EFFECT OF MERGERS AND ACQUISITIONS ON FINANCIAL PERFORMANCE OF FINANCIAL INSTITUTIONS IN KENYA

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ABSTRACT

Mergers and acquisitions are corporate restructuring activities conducted in a bid to enhance the firms' returns or increase the efficiency of their operations. There are enormous benefits attributed to mergers and acquisitions and this factor has increased the attractiveness of mergers and acquisitions globally hence the recent trend towards mergers and acquisitions. Due to changes in the operating environment, several licensed institutions, mainly commercial banks, have had to merge; combine their operations in mutually agreed terms where one institution takes over another's operations. The main objective of the study was to assess the effect of mergers and acquisitions on financial performance of financial institutions in Kenya. Specifically the study sought to establish the effect of capital base upon merger on financial performance of financial institutions in Kenya, to determine the effect of income diversification upon merger on financial performance of financial institutions in Kenya, to evaluate the effect of asset quality upon mergers on financial performance of financial institutions in Kenya and to investigate the effect of liquidity upon merger on financial performance of financial institutions in Kenya. The study was guided by monopoly - market power theory, the value-increasing theories, hubris hypothesis and the Modigliani–miller theorem. This study focused on 16 firms which had undergone mergers and acquisition between period 2005 and 2015. To this end therefore, a census on accessible population was done due to its small size. The secondary data was for the duration of 6 years including 3 years prior to merger or acquisition and 3 years after merger or acquisition. After data was collected, it was analyzed using correlations, descriptive statistics and multiple regression with the aid of Stata. The regression coefficients were tested for significance using t-statistic at 5% level of significance and conclusions drawn. The study revealed that capital base, income diversification, asset quality and liquidity had a significant effect on performance of financial institutions in Kenya upon mergers. This study recommends that financial institutions with a weak and unstable capital base should seek to consolidate their establishments through mergers and acquisitions. The study also recommends that Management should not only undertake mergers and acquisitions in order to improve operation and sustain failing businesses but also improve their asset quality and financial standing. Further, the study recommends that those firms facing operational constraints should to consolidate their energies by resorting to merger so as to improve their performance.

Key Words: *merger, acquisition, financial performance, capital base, income diversification, asset quality, liquidity*

INTRODUCTION

Mergers and Acquisitions (M&A) is an important financial tool that enables companies to grow faster and provide returns to owners and investors (Sherman, 2011). Generally, M&A refers to the change in ownership, business mix, assets mix and alliance with the view to maximizing shareholders' value and improve the firms' performance (Pazarkis, Vogiatzoglo, Christodoulou

& Drogalas, 2006; Gaughan, 2011; Nakamura, 2015). According to (Pazarkis et al., 2006; Gaughan, 2011; Nakamura, 2015), one of the main elements of improving company performance is the boom in mergers and acquisitions. However, in many cases, M&A are often used interchangeably. According to (Ross, Westerfield, Jordan & Etling, 2003), a merger is the complete absorption of one firm by another, wherein the acquiring firm retains the identity and the acquired firm ceases to exist. It is a corporate strategy usually done between two or more companies where by the acquiring firm and the acquired firm stands on a merger agreement. For instance, two firms may come to the agreement that they move together either individually or as a joint entity for their own mutual benefit and in this case, a merger occurs.

In Kenya, mergers have been witnessed in the banking and insurance sectors. For Instance Credit Finance Corporation and STANBIC banks merged to form CFC STANBIC bank. The resultant company is a subsidiary of Standard Bank Group. Mergers have also been experienced in the insurance industry where companies such as ICEA and Lion Assurance Company that merged to form ICEA LION group. Some of these mergers are used as market entry strategies by the companies involved or they happen as companies struggle to meet specific government legislation. More mergers are likely to take place in Kenya if the government through the Central Bank of Kenya implements its proposal to increase the deposit required of commercial banks to Ksh5 billion (Delloite, 2015).

