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EFFECT OF MERGERS AND ACQUISITIONS STRATEGIES ON FINANCIAL PERFORMANCE OF FINANCIAL SERVICES SECTOR

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Abstract

Purpose: The purpose of this study was to establish the effect of mergers and acquisitions strategies on financial performance of firms in the financial services sector in Kenya.

Methodology: The study adopted a mixed methodology research design. The study population included all the 51 merged financial service institutions in Kenya. Purposive sampling was used. Primary data was obtained from questionnaires and a secondary data collection template was also used. The researcher used quantitative techniques in analyzing the data. Descriptive analysis for the study included the use of means, frequencies and percentages. Inferential statistics such as correlation analysis was also used. Panel data analysis was also applied. Further, a pre and post merger analysis was used.

Results: Cost efficiency was found to have a positive and significant effect on financial performance of merged institutions. Diversification had no significant effect on financial performance of merged institutions. Synergy had a significant relationship with financial performance of merged institutions. Board size had a significant relationship with financial performance of merged institution and there was a significant relationship between the moderating effect of economic growth and financial performance of merged institutions.

Unique Contribution to Theory, Practice and Policy: The study recommended that policy makers (government) should be able to create or promote the enabling environment for facilitating mergers and acquisitions that concerns infrastructure provision, as a way of achieving cost reduction that could motivate similar mergers in other institutions in Kenya, stakeholders are to identify where their most immense profit pools lie and focus on improving those units responsible for them, the management of the financial services institutions should embrace diversification and financial innovation on product strategies as this will help in generating more income for the banks.

Keywords: *Cost efficiency, diversification, synergy, board size, financial performance, merged institutions, economic growth.*

1.0 INTRODUCTION

1.1 Background of the Study

A merger or an acquisition is a strategy that is carefully planned to achieve a synergistic effect (Akinsulire, 2012). The synergistic effect of mergers and acquisitions includes economies of scale through greater output, avoidance of duplication of facilities and staff services and stronger financial base. The economic benefits as a reason for pursuing a merger or an acquisition include income enhancement, cost reduction and growth (Amedu, 2014). Some of the reasons for mergers and acquisitions are to: purchase a company having competent management; improve earnings per share, inject fresh ideas for better prospects and enhancement of shareholders' wealth, gain access to the financial market, eliminate duplicate and competing facilities, secure scarce raw materials, diversify into other products or markets or to complete a product range, greater asset backing; and enhance economy of scale and corporate growth (Akinsulire, 2012: Amedu, 2014).

Mergers & Acquisitions (M&A)play major rolesin shaping activities of enterprises. Once a phenomenon seen primarily in the US, M&As are now taking place in countries throughout the world. Continental Europe has experienced M&A bursts coupled with relative inactivity both domestically and across national borders since the stock market bull run from the recession of 1980- 81, the deregulation of the financial services sector, and development of new financial instruments and markets, labeled the first European merger wave (Hitt,*et al* 2001). The first real increase in M&A activity in the UK, on the other hand, can be traced back to the 1920's when the development of mass production techniques created an increase in the vertical integration through scale of production, while the second M &As wave came in the 1960s as a response to the internationalization of the world economy. There was need for M&As to create larger firms that would be capable of being effective in international competition especially from countries like the US and Japan (Sundarsanam, 2003).

Merger and Acquisition has become a corporate strategy enabling a firm to strengthen its core competencies and the factors affecting mergers change with their changing legal, political, economic and social environments (Gyanwali, 2013). Firms engage in mergers and acquisitions activity for different economic reasons. For example;synergy is commonly used in a merger and acquisitions activity. Synergy has been described as the combination of firms that have a value which is greater than the sum of the values of the separate firms (DePamphilis 2009). Hypothetically the underlying principle of synergy is 2+2=5, or 5+5=11 which is technically incorrect. However, it is believed that the net positive gain will be achieved resulting from the merger of two separate entities. Synergy can be produced as operational, managerial and financial synergies (Ross et.al 2003). Operational synergy can be explained as the combination of economies of scale, which would reduce average costs as a result of more efficient use of resources, and economies of scope, which would help companies deliver more from the same amount of inputs" (DePamphilis 2009). Financial synergy refers to the impacts of mergers and

acquisitions on the cost of capital of the acquiring firm or the newly formed firm resulting from a merger or acquisition (DePamphilis 2009). The merged entity will be able to reduce the cost of capital and increase its buying power. However (DePamphilis 2015; Frankie TAN, 2009) explain that a conglomerate merger enables an individual unit under the umbrella of one centralized parent company achieve beyond what would have been achieved by each unit competing individually.

