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"EFFECT OF MERGER OF CFC STANBIC BANK GROUP ON PROFITABILITY"

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Abstract

The purpose of the study was to investigate the effects of mergers of CFC Stanbic Bank on profitability. Mergers fail to deliver the synergies, competitive scale, and financial results that executives had anticipated. A sample of 50 respondents using descriptive survey design. Data was collected from the published annual reports before and after merging using questionnaires, interview schedules and documentary analysis and was analyzed using regression analysis through SPSS. Data was presented in tables and pie charts. The findings of the may be used to assess whether mergers improve financial and operational efficiency of banks. The findings may be used by the government to assess policies relating to mergers and bank's performance. Respondents 17(41%) neither agreed nor disagreed whether the bank was profitable before merger, 39% used the rate of return of asset to measure profitability before merger, 24% saw the increase in shareholders' value as a good measure, 22 % thought profit margin while 15 % believed operational performance was a good measure. After the merger, 37% used the cash flow statement, 27% balance sheet and changes in statement of shareholder equity, while others used the auditors' reports and note to financial statements both at 10%. Overall, management and strategic fit between are essential through the entire acquisition and merger process. Future research can be done on effects of mergers and acquisition on the performance of companies in different fields.

Key Words: acquired companies, acquiring company, acquisition, combination, conglomeration, merger, strategic alliance

1. Introduction

A strategic alliance is an agreement between two or more parties to pursue a set of agreed upon objectives while remaining independent organizations. It is a voluntary arrangement between firms involving exchange, sharing, or co-development of products, technologies, or services. It arises from a range of motives and goals, take a variety of forms, and occur across vertical and horizontal boundaries (Sudarsaman, 2005).

A strategic alliance must be strategic in nature. It has to be supported by executive leadership and formed by lower management at the highest, macro level (Moses and Kalton, 1971). According to Sudarsaman (2005), it may lead to ease of market entry, shared risks, knowledge and expertise. A typical strategic alliance formation process involves these steps

(Moses and Kalton, 1971): Strategy Development; Partner Assessment; Contract Negotiation; Alliance Operation and Alliance Termination.

Merger is a technique of business growth. It is not treated as a business combination. Generally, it is done between two companies. However, it can also be done among more than two companies. During a merger, the merging companies come together to decide and execute a merger agreement between them. A cross-border merger is a transaction in which two firms with their home operations in different countries agree to an integration of the companies on a relatively equal basis. These companies take decision to combine their individual operations on a relatively equal basis to create combined competitive advantage that will contribute to success in the global marketplace. A cross-border acquisition is a transaction in which an expanding firm buys either a controlling interest or all of an existing company in a foreign country. Often, the acquired firm becomes a business unit within the acquiring firm's portfolio of businesses. Typically, managers in the acquired firm then report to the firm's management team. The aim of the mergers and acquisitions is generally to create synergy i.e. to create value that is more than the combined value of the individual firms (Moses and Kalton, 1971).

Mergers and acquisitions (M & A) is the fusion process or combination of two companies in a known company. An online purchase is simple, if a company buys another company directly. In general, this takes the form of shares, cash or a combination of both. In a hostile takeover, the acquiring company usually has enough shares to take over. In general, M & A transactions, most companies acquire smaller ones. However, there are times when a small company will acquire the majority of the outstanding shares and control this is also known as a reverse acquisition. A reverse merger is when a private company bought the majority shares of a company as an empty shell. In principle, the decision to merge or acquire another company with a capital is a budgeting decision. Concentrations in general are different from ordinary investment decisions in many different ways. First, the concentration may depend on the strategic value of the form difficult to measure. Second, the legal aspects of accounting and taxes of a merger may be complex. Mergers involving corporate control are also replacing the current government, which in general are often hostile to mergers (Beena, 2004).

According to Beena (2004), the key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A. This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone. There have been mergers and acquisitions all over the world as well as locally. This has assisted most firms ideally improve their value. Some of these M&A's include; Italian automaker Fiat SPA agreed to pay 1.27 billion Euros for another 16 percent stake in U.S peer Chrysler, in a deal that was faster and cheaper than expected (Thomson, Reuters 2011). Chinese regulators approved Nokia Siemens Networks' (NSN) acquisition of Motorola Solutions' telecom network gear business. Lawson Software Inc. agreed to be bought by Golden Gate Capital and privately held Information for around $2 billion in cash, as mid-sized business software makers looked to gain scale in a market dominated by Oracle and SAP AG. Oil giant Sinopec signed China's second-largest gas purchase agreement; worth around $85 billion over 20 years by one estimate, in a deal that also gives it 15 percent of an Australian gas-export project (Beena, 2004).

The operations and products of the merged banks have been pulled together and are able to provide you with a broader choice of tailor-made products and services, delivered to you in a manner that best suits you. Therefore this study intends to look specifically at the effects of mergers on the performance of companies.