Due to changes in the operating environment, several licensed institutions, mainly commercial banks, have had to merge; combine their operations in mutually agreed terms where one institution takes over another's operations (Brito, Pereira, Da Concorrencia, & Ribeiro, 2011). Some of the reasons put forward for mergers and acquisitions are to meet the increasing market demand and competition, diversify to international markets, employ the emerging new and expensive modern technologies, or to meet the new thresh hold capital required by the regulators such as in the banking sector (Kithinji & Waweru, 2010). However some studies have shown that not all mergers are profitable due to poor management of the post-mergers challenges and hence the question whether mergers are profitable or not?

In 2008, the government proposed to raise the minimum core capital for banks to 1 billion shillings from 250 million shillings, giving year 2012 as the deadline for all banks to comply (Beck, Cull, Fuchs, Getenga, Gatere, Randa & Trandafir, 2010). Subsequently, Kenyan banks opted for consolidation to meet the deadline to boost minimum core capital. Several banks had already completed a merger citing the need to enlarge their branch network and balance sheet. The local implications on banks of enhanced capital rules abroad following the 2008 global financial crisis have also encouraged mergers and acquisitions in the sector.

In recent years a substantial number of mergers and acquisitions have taken place in the banking sector in Kenya, partly occasioned by the need to meet the increasing minimum core capital requirements and to enhance the institutions market share in the local banking industry. Between

1994 and 2010 there was 20 successful mergers, with the number increasing to 28 by 2014 (Joash & Njangiru, 2015).

Beck, Cull, Fuchs, Getenga, Gatere, Randa and Trandafir, (2010) posits that increased competition and capital adequacy requirements are the key drivers behind sector consolidation. The Kenyan corporations utilize mergers as one of the most frequently selected instruments for growth (Economic Mergers in Kenya have been on the increase by multinational companies either acquiring local firms or two local firms merging across industries). A report by Botchway (2010) indicated that (M&A) is a critical vehicle in facilitating corporate growth and productivity. The globalization of markets and rapid technological changes has seen many firms face intense competition and are therefore resorting to M&A's to improve their competitiveness in the market by increasing market share relative to their competitors. Companies use M&A's to reduce business risk through broadening of the portfolio; to make it easier for them to enter into new markets through strategic placements and to capitalize on economies of scale (Kivindu, 2013).

Locally, the relationship between mergers and firm's performance has been the subject of abundant research in several fields and it has produced mixed results. Muya (2006) carried out a survey of experiences of mergers and found that mergers do not add significant value to the merging firms. Kithitu (2012) researched on the role of mergers and acquisitions on the performance of commercial banks in Kenya. The results revealed that mergers and acquisitions do add value to shareholders wealth. Ireri (2011) conducted a survey on effects of mergers and acquisitions on financial performance of oil companies in Kenya and from the researcher's finding on respondent opinion on M&A, financial performance were positively correlated with financial performance after the merger.

The above evidences, fail to show that there is a relationship between capital base, income diversification, asset quality, liquidity and the performance of financial institutions in Kenya as a result of mergers. Therefore, since the importance of merger cannot be overemphasized, this prompts the researcher's interest to establish the relationship of mergers performance of financial institutions in Kenya. This study sought to establish and fill the research gap by answering the question: what are the relationship between mergers and performance of financial institutions in Kenya?

GENERAL OBJECTIVE

The main objective of the study was to assess the effects of mergers and acquisitions on financial performance of financial institutions in Kenya.

SPECIFIC OBJECTIVES

1. To establish the effect of capital base upon merger on financial performance of financial institutions in Kenya.
2. To determine the effect of income diversification upon merger on financial performance of financial institutions in Kenya.
3. To evaluate the effect of asset quality upon mergers on financial performance of financial institutions in Kenya.
4. To investigate the effect of liquidity upon merger on financial performance of financial institutions in Kenya.