According to (*Ross et.al* 2003), "One important reason for a merger or acquisition is that the combined firm may generate greater revenues than two separate firms". Enhancing the revenue of companies can be done by market gains, strategic benefits, and market power. It is perfectly obvious that mergers and acquisitions can produce greater operating revenues from improved marketing. For example, "when Microsoft purchased Tiny Vermeer in 1996, Vermeer's front-page software used to create webpage that was selling at a snail's pace. But, when the software was superimposed on the Microsoft front page, the sales took off reflecting Microsoft marketing muscle" (*Ross et.al* 2003). Some merger and acquisition produces strategic benefits when companies enter into another line of business to enhance management flexibility with regard to the future operations. For example, according to (Ross *et.al* 2003), a motor company from the original business can provide opportunities to begin manufacturing electric motors and generators

Many merger and acquisition are undertaken with the belief that a merged firm may operate more efficiently than two separate firms. A firm can obtain cost reductions in several ways through a merger or an acquisition (Ross *et.al* 2003). According to Motis (2007), a firm can obtain cost advantage when its average cost per unit decreases as the total level of output increases. Economies of vertical integration can be gained by combining the companies operating in the same industry. For example, airline companies have purchased hotels and car rental companies. Vertical integration of companies may have a significant impact on companies to reduce cost, to improve supply chain operations, and in increase the profit margin. Some companies may acquire another company for the sake of complementary resources which makes the products commercially viable. For example, according to (Motis 2007) winter clothing store could merge with a summer clothing store to produce more sales over both the winter and summer seasons.

1.2 Problem Statement

The resultant benefits and costs of mergers and acquisitions is a strategic issue which may impact positively or negatively on financial performance (Healy, Palepu and Ruback 2012). Shareholders and their agents are therefore faced with a problem of trying to ascertain whether this strategic decision and activity will result in improvement of better financial performance (Katuu, 2003). Mergers and acquisitions could also concern policy makers because they may have negative consequences on the competitive environment by creating monopolies (Wang 2007). Several economic theories and M&A literature support the idea that shareholders experience positive abnormal returns arising from expected value creation post-merger (Halebian, 2009;Cartwright *et al*, 2013; Moeller et al., 2015). Thus, M&As are expected to create value as a result of firms exploiting economic resources that are both available and implementable but, the general result is that the shareholders of target firms earn positive and

significant returns, whereas returns for acquiring firms are much lower and possibly negative(Cartwright *et al*, 2013). This is the practical gap that necessitates this study.

Many studies in M&As have been done in developed markets globally mainly in Asia, Europe and the USA. Healy,*et al* (1992) examined post-acquisition performance for 50 largest U.S. mergers between 1979 and 1984 by measuring cash flow performance, and concluded that performance of merging firms improved significantly following acquisitions, when compared to their respective industries. Lubatkin (1983) reviewed the findings of studies that investigated either directly or indirectly the question, "Do mergers provide real benefits to the combined firm?" The review suggested that combined firms might benefit from merging because of technical, and diversification synergies. Ghosh (2001) examined the operating cash flow performance improvement after corporate acquisitions; and the results showed that merging firms did not show evidence of improvements in the operating cash flow performance of post-merger and acquisition. Wang (2007) investigated the wealth effect of investment banks and fairness opinions they provide in corporate mergers and acquisitions. The study found that firms undertaking opinioned mergers under-perform firms with non-opinioned matching mergers in short windows around the announcement date. Lack of conclusiveness of studies linking merging activity to performance is a distinct knowledge gap.