CFC Bank is incorporated in Kenya and is listed on the Main Investment Market Segment of the Nairobi Stock Exchange and with its registered office at CFC Centre, Chiromo Road, and P.O Box 72833, Nairobi – 00200. In addition to its banking business, CFC Bank owns, directly or indirectly, a number of substantial subsidiaries, notable amongst them being (a) The Heritage A.I.I. Insurance Company Limited (b) CFC Life Assurance Limited (c) The Heritage A.I.I. Insurance Company (Tanzania) Limited and (d) CFC Financial Services Limited, together ("the CFC Subsidiaries"). In a consolidated group basis, the total assets of CFC Bank as at 31st December 2006 stood at Kenya Shillings Forty billion three hundred sixty-eight million six hundred sixty-two thousand (K.Shs.40,368,662,000), with

shareholders' funds attributable to equity holders of CFC Bank of Kenya Shillings Four billion seven hundred thirty two million ninety-one thousand (K.Shs.4,732,091,000).

1.1 Problem Statement

Kenya has experienced Banking problems since 1986 leading to major Bank failures (37 failed Banks have been noted since 1998) following the crisis of 1986-1989; 1993/1994 and 1998, according to studies highlighted by Chesang (2002). The number of Banks absorbing their subsidiaries or merging with other Banks has equally increased, according to the CBK Act (2000).

With the growth that Africa is experiencing; access to resources as well as the opportunities in infrastructure development, private equity still remains a significant driver of M&A in the Banking Industry despite the failures experienced so far. World over, the economy has seen growth and this includes the Banking industry. As Africa becomes prime hunting ground for international investors, M&A activity in the Banking Industry in the continent still appears pale in comparison to firms in similar industries in more developed economies. There is therefore need to keep up with survival by crafting competitive strategies that help maintain competitive top slots and M&A is one of these strategies.

Locally, however, there has been failure to realize that M&A is a good strategy for growth as opposed to growing organically- Banks in Kenya are today concentrating on opening more branches instead as many other local firms are unwilling to relinquish control as well as rationalizing of operations that may come with the merger or acquisition by another firm - but this opposition may come at a cost as Makau (2008) suggests. He adds that if M&A is successful in Kenya, it should be encouraged and any issues that stifle the same should be curbed before it's too late. According to IMF (1998), in the context of widespread insolvency, restructuring is a necessary "medication" to restore health to individual banks and the financial system. In view of the importance of the banking system, it is necessary to avoid fiscal and monetary cost of permanent subsidization of an ailing system without sound banking.

IMF report (1998) adds that waiting for the recovery of the economy to outgrow banks problems may not work unless the problem is shallow. Further, tightening prudential controls may not be an adequate measure to restore financial stability. This study chooses to address mergers as one of the unique options of restructuring as selected by CFC Stanbic, seeking to

understand why while some institutions shy away from M&A, CFC Stanbic still chose it as a viable option to pursue efficiency and remain competitive.

Studies have also been conducted on merger restructuring and financial performance of Commercial Banks in Kenya, by Chesang (2002) but no known studies have been conducted to determine that the same option can lead to competitive advantage sighting a unit within the Banking Industry as an example and this study will fill that gap.

1.2 Objectives

The general objective of this study was to investigating the effect of merger of CFC Stanbic Bank Group on profitability.

1.3 Research Questions

What is the effect of merger of CFC Stanbic Bank Group on profitability?

1.4 Significance of the Study

This study was carried out during the current era of high level competition experienced by firms in banking industry as a result of globalization and reduction of barriers to entries. The banking industry is experiencing high costs of competition coupled with high costs of promotion and customer retention. This leaves the banks with few opportunities of exploiting the market to sustain them in the industry. Mergers and acquisitions are now used to circumvent competition and reduce the borrowing interest rates to attract investors (Damodaran, 1998). In developing countries the activities of mergers are a recent phenomenon and their impacts have not been investigated to score their importance. This study is therefore carried out at an opportune time to provide direction on the significance of mergers in influencing performance levels of companies.

The findings of this study would be used by different stakeholders in different ways. The study would be important to management of companies in that the management of companies would use findings to formulate policies and strategies which would be used to enhance performance of the business through merger. It would also assist them to understand the challenges facing mergers and how they can face them in the event their companies want to merge with other companies.

Employees of merging companies would use the findings to understand the positive and negative effects of embracing merger in organizations so as to improve their job security and

blend skills for the general welfare of other employees, it would also assist them to improve and adjust to the environment of the new companies formed after merger.

The study would be used by scholars to carry out further studies in the related areas to compliment and supplement the current studies, scholars would also use it to establish the effects on mergers on performance of companies and their challenges and carry out further investigations to improve on the challenges. Central bank would use the findings to establish the effects of mergers in the banking industry and make recommendations on what ought to be done to improve service delivery in the banking industries and finally in other institutions. The study would recommend various ways other organizations would use to change the negative popular perception of M&A. The management scholars would use this as a case study on various factors related to the success of M&A that need to be considered when preparing a platform for competition. It would also add to the body of knowledge in this specific area.

1.5 Scope of the Study

A study on effects of mergers on the performance of companies was carried out on CFC and Stanbic Limited in Kenya with greater emphasis on profitability. The study was conducted at the CFC Stanbic Bank Limited, CFC Stanbic Centre, and Chiromo and mainly focused on the merger of CFC and Stanbic Bank Limited since they are the most visible high profile merger in the banking industry in Kenya. It involved a study of the published annual reports and accounts of the CFC and Stanbic Limited before and after the merger. The study also conducted a survey on the opinion of managers as to whether they believe the merger added value to the banks which would be done by use of questionnaires. The study further looked at the effect of merger on shareholders returns during the period of merger. The study targeted 50 respondents.