THEORETICAL FRAMEWORK

Monopoly -Market Power Theory

Monopoly -market power Theory initiated in 1990, and its proponent was Trautwein. According to the monopoly theory, mergers are realized in order to achieve a monopoly through increased market power. It is an explanation of horizontal and conglomerate mergers. Market power can be accomplished through the deliberate reduction of supply, cross-subsidizing products and deterring potential market entrants (Trautwein, 1990; Rodermann, 2004). These benefits are also referred to as collusive synergy (Chatterjee, 1986) and competitor interrelationships (Porter, 1985).

This theory states that Mergers were executed to achieve market power. The implication of this type of merger is that conglomerates use it to cross subsidize products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market. These three advantages of the monopoly theory supported the idea of a collusive synergy (Trautwein, 2006) or competitor Interrelationships (Barros, 1998). Choi and Weiss (2005) argue that M&A can also create value if they increase firm market power, allowing the post-merger entity to earn higher economic rents. However, this rationale for market-value gains is questionable in some industries such as the US personal lines insurance industry. The study by Choi and Weiss (2005) do not support the structure-conduct-performance hypothesis that concentration and larger firm size lead to market power and anti-competitive conditions.

The theory is of value to the proposed study for it points out how mergers are realized in order to achieve a monopoly through increased market power.

The Value-Increasing Theories

Malatesta (1983) and Lubatkin, (1987) are considered as the pioneers of The Value-Increasing Theories. According to the value increasing school, also called synergies theory, mergers occur, broadly, because they generate 'synergies' between the acquirer and the target which, in turn, increases the value of the firm (Malatesta, 1983; Lubatkin, 1987).The theory of efficiency suggests, in fact, that mergers will only occur when they are expected to generate enough

realizable synergies to make the deal beneficial to both parties; it is the symmetric expectations of gains which results in a 'friendly' merger being proposed and accepted. If the gain in value to the target was not positive, it is suggested, the target firm's owners would not sell or submit to the acquisition, and if the gains were negative to the bidders' owners, the bidder would not complete the deal. Hence, if we observe a merger deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target.

Through use of Value-Increasing Theories, the study will realize how income diversification is gained by firms immediately after merging through generating 'synergies' between the acquirer and the target which, in turn, increases the value of the firm. Basically this theory gives insights of how firms grow and increases their values significantly as a result of merging with increased profitability.

Hubris Hypothesis

Roll (1986) proposed the theory of the Hubris Hypothesis. According to the managerial hubris hypothesis, even if managers try to maximize the value of the firm, they might overestimate the value of what they buy because of hubris (Roll, 1986). This is particularly true in waves of consolidation, when managers blindly follow the markets and change their beliefs on conglomeration versus strategic focus or when multiple bidders compete for the same target. Managers also could underestimate the cost of post-merger integration or overestimate their ability to control a larger institution. Thus, a transaction that is believed to benefit the acquirer could simply be a poor strategic decision where benefits are overestimated or costs are underestimated. The result is that shareholders of the acquiring firm lose from the deal because the market reacts to the mistake of the acquiring firm's manager.

This theory will be of great significance in this study for it highlights how the acquirer of the firms should be very keen in acquiring firms in order to prevent from potential failure as a result of overestimated acquisition fee. This adds value to the study for it pinpoints how firms may make potential loss after acquisition if the acquired firm was overestimated due to tough competition.

The Modigliani–Miller Theorem

Modigliani and Mille (1963) is said to be the key initiator of the Modigliani–Miller Theorem. It is a theorem on capital structure arguably forming the basis for modern thinking on capital structure. They theorized that in perfect markets, it does not matter what capital structure a company uses to finance its operations (Modigliani & Mille 1963). They theorized that market value of a firm is determined by its earning power and by risk of its underlying assets and its value. It states that, a certain market price process (the classical random walk), in the absence of taxes, bankruptcy costs, agency costs, and asymmetric information, and in an efficient market, the value of a firm is unaffected by how that firm is financed. It does not matter if the firm's capital is raised by issuing stock or selling debt. It does not matter what the firm's dividend

policy is. This study will help evaluate the impact of expanded capital base after the merger and how it impacts on the overall performance. The theory will add value to the study for it will pinpoint how capital base will influence performance.