Limited studies have been carried out on the M & As in the Kenyan market. These studies' findings have not shown that M & A activities positively affect financial performance. Some of them even give contradictory findings. Chesang (2002) carried out a studied on implications of merger restructuring on performance of commercial banks in Kenya. She used ratio analysis on this study and concluded that there was improved performance in some cases though; the extent of the contribution was not significant. Korir (2006) researched on the merger effects of companies listed in the NSE and found out that mergers improve performance of companies listed at the NSE. Ochieng (2006) did research on the merger between CBA & FABK and the results showed a decline in earnings and lower ratios arising out of the deal. Marangu (2007) studied effects of mergers on financial performance of non-listed banks in Kenya from 1994-2001 and using the ratio analysis, he concluded that there was significant improvement in performance for the non-listed banks that merged compared to the non-listedbanks that did not merge within the same period. The empirical studies conducted in Kenya including; (Maranga, 2010; Katuu, 2003; Muya, 2006; Kiplagat, 2006; Wesonga, 2006; Nyagah, 2007; Njoroge, 2007; Kithinji, 2007, Ndura 2010, Ndung'u 2011, and Ireri 2011) have all failed to treat mergers and acquisitions as a strategic activity. Despite these M&As activities continue to take place in the Kenyan economy; this presents a conceptual knowledge gap. In light of these inconclusiveness and conceptual gaps poised from these past studies, this study sought to establish if mergers and acquisitions strategic activities lead to improved financial performance of financial services institutions in Kenya.

1.3 Research Objectives

1.3.1 To establish the effect of cost efficiency on the financial performance of merged institutions.

1.3.2 To assess the effect of diversification on the financial performance of merged institutions.

1.3.3 To determine the effect of synergy on the financial performance of merged institutions.

1.3.4 To establish the effect of board size on the financial performance of merged institutions.

1.3.5 To determine the moderating effect of economic growth on financial performance of merged institutions.

2.0 LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Agency Theory

Agency theory is concerned with the separation of interests between company owners and managers (Jensen and Meckling, 1976; Shapiro, 2005; Carpenter et al., 2009; Heracleous and Lan, 2010). The main assumption of agency theory is that principals and agents are all rational and wealth seeking individuals who are trying to maximize their own utility functions. In the context of corporate governance, the principal is the shareholder and the agent is the director or senior management (Shapiro, 2005; Carpenter et al., 2009). Agency theory explains this relationship as a contract, but there are two problems: *first*;the problem occurs when there is conflict of interest between the principals and the agents; and it becomes very difficult and expensive for the principals to verify the agents' actions. *Second*; is how to share the risk as both parties have different risk preferences (Jensen and Meckling, 1976; Shapiro, 2005; Carpenter et al., 2009; Heracleous and Lan, 2010; Berger and Bonaccorsi di Patti, 2011; Aggarwaland Kyaw, 2012)

Agency theory is based on the following assumptions concerning "people; self-interest, bounded rational, and risk aversion. Assumptions concerning the organizations are; goal conflicts among members, and assumptions concerning information are such that, information is a commodity which can be purchased". Eisenhardt (1989) describes the two lines of the theory as positivist agency theory, and the principal-agent research. The first line identifies the circumstances leading to the conflict and explains the possibilities of reducing the management's self-interest behavior. In this line of theory, the board of directors are included in the agency theory as the monitoring instrument of the shareholders over the management. The second line of theory focuses on searching for the best solution contractually that can align these positions. Shapiro (2005) review of agency theory which is partly based on Eisenhardt (1989) also explains the theory in similar lines. Economic studies generally focus on the relationship between stockholders and managers and includes *first*; principals must always ensure that the selected agents act on their behalf, however; because managers have their own personal interest and often act opportunistically this cannot be assumed. *Second*; to solve this conflict of interest and information asymmetry between the parties the principal has several options of monitoring the agents' actions including; boards of directors, auditors, supervisors (and) structural arrangements (Heracleous *et al,* 2010;Berger and Bonaccorsi di Patti, 2011; Aggarwal and Kyaw, 2012). Further, agents can also be compensated in terms of behavior-oriented contract thus salary or performance (output) oriented contract, which includes commissions, bonuses, piece rates, stock grants, stock options and profit sharing. Eisenhardt (1989) asserts that the second alternative is best suited to align both positions thus ensuring that the agent acts in the principal's interest. All

these alternatives however come with costs; and these costs include cost of compensation, monitoring costs and costs that that may arise from the agents' actions that are not in line with the principals' best interests. It has also been stated that agents are risk averse while principals are risk neutral, and this is because agents are not able to diversify their risks (Heracleous *et al*, 2010; Berger and Bonaccorsi di Patti, 2011; Aggarwal *et al*, 2012).

