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Factors Motivating Mergers and Acquisitions in Kenya: Case of Firms Listed on the Nairobi Stock Exchange

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ABBREVIATIONS

CMA	Capital Markets Authority
GDP	Gross Domestic Product
M & A	Mergers & Acquisitions
NSE	Nairobi Stock Exchange
SPSS	Statistical Package for Social Sciences
UK	United Kingdom
US	United States

Abstract

The study sought to investigate the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange. A descriptive survey was undertaken. The population of the study was all the firms listed on the Nairobi Stock Exchange that had participated in mergers and acquisitions, whose number stood at five (5) as at June 2011. A census of all these firms was conducted. Primary data was collected from the Heads of Finance function with the aid of semi-structured questionnaires that were administered by drop-and-pick method. The data pertaining to profile of the respondents and their respective organizations was analyzed using content analysis. Data pertaining to the study objectives of the study was conducted using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others. Findings of the study further show that the following are the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange (according to the importance attached to each factor) are: acquisition of specific assets; economies of scale; managerial motives; risk reduction; decrease in cost of capital; and economies of scope. The findings also show that other factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange (according to the importance attached to each factor) are: financial synergy; diversification; operation synergy; human capital; customer capital; and good growth prospects. The findings also indicate that mergers and acquisitions is a source of synergy, the cost reduction that occurs as a result of a corporate combination and the ability of a firm to utilize one set of inputs to provide a broader range of products and services.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Mergers and acquisitions (M & As) represent the end of the continuum of options companies have in combining with each other. Representing the least intense and complex form of combination is licensing. Next come alliances and partnerships and then joint ventures. Mergers and then acquisitions conclude the combination options. It is the mergers and acquisitions that are the combinations that have the greatest implications for size of investment, control, integration requirements, pains of separation, and people management issues (Hamel, 1991; Harbison, 1996; Doz and Hamel, 1998; Sparks, 1998, 1999). The focus of this study being mergers and acquisitions, it is important to distinguish them. In a merger, two companies come together and create a new entity. In an acquisition, one company buys another one and manages it consistent with the acquirer's needs.

Mergers and acquisitions are widely used phrases that do not have exact definitions. For instance, Weston and Copeland (1992) describe a merger as a transaction between more or less equal partners, while acquisitions are used to denote a transaction where a substantially bigger firm takes over a smaller firm. Clearly, Weston and Copeland distinguish mergers and acquisitions on basis of firm size involving with the transaction. Datta and Pinches (1992) use another basis to describe the difference between a merger and an acquisition. They define a merger as a direct negotiation with the target firms' management and/or the board of directors and approved by them before going to a shareholder vote. On the other hand, acquisitions can take place in an unfriendly way, where the offer is made directly to the target firm shareholders.

According to Gaughan (2007), DePamphilis (2003), Scott (2003), a merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. In a merger, the acquiring company assumes the assets and liabilities of the merged company. Moreover, although the buying firm may be a considerably different organization after the merger, it retains its original identity. An acquisition occurs when one company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm such as a manufacturing facility (DePamphilis, 2003). In other words, an acquisition is the purchase of an asset such as a plant, a division, or even an entire company (Scott 2003). On the surface, the distinction in meaning of "merger" and "acquisition" may not really matter, since the net result is often the same: two companies (or more) that had separate ownership are now operating under the same roof, usually to obtain some strategic or financial objective. Yet the strategic, financial, tax, and even cultural impact of a deal may be very different, depending on the type of transaction (Sherman, Hart 2006).

Mergers and acquisitions have become a more and more popular tool for companies to expand strategically, either developing existent capabilities or entering into new activities. It is also frequently used to eliminate competition. The global number of acquisitions has tripled between 1991 and 2001 with an annual volume of $ 2.89 trillion in 2008. (Hall, 2008). Schoenberg (2003) defines acquisition as the purchase by one company, the 'bidder', of a controlling interest in another company, the 'target'." The global competition, companies are exposed to, requires them to constantly grow and improve but also enables them to choose from a wide variety of possible takeover targets. The "classic" reasons to engage in acquisitions are motives concerning market power or potential economies of scale or scope, which are expected to create sustainable long-term value.