2. Literature Review

2.1 Theoretical Review

Merger is an act or process of purchasing equity shares (ownership shares) of one or more companies by a single existing company. The aim of most of the companies is to make profits. For this they follow different tactics or strategies. Over the past few decades we have seen numerous examples where companies made huge success by mergers. It is an important tool to grow fast and earn money. The organizations spend millions of dollars for this. They

do this to achieve synergy and have competitive advantage over their competitors. In other words this is usually done to add new product line, customer segment, geographical region etc. M&A also attracts a great attention from the media. But in reality the success rate is not satisfactory and sometimes the incompatible environment or situations makes a sure success a complete fiasco (Sherman, 2006).

Mergers and Acquisitions have always played a vital role in corporate history, ranging from 'greed is good' corporate raiders buying companies in a hostile manner and breaking them apart, to today's trend to use mergers and acquisition for external and industry consolidation (Sherman, 2006). The terms mergers and acquisition are often used interchangeably but it is important to understand the differences between the two. In the academic literature, there are a number of authors who define merger, acquisition and takeover differently. According to Sudarsanam (2005), a merger takes place when two or more corporations come together to combine and share their resources to achieve common objectives. But according to Sherman and Hart (2006), a merger is a combination of two or more companies in which the assets and liabilities of the selling firms are absorbed by the buying firm.

An acquisition is the purchase of an asset such as a plant, a division or an entire company. Sudarsanam (2005) defines acquisition as an 'arms - length deal', where one company purchases the shares of another company and the acquired company is no longer the owner of the firm. The term 'takeover' is sometimes used to refer a hostile situation. This happens when one company tries to acquire another company against the will of the company's management; a takeover is similar to an acquisition and also implies that the acquirer is much larger than the acquired.

According to Gaughan (2002), mergers and acquisition are friendly transactions in which the senior management of the companies negotiate the terms of the deal and the terms are then put in front of the shareholders of the target company for their approval whereas in a takeover, a different set of communication takes place between the target and the bidder, which involves attorney and courts. Bidders here try to appeal directly to the shareholders often against the recommendations of the management. In line with common practice, terms mergers, acquisitions and takeovers would be used synonymously in this dissertation. According to Sherman and Hart (2006), at the end, the differences in the meaning may not really matter since the result of these processes is often the same i.e. two companies that had

separate ownership are operating under the same roof, usually to obtain some strategic and financial objective.

2.1.1 Value Increasing Theories

Value increasing theories explain that mergers would lead to value addition to the firms size and returns to scale, diversification, economies of scale, transaction costs and information efficiency. According to Haberberg & Rieple, (2008) a firm must decide between internal or external production. Transaction costs within and outside firm determine decision on firm size and merger, Williamson (1985) goes a step further by defining the transaction cost as a function of "transaction frequency" and "asset specificity". Vertical integration is only optimal when "asset specificity" and "transaction frequency" are high.

2.1.2 Value Reducing Theories

This theory asserts that mergers bring about a negative effect to the resultant firm because it leads to high operation costs brought about as a result of large size of the organization. For instance, agency costs of free cash flow (Jensen, 1986); free cash flow is a source of value reducing mergers. Firms with FCF are those where internal funds exceed investment required for positive NPV projects. Managerial entrenchment (Shleifer, 1989), this is because managers are reluctant to distribute cash to shareholders and investments may be in form of acquisitions where managers over pay but reduce likelihood of their own replacement. "Disciplinary mergers" are solutions to these "agency-problem driven mergers" Jensen, 1986, p. 328: "Free cash flow theory predicts which mergers and takeovers are more likely to destroy, rather than to create, value; it shows how takeover are both evidence of the conflicts of interest between shareholders and managers, and a solution to the problem" Mitchell (1990) provide empirical evidence that "bad bidders become good targets". This theory is also called inefficient management theory which is similar to the concept of managerial efficiency but it is different in that inefficient management means that the management of one company simply is not performing up to its potential. Inefficient management theory simply represents that is incompetent in the complete sense.

2.1.3 Value Neutral Theory

The hubris hypothesis of "corporate takeovers" helps to explain neutral theory of merger illustrating that a merger would bring neither positive nor negative results. For instance merger bids result from managerial hubris – managers are prone to excessive self- or over-

confidence while winner's curse is a case where a competitive bidding has a distribution of value estimates.

Manager with most optimistic forecast wins bidding process caused by fact that the winning bid more likely overvalues target. Mergers can occur even when no value effects because target sells when bid is higher than target value. No value effect is felt under the hubris hypothesis: wealth transfer from the bidding firm's owners to target shareholders, according to Damodaran (1998): "the hubris hypothesis can serve as the null hypothesis of corporate takeovers".

Hubris hypothesis implies that manager's look for acquisition of firms for their own potential motives and that the economic gains are not the only motivation for the acquisitions. This theory is particularly evident in case of competitive tender offer to acquire a target. The urge to win the game often results in the winners curse refers to the ironic hypothesis that states that the firm which over- estimates the value of the target mostly wins the contest.