Some of the critiques put forward towards the agency theory include those of Shapiro (2005), Heracleous et al (2010), who disputed the assumption that complex organizational structures and networks can be reduced to dyads of individuals. They say that agents are capable of serving several principals with multiple goals and even they themselves can be principals in a long chain of principal-agent relationships both inside and outside the organization (Shapiro, 2005; Heracleous *et a*l,2010). Secondly, on the assumption of self-interest and agents' own profit maximization goals, (Heracleous *et al*, 2010) introduce a new perspective on the theory and recommend the adoption of ways in which to cope with current ideas of corporate social responsibility and team production. These ways include; redefining the principal from shareholders to the corporation, redefining the status of the board from stockholders' agents to autonomous fiduciaries and redefining the role of the board from monitors to mediating hierarchy (Heracleous *et al*, 2010; Berger and Bonaccorsi di Patti, 2011; Aggarwal *et al*, 2012).The shareholders are in production unit team that also includes other stakeholders such as employees and management. Despite the critiques, the benefit of this theory is that it is applicable in different areas of research. One such area is M&As, in which it is in generally assumed that resistance to takeover bids is not in the interest stockholders, but that of managers because of the managers fear that they may lose their jobs during a takeover (Eisenhardt, 1989; Shapiro, 2005;Heracleous *et al*, 2010).

Carpenter et al. (2009) support this line of thinking and uses the theory in his current M&A research model mentioning that majority of M&A researches operate on this basis. For example it is used in the description of the market for corporate control; thus if companies are managed by ineffective agents, this will definitely be reflected in the company's share price as this will be lower as compared to a company that is managed by effective managers. These ineffectively managed companies are often targets of takeovers, because of the expected possible gains for the acquirer. Therefore, "acquisitions can be seen to be value enhancing when they are used to discipline ineffective managers".

Agency theory can also be approached from the perspective of free cash flow; accordingly it is expected that agents who have a lot of free cash at their disposal usually act opportunistically instead of investing in projects that are beneficial for their principals. Hence a reduction of such free cash flow reduces such behavior, which can be achieved by decreasing the amount of available cash by paying out dividends to the shareholders or and paying interest for a debt (Berger *et al*, 2006; Aggarwal *et al*, 2010). "Payouts to shareholders reduce the resources under managers' control, thereby reducing managers' power, [….]" and their possibility to be involved in wasteful activities. The other way of reducing the amount of free cash flow that differs significantly from the first one is to cut payments of dividends in the future as dividends are merely a "promise" to the shareholders and not a legal obligation as interest payments for debts are. Holders of debt can file for bankruptcy if a company fails to meet its obligation in terms of

payment of interest and principal, which may result into loss of control for the management (Jensen, 1986). Therefore, "greater financial leverage; thus increasing the amount of borrowed funds in relation to capital may affect managers and reduce agency costs through the threat of liquidation, which causes personal losses to managers of salaries, reputational perquisites, and through pressure to generate cash flow to pay interest expenses" (Berger*et al*, 2006). Hence, "the threat caused by failure to make debt service payments is an effective motivating force to make […] organizations more effective" (Jensen, 1986).

(Carpenter et al. 2009; DeYoung et al. 2009) try to explain the circumstances, in which managers use acquisitions to satisfy their self-interest. Based on (Shapiro 2005, Eisenhardt, 1989) description of agency theory it can be concluded that problems to do with managers contracts and lack of adequate monitoring lead to such behavior. Ownership effects are also considered relevant in this context, high and low levels of manager ownership in a company are indicative of misalignment of management's interest with shareholders' interests. Large shareholders fulfill external monitoring roles better and might trigger mergers to counter poor management (Carpenter et al., 2009).

These are supported by Collins et al. (2007) in their research model that links bank governance with acquisition performance. Researchers premise that empirical M&As research show that target shareholders often benefit and that "very few studies have detected positive returns to acquiring firm shareholders particularly in the US."They state that the poor results "point to poor governance arrangement" and suggest the counter-measures in terms of executive compensation and managerial ownership incentives (fixed salary as opposed to performance related incentives; high against low level of stock ownership), board composition (number of independent directors in relation to the overall number of directors) and board diversity in terms of gender or ethnic diversity).