RESEARCH METHODOLOGY

Research Design

Thornhill (2003) described a research design as a plan of action that a researcher has to take in order to tackle a problem. A similar definition has been given by Saunders et al (2003) who described a research design as a plan of study providing the overall framework for collecting data. Once the problem has been formulated, a design is developed in order to provide a format for detailed steps in the study. This study was a causal research. The study sought to establish the effect of mergers and acquisitions on the financial performance of financial institutions in Kenya. Since this is a causal relationship between variables, causal research design was more applicable. Airasian and Gay, (2006) reveal that causal research design is important in explaining issues that have already happened where there is no need to control the variables. Since the effects of mergers and acquisitions being examined had already taken place, then this research design became the most convenient one to use for this study.

Target Population

The target population of this study included the registered commercial banks, microfinance banks and insurance companies. According to the Central Bank of Kenya there are 43 registered commercial banks in Kenya and 12 microfinance banks. The Insurance regulatory authority also indicated that there are 49 registered insurance companies. This provided a total of 104 financial institutions that were the target population for this study. The financial institutions that had gone through mergers and acquisitions totals to 16 companies as illustrated in Appendix I. This study focused on 16 firms which have undergone mergers and acquisition between period 2005 and 2015.

Sample Size and Sampling Design

A sample is a portion of the target population from which data is collected, summarised, analysed and inferences about the target population from which the sample is drawn is done (Kumar, 2005). A good sample should be logical and practicable (representative) and have regard for time, costs, validity and accuracy of the data (Kumar, 2005). To this end therefore, a census on accessible population was done due to its small size. Census is the study of whole population and as such, it enhances validity of the data and results by including all information for all the elements in the study (Saunders, Lewis & Thornhill, 2009). In addition, it eliminates sampling error (Watson, 2001).

RESEARCH RESULTS

The results were computed to produce percentages, frequencies, mean and standard deviation for efficiency in interpretation. Qualitative analysis was conducted to supplement the quantitative analysis.

T-test

Paired t-test of significance was calculated and the findings were as below.

Table 1 indicates that the Returns on assets after merger mean for the period after the announcement date was 2.75273. Returns on assets before merger mean for the period before the announcement date was 2.23517. This means that Returns on assets increased after merger.

Capital base after merger mean for the period after the announcement date was 0.29058. Capital base before merger mean for the period before the announcement date was 0.25640. This means that Capital base increased after merger.

Income diversification after merger mean for the period after the announcement date was 0.63350. Income diversification before merger mean for the period before the announcement date was 0.31423. This means that Income diversification increased after merger

Asset quality after merger mean for the period after the announcement date was 0.34965. Asset quality before merger mean for the period before the announcement date was 0.30392. This means that asset quality increased after merger

Liquidity after merger mean for the period after the announcement date was 0.30684. Liquidity before merger mean for the period before the announcement date was 0.55517. This means that Liquidity decreased after merger

Table 1: Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	Returns on assets before merger-	2.235	16	1.251	0.313
	Returns on assets after merger	2.753	16	1.363	0.341
Pair 2	Capital base before merger-	0.256	16	0.066	0.017
	Capital base after merger	0.291	16	0.075	0.019
Pair 3	Income diversification before merger-	0.314	16	0.147	0.037
	Income diversification after merger	0.634	16	0.073	0.018
Pair 4	Asset quality before merger-	0.304	16	0.071	0.018
	Asset quality after merger	0.35	16	0.081	0.02
Pair 5	Liquidity before merger-	0.555	16	0.254	0.064
	Liquidity after merger	0.306	16	0.14	0.035

The paired t-test statistic was calculated at 5% level of significance. The p-value were less than the significance level of 5%, meaning that the capital base, income diversification, asset quality and liquidity means before and after the announcement were significantly different. Hence the rejection of the null hypothesis that. This implies that there are significant differences in the means before and after. As a result of these findings its feasible now to proceed and evaluate the effect of the after merger effects on financial performance.