Table 2.1 Summary of theories of merger and their effects

Source: Gaughan 2002 Theories of Mergers.

2.2 Types of Mergers

Mergers from the economic perspective can be categorized as: horizontal, vertical, or conglomerate. Horizontal mergers involve firms operating in similar businesses (Chevron and Texaco). Vertical mergers occur in different stages of production operations (AOL and Time Warner). In conglomerate mergers, the firms are in unrelated business activities (Tyco International has been acquiring companies in diverse activities). In respect with the economic theory classify mergers into three categories which are horizontal merger, vertical merger, lateral merger and conglomerate merger.

A. Horizontal merger and acquisitions- This is the combination of two corporations in similar lines of business or between two competitors. The main reason for merging and acquiring similar business is with the aim of obtaining synergy between the two business units. Apart from this, other reasons for horizontal M&A's are to increase the market power, exploit economies of scale, to diversify through separate markets and provide different services. The level of competition in an industry is affected by the increased horizontal M&A's and according to the economic theory consumer's benefit from the increased competition (Weston, 2001).

B. Vertical Merger and Acquisition-These are combination between companies in same lines of business but different aspects of production. Vertical M&A may be of two types: When a producer acquires a supplier of the raw material in the chain of production, with the aim of reducing cost of production, it is called backward vertical integration. When a company buys its vendor, in the direction of its consumer to reduce marketing and delivering costs, it is called a forward M&A (Sherman, 2006).

C. Lateral Merger-This is where firms in different industries but at the same level of production combine to form one and conglomerate merger where firms in different industries and different levels of production combine to form one. The sales volume of banking industry would be measured in terms of the amount of loans accessed by the borrowers and the volume of bank products sold to customers in a particular financial period.

D. Conglomerate Merger and Acquisitions-This is a combination of companies with different or unrelated fields of business. These companies neither are related nor are they competitors. The main motives for conglomerate M&A are efficient capital allocation and the reluctance to distribute cash flows to the company's shareholders. Companies also seek diversification of risks and entry to a new emerging market through this type of acquisition (Cartwright, 2002). The study makes a distinction of one more category called the concentric merger, which is acquisition of the dissimilar but associated field of business in which the buying company looks forward to expansion.

2.2.1 The Reasons and Motivations behind Mergers

The motivations behind mergers include growth, creating synergy, diversification, deregulation and economies of scale and scope. It enhances industry consolidation when the overall market is mature and where market opportunities are flat or shrinking. It enables geographic expansion into neighboring regions for adding new areas in its basket. It enhances expansion into new markets, for revenue growth, in which the opportunities are less for the internal development. It involves acquisition of new technology or products or knowledge when the firm doesn't have the resources to develop the product or technology. It involves combining with one or more other firms in order to realize a synergy that would form a preeminent firm with superior market advantages or economies of scale (Briscoe, 2004).

2.3 Benefits Derived from Mergers

A. Economies of Scale- By merging, the companies hope to benefit from the following: Economies of scale- Size matters, improved market reach and industry visibility and acquiring new technology. Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs. Mergers also translate into improved purchasing power to buy equipment or office supplies - when placing larger orders, companies have a greater ability to negotiate prices with their suppliers (Cartwright, 2002). Staff reductions - As every employee knows, mergers tend to mean job losses. Consider all the money saved from reducing the number of staff members from accounting, marketing and other departments. Job cuts will also include the former CEO, who typically leaves with a compensation package. Companies buy companies to reach new markets and grow revenues and earnings. A merger may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones. To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge (Sherman, 2006).

B. Growth & Expansion- Growth being the reason behind M&A seems to be a straightforward statement. Companies try to strengthen corporate growth strategies. The main objective is to broaden product lines and increase the market share and finally stabilize the financial position of a company. Whether growth refers to revenue growth or to growth in profitability is the main difference, and the two may be very different. Companies can grow in two ways through internal expansion or organic growth. This process of growth is slow and presents its own risk. Through M&A’s this process can allow companies to capture the opportunities available in the market more quickly. M&A’s enables a company to acquire a running business rather than build up a new one (Gaughan, 2002). The value created after the merger is more than the individual values of the independent firms before merging. This is usually a significant factor for the firms entering into the business. This is usually achieved through economies of scale. The factors which can contribute to the economies of scale are: Some production processes are efficient usually when the production is in the bulk e.g. the automation industry. Large scale can allow use of more specialized or more efficient factors of production (land, labour, capital). Firms can spread their costs over larger number of

output units and thus experience falling long-run average costs (Lindeman, 2002). If there are companies that can take advantage of merging with the appropriate companies, then the option of mergers and acquisition is generally very prudent. Example, Compaq and HP combined together to take the advantage of economies of scale and generated synergy. Firms can take advantage of synergies between their different operations and product lines. For example, when Tata Steel acquired Corus in 2007, it gained access to Corus rolling mills and distribution channels in Europe, while Corus gained access to Tata Steels in-house sources of iron ore (Haberberg, 2008). Synergies are created when the value of the combined firms involved in M&A's process is more than the sum of their pre-acquisition. The concept of synergy is used to refer to the economies of scale at the firm level. Synergy is also said to arise from intangible assets such as goodwill, knowledge and organizational arrangements in an industry.