It is therefore possible that one merger can be used simultaneously to discipline ineffective managers and satisfy the self-interests of others, depending on the point of view. In this case the agents of the target company are disciplined or replaced by the agents of the bidder company, at the same time, the managers of the bidder company can fulfill their own opportunistic goals like increased job security. When this happens, the former owners of the target company may now benefit from increased agent performance, but they will still be dealing with a set of agents that act opportunistically, although their performance level may be higher than the level of the previous agents. Agency theory therefore explains why firms diversify, and also explain why diversification does not create value for companies. The idea is that diversification is often undertaken to gain efficiencies and to ensure benefits to all stakeholders; that organization's activities are run in a professional manner and free from any conflict of interest. This should therefore lead to increased value for the firm. Rationally, it is a diversified company that should address the agency conflicts within firm. Diversification can provide incentives for agents through investment and ownership, therefore the emphasis is not only based on performance evaluation of financial outcomes, but more on optimizing behavior (Jensen & Meckling, 1976; Jensen, 1986; Adams, 2014).

Generally agency theory explains the relationship between principals and agents and the instruments that align both positions. In the context of M&A the theory is used to explain

changes in the financial performance of a company. M&As lead to performance enhancement, if they are used to discipline ineffective managers (Carpenter et al., 2009). It is also possible that M&As are misused by managers to satisfy their own self-interest, if the principals' interests are not aligned with the agents' interests by instruments like monitoring, management ownership and compensation (Collins et al., 2007). Further it is intimated that lower levels of free cash reduces the possibilities of agents getting involved in wasteful activities.

2.2 Empirical Review

Elif and Halil (2013) studied the impact of diversifying acquisitions on acquiring Turkish firms. They used a sample of 98 acquisitions during periods ranging from 2000-2011, the study found out that acquiring firms often experience statistically significant abnormal returns surrounding the announcement date. The cross-sectional regression results showed that diversifying acquisitions create high abnormal returns to acquirers as compared to focused acquisitions. The results also showed that smaller firms experience significant abnormal returns compared to larger firms in the sample; hence the acquiring public firm's result in higher wealth created to acquirers. Finally results differed among group affiliates and independent firms. Where an acquisition was made by an independent firm, diversifying acquisitions generated higher abnormal returns compared to focused acquisitions. However, if the acquirer was a group affiliate, there was no significant difference between the two types of acquisition activities in terms of wealth creation.

Iorio, Heaney, Hallahan and Graham (2014) examined the synergy and internalization hypotheses for international acquisitions using a sample of Australian companies with particular focus on the relationship between the synergistic gains and R&D capabilities of both the acquirer and target. Result indicated that overall, significant and positive cumulative abnormal returns are observed for the Australian acquirers in cross-border acquisitions, with the most pronounced effect apparent for R&D intensive Australian acquirers. Consistent with previous studies, target firm shareholders experienced positive and significant abnormal returns. Taken together, these results indicate the existence of synergistic gains, which are shared between acquirer and target shareholders.

Eyenubo (2013) assessed the relationship between bigger board and financial performance by adopting the use of secondary data from the Nigerian Stock Exchange fact book drawn from various industries during the period 2001 – 2010 via the regression statistical technique. The findings of the study revealed that bigger board size affects the financial performance of a firm in a negative manner. Based on the findings of the study, firms are enjoined to place a remarkable degree of emphasis on the area of corporate governance and to some extent embark on eliminating CEO duality.

Ongore (2013) studied moderating effect of ownership structure on bank performance by use of linear multiple regression model and generalized least square on panel data of commercial banks in Kenya to estimate the parameters. The findings showed that GDP had an insignificant correlation coefficient with ROA.

Constantinos and Sofoklis (2009) investigated the effects of bank specific and macroeconomic determinants of bank profitability, using a panel data approach of six Greek banks. The inflation

rate appeared to have a positive but slight effect on bank profitability. Other macroeconomic variables investigated, such as GDP, were found to be highly insignificant.

3.0 RESEARCH METHODOLOGY

The study adopted a mixed methodology research design where qualitative and quantitative research approaches were used to answer the research questions. The study population included all the 51 merged financial service institutions in Kenya which had completed their merger process by 31 December 2013. Purposive sampling was used. Primary data was obtained from questionnaires and a secondary data collection template was used to collect data on Return on Assets, Return on Equity and mergers and acquisitions aspects. The researcher used quantitative techniques in analyzing the data. Descriptive analysis for the study included the use of means, frequencies and percentages to describe the primary and secondary data collected. Inferential statistics such as correlation analysis was also used to test for the relationship of the variables from the secondary data. Panel data analysis was also applied to describe change in the study variables over time and trends over a period of five years from 2009 to 2013. A pre and post merger analysis was used to test whether the merger and acquisitions had brought any significant difference in the merged firms.