Test of Hypotheses

A multiple regression analysis was conducted in order to test the effect variables (independent) on the performance of financial institutions in Kenya. Statistical package for social sciences (SPSS) was used to code, enter and compute the measurements of the multiple regressions for the study.

The main objective of this study was to assess the relationship between mergers and performance of financial institutions in Kenya. To achieve this, specific objectives were developed and hypothesis in relation to this were tested. The findings are presented in the sections that follow.

Effect of capital base after merger on performance of financial institutions in Kenya

To evaluate the effect of capital base after merge on performance, capital base was regressed against performance measure. The following hypothesis was tested.

H0: Capital base after merger has no effect on performance of financial institutions in Kenya

The regression output is as shown in Table 2According to the regression equation established, taking capital base constant at zero, performance rating would be 1.039. The data findings analyzed also shows that a unit increase in capital base will lead to a 0.439 increase in performance. The significance value is .0192 less than p value of 0.05 thus statistically significant. We therefore reject the null hypothesis that Capital base after merger has no effect on performance of financial institutions in Kenya and accept the alternative hypothesis that Capital base after merger has an effect on performance of financial institutions in Kenya. In line with the study findings, Javaid (2011) observed that capital strength of a firm is of paramount importance in affecting its profitability. A well-capitalized firm is perceived to be of lower risk and such advantage is converted to profitability. He adds that a well-capitalized firm faces lower expected costs of financial distress and such advantage is translated into high profitability. Merged firms have access to financial markets that were not available to one or both of the smaller firms.

The cost of capital falls below premerger levels. For example, the combined firm may have a lower probability of bankruptcy than the two separate firms if the cash flows of the two firms are not perfectly positively correlated (Bruckner, 2005). Beck et al., 2010) in his study on the impact of mergers on firm performance observed that mergers and acquisitions of commercial firms had consequently increased the capital base of firms and that increase in capital base of firms does

not only enhance revenue generation but acts as a hedge against future losses, economic slow-down and to secure the capital of shareholders.

Table 2: Capital base after merger and performance

Model	Un-standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.039	1.2235		6.615	0.000
Capital base	0.439	0.1032	0.152	4.223	.0192

Effect of Income diversification after merger on performance of financial institutions in Kenya

To evaluate the effect of Income diversification after merge on performance, Income diversification was regressed against performance measure. The following hypothesis was tested.

H0: Income diversification after merger has no effect on performance of financial institutions in Kenya

The regression output is as shown in Table 3.

According to the regression equation established, taking Income diversification constant at zero, performance rating would be 1.001. The data findings analyzed also shows that a unit increase in Income diversification will lead to a 0.487 increase in performance. The significance value is .0251 less than p value of 0.05 thus statistically significant. We therefore reject the null hypothesis that Income diversification after merger has no effect on performance of financial institutions in Kenya and accept the alternative hypothesis that Income diversification after merger has an effect on performance of financial institutions in Kenya.

In tandem with the study findings, Choi and Kotrozo (2006) mentioned that activity diversification results in more complex organizations which "makes it more difficult for top management to monitor the behavior of the other divisions/branches. They further argued that the benefits of economies of scale/scope exist only to a point and costs associated with a firm's increased complexity may overshadow the benefits of diversification.

As such, the benefits of diversification and performance would resemble an inverted-U in which there would be an optimal level of diversification beyond which benefits would begin to decline and may ultimately become negative. Olweny & Shipho (2011) study effects of banking sectoral factors on the profitability of commercial banks in Kenya and noted that the more banks generate their revenue from different activities, the more profitable they become, thus linking diversification of income with profitability of commercial Banks.

Table 3: Income diversification upon merger and performance

Model	Un-standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.001	1.2235		6.615	0.000
Income diversification	0.487	0.2178	0.116	3.936	.0251

Effect of asset quality after merger on performance of financial institutions in Kenya

To further evaluate the effect of asset quality after merge on performance, asset quality was regressed against performance measure. The following hypothesis was tested.