C. Synergy- Synergies are mainly classified into: - Operating synergy-This is achieved by the combination of companies that result in operating economies from a reduction in costs. These cost reduction may result from economies of scale. (Gaughan, 2002) This is an economic term that refers to the reduction in per unit costs that result from an increase in the size or scale of companies operations. Cost advantages can also be achieved from the expansion of the scope of the company's operations. Economies of scope result from the ability to use combining inputs or production facilities and offer a wide range of products and services. Diseconomies of scale may also arise due to higher cost associated with the management of the organization and other problems associated with coordinating a larger scale operation like culture divergence, management style and structure.

D. Revenue Sharing Synergy-These synergies are created when it increase the ability of the combined firm to generate and increases revenues. If a corporation has an increase in its revenue after the merger, then perhaps synergies explain the gain (Gaughan, 2002). Among the two types of synergy, revenue sharing synergy is more difficult to achieve. It is easier to implement cost-cutting techniques and to find areas of overlapping business that can be eliminated, thereby reducing costs. It is often more difficult that the combination of two companies generates higher revenues than they would have as two separate companies. This is one of the main challenges of M&A's, and many do not succeed in their attempt to increase revenue growth in a way that more than offsets the costs of the deal (Gaughan, 2002).

There are also other sources of synergy such as: Financial Synergy-When a company with better financial position with less profit making opportunities merges with a company with has certain growth opportunities but has insufficient access to capital, financial synergy is created and the above problem is alleviated. This can be seen with the merger of small companies by a large corporation. The only vital point is that the target actually has profit-making tools. Financial synergies are more focused and include tax benefits, diversification, a higher debt capacity and use for excess cash (Damodaran, 2004). This synergy is seen in the merger of private businesses with the public ones. There might be another view-point taking financial in the form of hostile takeovers. But according to (Sherman, 2006) hostile takeovers are not followed by significant change in the level of the capital investments of acquired firms. So, the standard point of view still focuses on the improvement of the performance rather than destruction of the target firm.

E. Tax Based Synergy- Sometimes a combination may be fruitful for a buyer when it is successful in exploring the unexploited tax benefits of the target. Tax benefits arise when target's assets book value is lower than its market value. Then the company acquiring this target has the advantage of showing assets it buys in the balance sheet at the market value which is lower than the book value. Also, the net operating losses (NOL's) may be transferred to a buyer which may enable the target to offset profits on which it had to otherwise pay taxes. Other sources of tax based synergies may be depreciated tax shields, which may come from a step up in the basis of the target assets following an acquisition (Gaughan, 2002). However, tax benefits may not be the same in all the countries and the tax legislation might curb the merger process for such a motive. Many authors have criticized the concept of synergies over the years operational and managerial synergies seem to be vague concepts of merger activity. According to Sherman (2006), financial synergy cannot be achieved in an efficient capital market. There was no evidence for a lower systematic risk or perfect internal capital market.

F. Improved Management and Diversification- It is reasonable motive for acquisition by large companies with high level of management expertise when the target is a company that lacks such resources. It takes a greater degree of managerial sophistication to control a larger organization than a small business. A company which is efficient may acquire a company which is relatively inefficient (Beena, 2004). This process improves the efficiency in many ways. Inefficient managers may be replaced with better ones and the threat of being a target,

the managers is forced to improve the efficiency. The salary of the managers is related with the size of the company (Martin a, 1991). Mergers are a simple way to eliminate inefficiency as the managers would never demote themselves and shareholders don't have direct access to those who run the firm. The role that managerial pride plays in M&A's for their own personal reasons rather than the economic gains of the company is questionable. Managers commit errors of over-optimism in evaluating mergers at the cost of the company. (Gaughan, 2002) Managers might unintentionally and randomly make errors also in a merger process which leads to excessive premiums paid for the target companies. On the other hand managers who are rational may make valuation mistakes in spite of the gains from the acquisition and may also deliberately overpay for target companies at the expense of the shareholders. For example managers who have an empire building ambition are obsessed with power and want to expand their control beyond reasonable boundaries.

G. Diversification- is said to be one of the most important motive for M&A activity. According to Thompson (2008), a company which has excess of cash or credit is influenced by executive desires to growth rather than simply distributing excess resources to the shareholder INR. Also conglomerate acquisition allows companies to diversify their risk and exposure to volatile industry segments by acquiring firms in different industries. There are many advantages of diversification. It helps to increase the value of the company through economies of scale, scope or market power Geographical diversification gives a company access to bigger markets and a state of depression is not likely to occur at all places at the same time and to the same extent. However, there are arguments put against diversification. Following a conglomerate acquisition, firm's value drops by 13 % - 15% on an average. Also Brealey (2004), argue that diversification is easier and cheaper for the shareholders than for the corporation and investors don't pay premiums for diversified firms.