The perceived motivation drivers for this merger activity are generally considered to be the acquiring firms' desire to increase its return by expanding geographically. This perception is similar to Stewart's premises of merger motivation. According to Stewart (*The Quest for Value*, pp375-383), the actual motivating forces behind mergers should be ones that will (1) increase financial performance (net operating profits), (2) financial benefits through borrowing against the seller's unused debt capacity or against an increase in the consolidated debt capacity (lending capability for banks), and (3) tax benefits derived from expensing the stepped-up basis of assets acquired or from the use of otherwise forfeited tax deductions or credits. Stewart's merger motivation theory of increasing financial performance (net operating profits) is largely accepted as being a merger motivator, especially in the banking industry. An increase in net operating profits may either be derived from cost savings or increase in revenue. Many of those involved in the mergers agree that cost savings are a significant reason for the activity.

Downsizing (Craig, 1997) and global consolidation allowing firms to increase size and market capabilities while creating technological efficiencies (Investor's Chronicle, 1997) are largely responsible for the cost savings of mergers. However, the research results on the financial performance of the merged firms have resulted in conflicting conclusions. While some research has found firm acquisitions are not improving the financial performance of the combined firms (Baradwaj, Dubofshy, and Fraser, 1992; Palia, 1993; Hawawine and Swary, 1990; Toyne and Tripp, 1998; Madura and Wiant, 1994), other research has resulted in opposite conclusions (Cornett and De, 1991; Chong, 1991; Cornett and Tehranian, 1992; Subrahmannyam, Rangan, and Rosenstein, 1997).

According to Berkovitch, and Narayanan (1993), three major motives for takeovers have been advanced in the literature: the synergy motive, the agency motive, and hubris. The synergy motive comes from a value creation point of view, while the agency motive and hubris play a role in the redistribution theory. The synergy motive suggests that takeovers occur because of economic gains that result by merging the resources and capabilities of the two firms (Firth, 1980). The agency theory supposes that mergers and acquisitions occur since they enhance management welfare of the acquiring firm at the expense of acquirer shareholders wealth (Long and Walking, 1984). Hubris suggests that managers make wrong assumptions in evaluating target firms and engage in mergers or acquisitions even when there is no synergy (Roll, 1986). The purpose of this study is to determine the underlying and driving forces or causation based upon examination of resent mergers and acquisitions in Kenya, with a focus on the Nairobi Stock Exchange.

Nairobi Stock Exchange is Africa's fourth largest stock exchange in terms of trading volumes, and fifth in terms of market capitalization as a percentage of GDP. According to the Nairobi Stock Exchange report (December, 2007), as a capital market institution, the Stock Exchange plays an important role in the process of economic development: It helps mobilize domestic savings thereby bringing about reallocation of financial resources from dormant to active agents; Long-term investments are made liquid, as the transfer of securities (shares and bonds) among the participating public is facilitated; The Exchange has also enabled companies to engage local participation in their shares ownership, thereby giving Kenyans a chance to own shares of reputable firms; Companies can also raise extra finance essential for expansion and development. To raise funds, a company (issuer) issues extra shares; an issuer publishes a prospectus, which gives all pertinent details about the operations and future prospects of a company, while at the same time stating the price per share of the Issue; A stock market also enhances the inflow of international capital; and Stock markets also facilitate government's privatization programmes.