H0: Asset quality after merger has no effect on performance of financial institutions in Kenya. The regression output is as shown in Table 4.

According to the regression equation established, taking asset quality constant at zero, performance rating would be 1.102. The data findings analyzed also shows that a unit increase in asset quality will lead to a 0.752 increase in performance. The significance value is .0269 less than p value of 0.05 thus statistically significant. We therefore reject the null hypothesis that asset quality after merger has no effect on performance of financial institutions in Kenya and accept the alternative hypothesis that asset quality after merger has an effect on performance of financial institutions in Kenya. Similar to the study findings, Joshua (2011) evaluated the impact of merger and acquisition on financial efficiency of insurance companies in Nigeria. In his study, he used operating profits, net income and net assets of sample companies to determine financial efficiency by comparing data before and after merger the merger. The study established that there was higher post-merger financial efficiency compared to the pre-merger periods.

Kosmidou (2008) applied a linear regression model on Greece commercial banks data for 1990 to 2002, using ROA and the ratio of loan loss reserve to gross loans to proxy profitability and asset quality respectively. The results showed a negative significant 20 impact of asset quality to bank profitability. This was in line with the theory that increased exposure to credit risk is normally associated with decreased firm profitability. Indicating that banks would improve profitability by improving screening and monitoring of credit risk.

Table 4: Asset quality after mergers and performance

Model	Un-standardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.102	1.2235		6.615	0.000
Asset quality	0.752	0.3425	0.054	3.724	.0269

Effect of liquidity after merger on performance of financial institutions in Kenya

To further evaluate the effect of liquidity after merge on performance, liquidity was regressed against performance measure. The following hypothesis was tested.

H0: Liquidity after merger has no effect on performance of financial institutions in Kenya.

The regression output is as shown in Table 5.

According to the regression equation established, taking liquidity constant at zero, performance rating would be 1.847. The data findings analyzed also shows that a unit increase in liquidity will lead to a 0.545 increase in performance. The significance value is .0454 less than p value of 0.05 thus statistically significant. We therefore reject the null hypothesis that liquidity after merger has no effect on performance of financial institutions in Kenya and accept the alternative hypothesis that liquidity after merger has an effect on performance of financial institutions in Kenya. In line with the study findings, According to Dang, (2011) adequate level of liquidity is positively related with bank profitability. The most common financial ratios that reflect the liquidity position of a bank according to the above author are customer deposit to total asset and total loan to customer deposits. Other scholars use different financial ratio to measure liquidity. For instance (Ilhomovich, 2009) used cash to deposit ratio to measure the liquidity level of banks in Malaysia. However, the study conducted in China and Malaysia found that liquidity level of banks has no relationship with the performances of banks (Said and Tumin, 2011).

Tuni (2011) studied the impacts of M&A on profitability of financial institutions in Kenya. The study zeroed on two overriding objectives: To determine the profitability of merged institutions before and after the merger/acquisition and to determine the impact of M&A on the profitability of the financial institutions. A sample of 20 financial institutions was selected from the population of interest of 70 institutions that had merged. 10 years' financial statements from the 20 financial institutions were used to calculate and analyze the performance indicators being earnings per share, ROA and ROE. It was found that before the merger, 7, 8 and 7 institutions had positive ROA, ROE and EPS respectively. On the year of the mergers and acquisitions, there was a change on the performance exhibited by these indicators. After the mergers and acquisitions, 6, 8 and 8 financial institutions posted an improvement in ROA, ROE and EPS respectively

Table 5: Liquidity after mergers and performance

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.847	1.2235		6.615	0.000
	Liquidity	0.545	0.1937	0.263	3.247	.0454

CONCLUSIONS

The study sought to establish the effect of capital base upon merger on financial performance of financial institutions in Kenya. Based on the findings, it can be concluded that the capital base of financial institutions increased as a result of merger or acquisition. It can also be concluded that the capital base increased in terms of increase of assets, cash and securities, competitive advantage increased market. In addition the study concludes that there is a significant relationship between pre and post-merger/acquisition capital base of firms and level of profitability.