Achieving these economies of scale is the natural goal of horizontal mergers. It provides the advantage of decrease in average cost of production due to increase in scale of production. Low costs are important for company's profitability, success and survival. Brealey (2004) Operating economies can also be achieved by combining firms at different stages of an industry which can lead to better coordination at different levels. Economies of scope imply to savings of production attributable to an increase in a variety of goods produced. There are significant gains in cost efficiency for targets consistent with gains from economies of scope and also find significant improvements in efficiency for acquiring firms (Brealey (2004).

Economies of scale and scope may arise in M&A process through the consolidation of marketing and sales force, improving customer base and sharing technological innovations within the newly created company. Reduced competition and larger markets allow greater pricing power which in turn allows higher sales growth and increased profits (Damodaran, 1999). It is one of the important factors for the increase in the number of mergers and acquisitions in a specific industry. Opportunities for companies are created as deals which were previously prevented are made possible through deregulation.

2.4 Conceptual Framework

Fig 2.1 conceptual framework

Source: Author (2015)

The study was hinged on a conceptual framework where the envisaged aspects of mergers and acquisition which are profitability, cash flow and share price (and synergy, diversification, and differentiation) formed the dependent variables while the expected outcomes formed the independent variable. The interplay of the said variables would be regulated by an intervening variable hinged on government policy, nature of industry, level of competition.

2.5 Empirical Studies

2.5.1 Effect of Merger on Profitability Levels of the Business

A study carried out by Weston (2001) found out that there are normally a number of reasons why organizations undertake certain strategic measures. Most of these companies, being in business, usually aim at improving their operating performance, shareholder value as well as profit margins. As such, organizations normally pursue strategic moves such as Mergers & Acquisitions, takeovers, combinations among other strategies. This study aimed to look into the effect that the CFC and Stanbic Banks merger had on the position of Standard Bank Group Limited value performance. They studied the pre and post-merger performance of conglomerate firms, and found that their earnings rates significantly underperformed those in the control sample group, but after 10 years, there were no significant differences observed in performance between the two groups. The improvement in earnings performance of the conglomerate firms was explained as evidence for successful achievement of defensive diversification.

Brealey (2004) studied the financial performances of 43 merging firms in Japanese manufacturing industry and found that the rate of return on equity increased in more than half the cases, but rate of return on total assets was improved in about half the cases. However, both profit rates showed improvement in more than half the cases in the five-year test, suggesting that firm performances after mergers began to be improved along with the internal adjustment of the merging firms: there was a necessary gestation period during which merging firms learnt how to manage their new organizations.

A study by Seth (2000) reviewed the findings of studies that have investigated either directly or indirectly the question, do mergers provide real benefits to the acquiring firm? The review suggested that acquiring firms might benefit from merging because of technical, pecuniary and diversification synergies. Pawaskar (2001) analyzed the pre-merger and post-merger operating performance of 36 acquiring firms during 1992-95, using ratios 5:2 of profitability, growth, leverage, and liquidity, and found that the acquiring firms performed better than industry average in terms of profitability. Regression Analysis however, showed that there was no increase in the post-merger profits compared to main competitors of the acquiring firms.

Surjit (2002) compared the pre and post-takeover performance for a sample of 20 acquiring companies during 1997-2000, using a set of eight financial ratios 3, during a 3-year period before and after merger, using t-test. The study concluded that both profitability and efficiency of targeted companies declined in post-takeover period, but the change in post-takeover performance was statistically not significant.

3. Methodology

3.1 Research Design

This study employed both qualitative and quantitative designs. The qualitative design employed a descriptive survey design, which is a type of research undertaken with the aim of describing characteristics of variables in a situation and data is entered as narratives. This design was preferred because some data was collected using face to face interviews for the purpose of estimating the level of mergers and acquisition and its effect on banks performance. The quantitative design involved collecting data in numerical form to estimate the impact of mergers and acquisition using cross-sectional data design, as mentioned by

Borg and Gall (1989); this extended the fact findings, to understand the important principles and solutions employed during the project period.

The population of this study consisted of 50 respondents consisting of 18 top level managers to give most reliable information and 32 middle level managers who were responsible in implementation of decisions and policies formulated by the top management

Table 3.1 Target population

Source: Stanbic (2015)

Purposive sampling is justified for the study basing on the argument by scholars (Kombo and Tromp, 2006) that it is useful when the sample has information rich cases for in-depth analysis related to the issues been discussed.

The sampling was done using systematic random sampling of the targeted population. The sampling method was chosen because of the accurate representation of the population and it also gives specific amount of information in comparison to other sampling also used to give each member of strata equally chance of being selected in that stratum thus reducing the biasness and increasing accuracy.

According to Babbie & Mouton (2001), some popular methods of data collection include; questionnaires, interview schedules, and analysis of documents.

According to Oso and Onen (2003), questionnaires are used to permit greater depth of responses and allow the respondents to express themselves freely without bias or intimidations.

Questionnaires covering both closed and open ended questions were given to the respondents as a way of acquiring data on the evaluation of the effect of mergers and acquisition on banks performance. The 50 respondents were approached to give information on how mergers and acquisition has affected their bank performance.

The study used quantitative and qualitative method of data analysis.

4. Data Analysis, Presentation and Interpretation

4.1 Pre-merger Profitability

The study sought to determine the profitability before the merger. The study findings are presented in the table below.