4.0 RESULTS AND DISCUSSIONS

4.1 Response Rate

One hundred and twenty (120) questionnaires were administered to the respondents.

Table 1: Response Rate

Response	Frequency	Percent
Returned	83	69.2%
Unreturned	37	30.8%
Total	**120**	**100%**

Out of which 83 were properly filled and returned, representing a response rate of 69.2% as shown on table 1 According to Mugenda and Mugenda (2013) and also Kothari (2010) a response rate of 50% is adequate for a study. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good.

4.2 Demographic Characteristics of Respondents who participated in the Primary Study.

Table 2 presents the results on demographic characteristics.

Table 2: Demographics Demography

	Category	Frequency	Percent
Gender	Female	36	43.4
	Male	47	56.6
	Total	**83**	**100**
Age	20-30	17	20.5
	31-40	22	26.5
	41-50	23	27.7
	Above 51	21	25.3
	Total	**83**	**100**
department	Accounts/Finance	25	30.1
	HR	6	7.2
	Customerservice/Business Development/Relationship Management	11	13.3
	Operations/strategy/planning	17	20.5
	Credit/risk/debt recovery	18	21.7
	Asset Finance	6	7.2
	Total	**83**	**100**
Position	Top Manager	15	18.1
	Senior Manager	25	30.1
	Middle Manager	43	51.8
	Total	**83**	**100**
Academic Qualification			
	College	14	16.8
	Undergraduate	37	44.6
	Masters	32	38.6
	Total	**83**	**100**
Number of Employees			
	11-50 employees	29	34.9
	over 50 employees	54	65.1
	Total	**83**	**100**

Majority of the respondents were male who represented 56.6 % of the sample while 43.4% were female. On the question of age, 20.5% the respondents were in the age bracket of between 20-30years, 25.5 % were between 31-40 years, 27.7% were between 41-50 years while 25.3% were above 51 years. On the question on department, 30.1% of the respondents worked in the

finance/account departments, 7.2% were from the HR department, 13.3% of were from the Customer service/Business Development/Relationship Management departments, 20.5% were from the operations, strategy and planning departments, 21.7% of the respondents were from the Credit, risk and debt recovery departments and 7.2% were from asset finance department.

The respondents were also requested to indicate their current position they held in the different departments 51.8% which was the majority indicated that they were in middle management position, 30.1% were in senior management position while 18.1% of the respondents indicated that they held top management positions.

On the question of academic qualification 44.6% had undergraduate qualification, 38.6% had masters qualification, while only16.89% had a college qualification. Lastly the respondents were requested to indicate the number of employees in their institutions, 65.1s% who were the majority indicated that their institution had over 50 employees.

The respondents stated that the mergers took place through the replacement of inefficient managers of the acquired firms and amalgamations. The respondents cited gaining market share, competitive advantage, increasing revenues, risk and product diversification and improving shareholder value were stated as the most important motivating factors behind the merger and acquisition. The most obvious motive to engage in M&A was to obtain synergy effects. These were attained through cost savings gained from economies of scale and scope.

On the question of the critical strategies that the management put in place to enhance success of the merger and acquisition, respondents stated size of merging partners, number of bidders and methods of financing. Stocks were preferred as a financing method.

4.3 Comparative Analysis

4.3.1 Comparative Analysis of Effect of Cost Efficiency on Financial Performance

A comparative analysis on the two industries was carried out to determine the effect of cost efficiency on performance of merged banks and merged insurance firms.

Table 3: Effect of Cost Efficiency on ROE

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	0.145(0.000)	0.277(0.000)
Cost Efficiency	0.007(0.736)	0.162(0.024)
R Squared	0.01	0.59
F statistic (ANOVA)	0.114(0.736)	5.311(0.024)

From table 3, cost efficiency only had a significant impact on performance (ROE) in the insurance sector (r=0.162, p=0.024) but was not a significant predictor of performance in the banking sector.). Cost Efficiency explains 59% of the variations in performance (ROE) in the insurance sector as shown by an R squared of 0.59 while in the banking industry; cost efficiency only explains 1% of the variations in performance (ROE).

In this study only the significant model were reported. The regression model for cost efficiency in the insurance sector is therefore:

ROE= 0.277+ 0.162 cost efficiency

A comparative analysis on the two industries was carried out to determine the effect of cost efficiency on performance (ROA) of merged banks and merged insurance firms.