1.2 Statement of the Problem

Over the last decade, mergers and acquisitions have been occurring at an unprecedented rate. The Increased level of mergers and acquisitions are one of the most important developments in corporate finance in the last few decades. M&A are economically relevant if they promote massive reallocation of resources in a short period of time, both within and across industries and regions, and potentially leading to wide-ranging institutional and organizational changes (Ferraz and Hamaguchi 2002). Therefore companies use M&A as a tool to gain competitive advantage, to generate efficiency gains, and also to enhance growth potential. M&As have been studied a lot and various findings have been achieved. More research about personal reasons and M&A decisions have been studied by Lausberg and Stahl, 2006; Hubbard and Palia, 1995; Bliss and Rosen, 2001; Amihud and Lev, 1981; Morck, Shleifer and Vishny, 1990; Jensen and Murphy, 1990 and Roll, 1986. There seems to be no simple answer for the motives behind a M&A. There is a lot of information but how can these pieces be put together so that it also helps the companies who are giving us researches an interesting experiment field.

Alan Lewis and Craig Mackenzie came to a conclusion that people are prepared to put their money where their morals are although there is no straightforward tradeoff between principles and money (2000, 180). Economic costs of underperformance do not on their own determine investment decision (Lewis and Mackenzie 2000, 186). Some academic researchers argue that that M&As create synergies that benefit both the acquiring company and the consumers (e.g., Weston, Mitchell and Mulherin, 2004). Others argue that M&A activities create agency problems, resulting in less than optimal returns (e.g., Jensen, 1986). Because the motives for M&As remain unclear, despite a number of studies, a need exists for continued research on this subject.

Studies on mergers and acquisitions undertaken in Kenya include the following: Chesang (2002) surveyed merger restructuring and financial performance of commercial banks in Kenya; Katuu (2003) undertook a survey of factors considered important in merger & acquisition decisions by selected Kenyan based firms; Njenga (2004) undertook an investigation into whether the demerger of coffee marketing societies have created or eroded owners wealth in parts of central Kenya; Yash Pal Bansal (2005) undertook a study on the process and challenges in the merger between Apollo & Pan Africa general insurance companies; Kiplagat (2006). Studied the effects of mergers on financial performance of companies listed at the NSE; Mukele (2006) undertook a survey of the factors that determine the choice of mergers & acquisition partners in Kenya; Marangu (2008) studied the effects of mergers on financial performance of non listed banks in Kenya; Barasa (2008) undertook a study on the effect of mergers and acquisitions announcements on share prices-evidence on the Nairobi stock exchange; and Oyuke (2009) studied mergers and acquisitions as competitive strategic options within the banking industry.

However, no study has yet investigated the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange. The arguments presented above are the main reasons and motivations for this study, and it is the ambition to conduct the analysis in line with previous academic evidence in the field of M&A. Therefore, this study will focus on firms listed on the Nairobi Stock Exchange M&A. The following research question was investigated: what are the motives for M & As among firms listed on the Nairobi Stock Exchange?

1.3 Objective of the Study

The study sought to investigate the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange.

1.4 Significance of the Study

This study seeks to raise ideas and issues in the hope that the various stakeholders and persons directly addressing issues related to motives for mergers and acquisitions will continue the discussion. Specifically, the findings of this study, it is hoped, will be beneficial to various key stakeholders as discussed in the subsequent sections.

The management of Firms Listed on the Nairobi Stock Exchange: The management of firms listed on the Nairobi Stock exchange will gain a better understanding of the factors motivating Mergers and Acquisitions in Kenya and on the basis of the findings of the study, the management of the firms listed on the Nairobi Stock exchange may undertake mergers and acquisitions from an informed position.

Capital Markets Authority and other Regulatory Bodies: The Capital Markets Authority (CMA) and other regulatory bodies that are responsible for the licensing, regulation and supervision of operators in the capital markets, including policy formulation, monitoring and evaluation will make informed decisions on the basis of the findings, when executing their mandates.

Academics and Researchers: The study will make a significant contribution to the growing body of research on mergers and acquisitions. The findings may also be used as a source of reference for other researchers. In addition, academic researchers may need the study findings to stimulate further research in this area and as such form a basis of good background for further researches.