Table 4.1 Pre-merger Profitability

The findings show that both banks were both profitable before the merger and that they merged to strengthen their position in the market.

4.1.1 Profitability before the Merger

The study sought to find out whether there was profitability before merger. The responses are represented in the table below.

Table 4.2 Profitability Before the Merger

The majority of the respondents 17(41 %) would not neither agree nor disagree, while 9(22%) agreed, 4(10%) strongly agreed. 6(15%) and 5(12%) disagreed and strongly disagreed respectively.

4.1.2 Measure of Profitability

To determine how the profitability was measured the researcher went ahead to ask the respondent how the bank measured their profitability. Table 4.7 displays the results.

Table 4.3 Measure of Profitability

The table above shows that 39% use the rate of return of asset to measure profitability, while 24% saw the increase in shareholders' value as a good measure, 22% saw the profit margin as the best measure while 15% saw operational performance as a good measure of profitability.

4.1.3 Assessing the Profitability

The study sought to determine which financial statement is used to measure profitability. Below are the responses.

Table 4.4 Accessing the Profitability

From the table above 37% used the cash flow statement to assess profitability, 27.0% used the balance sheet was better, 27% used the changes in statement of shareholder equity, while others used the auditors reports and note to financial statements both at 10.0% .

4.2 Regression Analysis

In order to establish the impact of mergers on the financial performance of commercial banks in Kenya the researcher conducted a regression analysis. The researcher applied the statistical package for social sciences (SPSS) aid in the computation of the measurements of the

multiple regressions for the study. Two regression analyses were conducted: one for before the merger whiles the other one for after the merger**.**

Table 4.22 Regression of Study Variables

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.897[a]	.805	.794	.43463

Profit contributed 80.5% of the effects of mergers and acquisition on the financial performance of commercial banks prior to the merger as represented by the R square. This therefore means that there are other factors not studied in this research which contributes 19.5% of the impact of mergers on the financial performance of the banks in Kenya. Therefore, further research should be conducted to investigate these factors affecting (19.5%) the changes noted in the financial performance of banks following the merger.

5. Summary, Conclusions and Recommendations

5.1 Summary of the Major Findings

From the study the majority of the respondents 17(41%) would not neither agree nor disagree whether the bank was profitable before merger, while 9(22%) agreed, 4(10%) strongly agreed. 6(15%) and 5(12%) disagreed and strongly disagreed respectively. The study established that 39% use the rate of return of asset to measure profitability before merger, 24% saw the increase in shareholders' value as a good measure, 22 % thought profit margin while 15 % believed operational performance was a good measure of profitability. After the merger, 37% used the cash flow statement to assess profitability; 27% used the balance sheet and changes in statement of shareholder equity, while others used the auditors' reports and note to financial statements both at 10%. The independent variables contribute 80.5% of the effects of mergers and acquisition on the financial performance of commercial banks prior to the merger as represented by the R square. Conversely, other factors not studied contributed 19.95% of the impact of mergers on the financial performance of the banks in Kenya.

5.2 Conclusions

The overall result is that management is essential through the entire acquisition and merger process and can be perceived as the crossbar of the whole exercise. Thorough integration, financial evaluation of synergies, and extensive planning are additional key elements of

performance realization. It is the result of the examination of performance that one can be sure that an acquisition and merger has been successful. Scrutinizing the theoretical the key elements of successful merger and acquisition revealed that organizational structure and culture are of importance for the outcome of the transaction as well as planning the process. Overall, management influences both issues and is additionally a further key element of the integration process which includes change management and employee motivation and retention. When it comes to measuring corporate performance and the achievement of synergies it was the evidence that three approaches were useful; measuring corporate objectives, evaluating financial key ratios, using the balanced sheet among the use of other financial statements. The use of the balanced balance sheet and financial might meet the difficulties in measuring intangible synergies and provide a complete picture of the company's performance. The study was able to determine that the merger and acquisition by the two banks were successful and be able to become profitable over the years.

5.3 Recommendations

5.3.1 Policy Recommendations

The strategic fit between the merging companies is vital. Focus on cost synergies is common and not less desirable despite the fact that revenue synergies have the highest upside potential. Also, expecting costs connected to the realization of synergies and the fact that synergies are realized over a range of years is important.

The valuation and assessment are of great importance no matter which synergies are expected in order to avoid paying too much since synergy evaluation is a great part of the price paid for the target.

An overall vision of the company should be implemented in the planning. A powerful common vision of the combined company is vital to create coherence across the company. Competent management may improve a deal even with the most challenging assumptions. Symbols and a strong common vision strengthen the possibility of a successful outcome. If people do not cooperate and yet even fail to understand the vision of new bank, the merger may fail.

A deeper insight into a single case may show other evidence than empirical results. Acquiring companies should be aware of the measurement of the company's performance.

Paying attention to the recommendations above, managers as well as analysts should be aware of the complexity of mergers and acquisitions success and that this complexity additionally affects measuring the outcome. This study recommends that the management continue adopting good leadership styles for they are important to the general performance of the merger of CFC Stanbic holdings Kenya limited.