Table 4: Effect of Cost Efficiency on ROA

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	1.003(0.11)	0.167(0.000)
Cost Efficiency	0.900(0.045)	0.160(0.005)
R Squared	0.31	0.88
F statistic (ANOVA)	3.870(0.045)	8.245(0.005)

From table 4 cost efficiency has a significant impact on performance (ROA) in both the insurance sector (r=0.160, p=0.005) and the banking sector (r=0.009, p=0.045). Cost Efficiency explains 88% of the variations in ROA in the insurance sector as shown by an R squared of 0.88 while in the banking industry; cost efficiency explains 31% of the variations in ROA.

The regression model for the banking sector is:

ROA= 1.003+ 0.9cost efficiency

The regression model for the insurance sector is:

ROA= 0.167+ 0.16 cost efficiency

4.3.2 Comparative Analysis of Effect of Diversification on Financial Performance

Table 5 shows the results on comparative analysis of diversification on financial performance.

Table 5: Effect of Diversification on ROE

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	0.142(0.000)	0.136(0.000)
Diversification	0.008 (0.509)	0.002(0.277)
R Squared	0.004	0.015
F statistic (ANOVA)	4.309 (0.509)	1.198 (0.277)

Table 5 shows a comparison on the effect of diversification on ROE in the insurance and banking sectors. From the table, diversification had no significant impact on performance in either the banking industry or the insurance sector.

Table 6: Effect of Diversification on ROA

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	1.04(0.005)	0.014(0.489)
Diversification	0.264(0.029)	0.17(0.117)
R Squared	0.40	0.30
F statistic (ANOVA)	4.895(0.029)	2.511(0.117)

Table 6 shows that diversification was a significant determinant of ROA in the banking sector (r=0.264, p=0.029) but not in the insurance sector.

The regression model for the banking sector is therefore:

ROA= 1.04+0.264 diversification

4.3.3 Comparative Analysis of Effect of Financial Synergy on Financial Performance

Table 5 shows the results on comparative analysis of synergy on financial performance.

Table 7: Effect of Financial Synergy on ROE

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	0.80(0.002)	0.195(0.000)
Financial Synergy	0.141(0.016)	0.153(0.230)
R Squared	0.048	0.017
F statistic (ANOVA)	5.927(0.016)	1.459(0.230)

Financial synergy was found to be a significant predictor of ROE in the banking sector but not in the insurance sector. Financial synergy was found to explain 4.8% of the variations in ROE in the banking sector and only 1.7% of the variations in the insurance sector. Findings are presented in table 7.

The regression equation for the banking sector is therefore:

ROE= 0.8+0.141 financial synergy

Table 8: Effect of Financial Synergy on ROA

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	0.484(0.393)	0.60(0.054)
Financial Synergy	1.876(0.158)	0.060(0.562)
R Squared	0.017	0.004
F statistic (ANOVA)	2.016(0.158)	0.339(0.562)

Financial synergy was not a significant determinant of ROA in both the banking and insurance sector. Findings are shown in table 8

4.3.4 Comparative Analysis of Effect of Operating Synergy on Financial Performance

Table 5 shows the results on comparative analysis of operating synergy on financial performance.

Table 9: Effect of Board Size on ROE

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	0.049(0.023)	0.113(0.001)
Board Size	0.013(0.000)	0.005(0.251)
R Squared	0.147	0.016
F statistic (ANOVA)	19.915(0.000)	1.338(0.251)

Board size was found to be statistically significant in determining ROE in the banking sector (r=0.013, p=0.000) but not in the insurance sector (r=0.005,p=0.251). 14.7% of the variations in ROE in the banking sector are explained by operating synergy as indicated by an R squared of 0.417.

The regression equation for the banking sector is therefore:

ROE= 0.049+0.013 board size

Table 10: Effect of Board Size on ROA

	Banks	**Insurance**
Parameter estimate	Coefficient(P value)	Coefficient(P value)
Constant	2.549(0.000)	0.042(0.111)
Board Size	0.418(0.000)	0.011(0.001)
R Squared	0.290	0.118
F statistic (ANOVA)	47.299(0.000)	11.274(0.001)

Board size was found to be statistically significant in determining ROA in both the banking sector (r=0.418, p=0.000) and in the insurance sector (r=0.011,p=0.001). 29% of the variations in ROA in the banking sector are explained by board size as indicated by an R squared of 0.29 while 11.8% of the variations in ROA in the insurance sector are explained by board size as indicated by an R squared of 0.118

The regression equation for the banking sector:

ROA= 2.549+ 0.418 board size

The regression equation for the insurance sector:

ROA= 0.042+ 0.011 board size

4.4 Multiple Regression

The effect of mergers and acquisitions on financial performance was captured statistically by the multiple regression model summaries in table 11.