The study also sought to determine the effect of income diversification upon merger on financial performance of financial institutions in Kenya. The study concludes that there is a significant relationship between pre and post-merger and acquisition Income diversification of firms and level of profitability. The study concludes that the Income diversification of financial institutions increased as a result of merger or acquisition in form of growth and survival of firms, reduction of operational costs and improved profit Income diversification. The study further concludes that financial institutions have the ability to compete in the market increased as a result of merger or acquisition.

In addition, the study sought to the effect of asset quality upon mergers on financial performance of financial institutions in Kenya. The study concluded that asset quality of financial institutions have increased as a result of merger or acquisition. Also based on the findings, it can be concluded that when companies come together there is increased asset quality.

Further the study sought to investigate the effect of liquidity upon merger on financial performance of financial institutions in Kenya. The study concluded that liquidity of Financial institutions have increased as a result of merger or acquisition. Also based on the findings, it can be concluded that when companies come together there is increased pool of liquidity as different employees with great experiences, skills and competencies come together and share ideas.

Generally, before mergers and acquisitions took place, financial institutions in Kenya did not have strong capital base, asset quality and liquidity. Their income diversification also increased with increase in profitability. The portion of the financial performance that was explained by capital base, income diversification, asset quality and liquidity of the firms was very small before mergers and acquisitions. However, after mergers and acquisitions took place, the capital base, income diversification, asset quality and liquidity of the firms improved significantly thus enhancing their financial performance. A strong positive relationship was witnessed between the liquidity of the firms and their financial performance as well as between the capital base, income diversification and asset quality and financial performance. Mergers and Acquisitions pursue the profitability, liquidity and solvency objectives of an organization. The study concludes based on the data presentations in chapter four and the summary of the findings above that commercial firms' financial performance improves with the merger and acquisition. This is because the

merger and acquisition brings about a bigger firm size and an increased liquidity which are important ingredients in firm performance. With increased commercial firms' stability and ability to lend, the commercial firms make higher profits. The study also concludes that mergers/acquisitions alone cannot result into strong, efficient and competitive financial systems because financial performance is dependent on several factors. Mergers/acquisition need to be supplemented by other measures such as enhancing the expertise and professionalism of the financial institutions personnel and bringing about more management efficiency to further increase the competitiveness of the financial institutions in the context of the challenges of a globalized and a very competitive industry.

RECOMMENDATIONS

From the findings presented in chapter four and summary above, this study recommends that financial institutions with a weak and unstable capital base should seek to consolidate their establishments through mergers and acquisitions. Through mergers and acquisitions, the financial institutions will be able to expand their market share and revenue base increasing their profitability.

The study also recommends that Management should not only undertake mergers and acquisitions in order to improve operation and sustain failing businesses but also improve their asset quality and financial standing. Management should come up with a sound strategy towards asset and liability management so as to avert the problem of mismatching investments and also the quality of assets should be enhanced.

Further, the study recommends that those firms facing operational constraints should to consolidate their energies by resorting to merger so as to improve their performance as the merger is not just for the best interest of the shareholders and also managers which will not be achieved when the firm is operating separately on its own. Therefore mergers ought not to be seen as a loss of control on managers or loss of ownership but a strategy of achieving better performance.

The study established that mergers and acquisitions enhance the liquidity of financial institutions. It will be important for firms that have weak liquidity to consider mergers and acquisitions so as to improve their liquidity since it plays a significant role in improving the financial performance of a company.

In addition, mergers and acquisition leads to a liquidity which ensures that the firm is able to meet short term financial obligations when they fall due and there is no time that the firm is declared bankrupt. Management should not only undertake mergers and acquisitions in order to improve operation and sustain failing businesses but also improve their competitiveness and financial standing. Management should come up with a sound strategy towards asset and liability management so as to avert the problem of mismatching investments and also the quality of assets should be enhanced.

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