This study recommends that the management adopt even more new financial management aspects and processes that are key in promoting the growth and performance of CFC Stanbic at all times. This can be done by engaging a high learned team in R&D where those concerned will be in a position to learn new approaches essential in financial management. The aspects learned will include good auditing skills, accounting skills, management of cash skills, investment skills and many more to enhance the profitability levels in the life of the merger.

Finally, innovation strategies in the adoption and use of technologies at CFC Stanbic need to be enhanced making sure that effective performance. New technologies and many more upcoming ones need to be adopted with caution to avoid budget stress.

5.3.2 Recommendations on Further Research

Future research can be done on effects of mergers on the performance of companies in different fields so as to shed more light on the effect of mergers and acquisitions on other companies in different countries.

The same study should be carried out in other firms to find out if the same results would be obtained. This study was carried out in CFC Stanbic, it would be interesting to find out if the same results will be obtained by use of the same approach.

There are many challenges facing the formation of mergers. A study should be carried to find out the extent to which the challenges influence on formation of mergers and why many firms' banks or commercial institutions have not formed mergers despite the advantages got from formation of the mergers.

In the Kenyan market a research comparing the effectiveness of strategic approaches in mergers within financial institutions would also an interesting topic to be undertaken on the different banks that have undertaken these strategies. A research on the mergers of other business entities, as opposed to financial, would be interesting.

It would be of great importance to find out the determinants of the success, or otherwise, of mergers.

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Appendix : Tables And Figures

Table 2.1 Summary of theories of merger and their effects

Theory	Principle
Value Increasing	Transaction cost efficiency – mergers optimize Transaction costs Synergy – scale, best practices, etc. Disciplinary – takeovers can be used to replace poor management
Value Reducing	Agency costs of free cash flow – managers reinvest FCF inefficiently back into firm Management entrenchment – firm invests to increase managers' value to shareholders
Value Neutral	Hubris – winner of takeover contest is firm that most overvalues target

Source: Gaughan 2002 Theories of Mergers

Theoretical prediction

Table 3.1 Target population

Respondent	**Target population**
Top Management-CFC Stanbic Bank Limited	18
Middle level management- CFC Stanbic Bank Limited	32
Total	50

Source: Stanbic (2015)

Table 4.1 Pre-merger Profitability

Bank	2006 Sh'000'	2007 Sh'000'
CFC Bank	2,162,103	3,150,516
Stanbic Bank	3,612,752	4,557,345

Table 4.2 Profitability Before the Merger

Level of agreement	**No. of respondents**	**Percentage (%)**
Strongly agree	4	10
Agree	9	22
Neither Agree nor disagree	17	41
Disagree	6	15
Strongly disagree	5	12
Total	**41**	**100**

Source: Researcher (2015)

Table 4.3 Measure of Profitability

Measure by	**No. of respondents**	**Percentage (%)**
operational performance	6	15
profit margin	9	22
increase in shareholders' value	10	24
rate of return on asset	16	39
Total	**41**	**100**

Source: Researcher (2015)

Table 4.4 Accessing the Profitability

Financial Statement	No. of respondents	Percentage (%)
Notes to the Financial Statements	4	10.0
Statement of Changes in shareholders' Equity Shareholders' Equity	11	27.0
Income Statement	2	5.0
Auditor's reports on those financial statements	4	10.0
Cash Flow Statement	15	37
Balance Sheet	11	27.0
Total	**41**	**100**

Source: Researcher (2015)

Table 4.22 Regression of Study Variables

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.897[a]	.805	.794	.43463

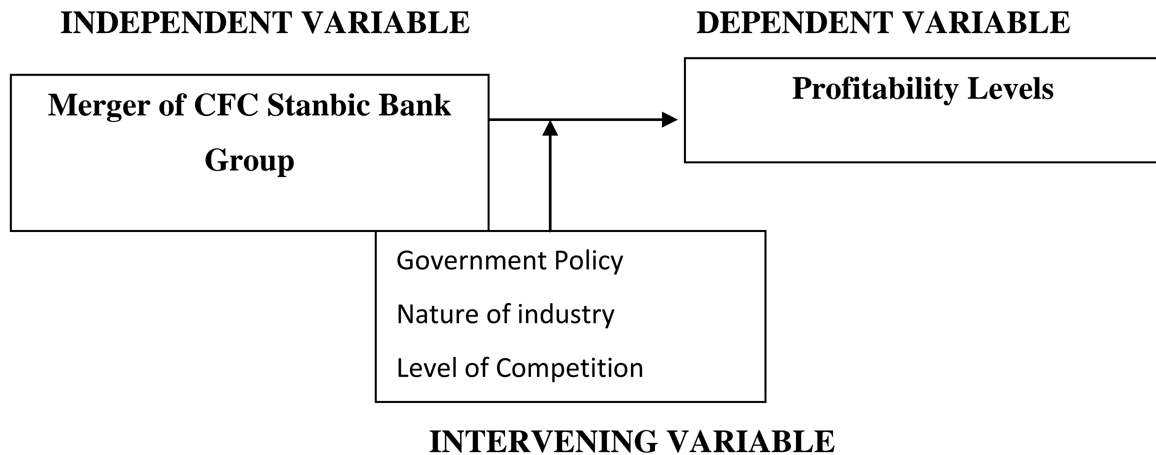

Fig 2.1 conceptual framework