Table 11: Multiple Regression

		B	**Std. Error**	**Beta**	**T**	**Sig.**
Model	(Constant)	1.612	0.73		2.207	0.029
	Cost efficiency	0.338	0.341	0.072	0.991	0.324
	Diversification	0.065	0.077	0.062	0.841	0.402
	Operating synergy	1.794	0.509	0.273	3.528	0.001
	Financial synergy	2.354	0.822	0.213	2.864	0.005
	Board Size	0.139	0.044	0.251	3.142	0.002
	Economic growth	0.063	0.062	0.073	1.01	0.314

Operating synergy, financial synergy and board size were found to be statistically significant in explaining the change in financial performance.

The multiple regression models are therefore:

Financial Performance= 0.338 cost efficiency + 0.065 diversification+1.794 Operating synergy +2.354 financial synergy+ 0.139 board size+ 0.063 economic growth.

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

A test was conducted on the effect of diversification on financial performance. There is no significant relationship between diversification and financial performance of merged institutions. The study however revealed that the merged financial institutions had has established many branches as a result of merger and acquisition activity, new branches formed after the merger has attracted a wide human resource portfolio, new branches formed after the merger has led to an increase in product portfolio, new branches formed after the merger has led to an increase in investment portfolio and that new branches formed after the merger have resulted into the expansion market portfolio. The implication is that a high degree of diversification seems to exist in merged financial services institutions

A test was conducted on the effect of synergy on financial performance. There is significant relationship between operating synergy, financial synergy and financial performance of merged institutions. The implication is that a high degree of synergy seems to improve performance in terms of profitability. Merger activity led to shared human resource talents, merger activity led to shared managerial capacity and efforts, merger activity led to shared marketing efforts, merger activity led to shared source of long term finance, merger activity led to shared source of overdraft finance, merger activity led to improved liquidity arising from the cash and cash equivalents of the merged firms and merger activity led to shared working capital.

A test was conducted on the effect of board size on financial performance. There is significant relationship between board size and financial performance of merged institutions. The implication is that a high number of board members seem to improve performance in terms of profitability. This is due to the fact that the overall board size has increased as a result of the merger, the total number of independent directors have increased as a result of the merger, an increase in board size due to merger activity also resulted in an increase in institutional shareholding and that an increase in board size has resulted in an improvement in the skills of the board. Based on the findings of the study, it can be concluded that board size affects financial performance of merged institutions positively. Board size was found to have a statistical significance on financial performance.

A test was conducted on the moderating effect of economic growth on financial performance. There is significant relationship between economic growth and financial performance where growth in real GDP leads to higher profitability. This is because during periods of declining GDP growth the demand for credit falls which in turn negatively affects the profitability of a bank. On the other hand a growing economy as expressed by a positive and increasing GDP would lead to an increase in the demand for credit hence leading to growth in profitability. Hence economic growth rate positively affects profitability

5.2 Recommendations

This study recommends that companies with a weak and unstable capital base should seek to consolidate their establishments through mergers and acquisitions. Through mergers and acquisitions, these companies will be able to extend their market share and revenue base hence

increase their profitability. In addition, mergers and acquisition leads to a higher CAR which improves the financial soundness of the companies.

The study also recommended that institutions should critically evaluate the overall business and operational compatibility of the merging institutions and focus on capturing long-term financial synergies. They should increase their scope to create high performing supply chains with significant long-term upside that provide sustained value for customers and stakeholders.

Firms were recommended to place a remarkable degree of emphasis on the area of corporate governance and to some extent embark on eliminating CEO duality. The study also recommends a board size (6 and 8) for better financial performance. This will reduce the problem of free rider and enhance effective monitoring and decision making. It will also bring about cohesion among the board members.

The study further recommended the government and Central Bank of Kenya to come up with strategies and policies to protect the financial services sector due to its immense contribution to the economy of the country by formulating policies aimed at controlling the effects of rapid fluctuations of the macro economic factors and their effects on the sector.

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