to consider the level of transferability and marketability of assets that are being invested in order to ensure that these assets provide the company with liquidity easily.

The management of banks should consider horizontal merger since it helps to raise the amount of revenue this is because it adds other products to the already existing ones. It also assists to improve performance of the organization.

The management of banks should consider vertical integration because it leads to improved, consistently high quality, uniform products for consumers, hence improving performance of banks.

The management of banks should consider lateral merger because it helps in achieving strategic objectives by having other forms of combinations such as expanding the product and market, or other aspects based on the strategy that the bank has in place.

The management of banks should consider conglomerate merger because it makes it possible for the banks to have its business diversified. It also assists in overcoming risks related to the market.

Suggestion for further studies

This study aimed at establishing the influence of mergers on performance of commercial banks in Kenya. The study recommends research on other industries that have been involved in mergers in order to increase knowledge on mergers. Additionally, it's important for studies to be done on effect of mergers and acquisitions on stakeholder value of the stated companies as well as for the petroleum companies.

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