2.0 LITERATURE REVIEW

2.1 Introduction

In order to address the aim of the research, it is of importance to have established a sound literature base around which the study is built. This chapter presents a review of the literature related to the purpose of the study. The chapter is organized according to the specific objectives in order to ensure relevance to the research problem. The review has been undertaken in order to eliminate duplication of what has been done and provide a clear understanding of existing knowledge base in the problem area. The literature review is based on authoritative, recent, and original sources such as journals, books, thesis and dissertations. The chapter presents an overview of mergers and acquisitions, including definition of mergers and acquisition, types of mergers ad acquisitions, a brief history of mergers and acquisitions; the theoretical context of mergers and acquisitions; the motives for mergers and acquisitions; empirical review; conclusions; and the conceptual framework for the study.

2.2 Overview of Mergers and Acquisitions

2.2.1 Definition of mergers and Acquisitions

The terms merger, acquisition and consolidation are sometimes used interchangeably. However, there are some differences. A merger refers to the combination of two organizations into one larger organization. Such actions are commonly voluntary and often result in a new organization name (often combining the names of the original organizations). An acquisition, on the other hand, is the purchase of one organization by another. Such actions can be hostile or friendly and the acquirer maintains control over the acquired one (Pernsteiner, 2003). Mergers and acquisitions differ from a consolidation, which is a business combination where two or more companies join to form an entirely new company. All of the combing companies are dissolved and only the new entity continues to operate (Pernsteiner, 2003). Here two distinct mergers types are suggested referring to mergers and acquisitions separately: Mergers: The assembly of two firms for leading to the foundation of a new firm; and Acquisitions: The merger of the two firms under the legal identity of one of the firms, while the other firm loses this identity.

2.2.2 Types of Mergers and Acquisitions

Economists classify M&As into three groups: (1) horizontal, (2) vertical, (3) conglomerate (Gaughan, 2007).

Horizontal Mergers: A horizontal merger is the merger of two or more companies operating in the same field and in the same stages of process of attaining the same commodity or service. That is, a horizontal merger is the combination of firms that are direct rivals selling substitutable products within overlapping geographic markets. The aim in this type of merger is to eliminate a competitor company, to increase market share, buy up surplus capacity or obtain a more profitable firm. Besides such benefits, this type of mergers has the drawbacks of restricting new entries into the market and harming outsiders due to diminishing competition (Gaughan, 2007).

Vertical Mergers: A vertical merger is a merger in which one firms supplies its products to the other. A vertical merger results in the consolidation of firms that have actual or potential buyer-seller relationships. The firms in vertical mergers operate at different stages of production process where buyer-seller relation or manufacturing at different stages of the same product is possible (Gaughan, 2007). There are two types of vertical mergers.

(i) 'Backward or upstream vertical integration' in which the primary motive is usually to move towards a dependable source of supply. Dependability can be determined not just in terms of supply availability, but also through quality maintenance and timely delivery considerations. Having timely access to supplies helps companies to provide their own products on a reliable basis (Coyle, 2000).

(ii) 'Forward downstream vertical integration' in which the primary motive is to move towards the final customer, who may be another industrial user or the public. This type of mergers secure outlet for sale of products (Coyle, 2000). That is to say, companies make use of the combined strength of their marketing functions. They obtain some advantages in the marketing of products and services. An example of a vertical integration is the merger of Milda Mecmua Gazete with Seka Aksu _sletmesi in 2003. Vertical mergers do not change the market structure directly. However, they may pave way to significant entry constraints. If any merger creates restrictions for other companies in respect to entering the market or supply sources, this can be quite constraining upon competition.

Conglomerate Mergers: A conglomerate merger occurs when unrelated enterprises combine. Conglomerate mergers result in joining of firms which compete in different product markets, and which are situated at different production stages of the same or similar products. That is to say, neither the products nor the inputs of these merging firms are the same. Conglomerate mergers result in significant advantages gained by the merging firms since they are the fastest means of entry into different activity fields in the shortest possible time span. Moreover, they reduce the financial risks by "not putting all the eggs in one basket" (Gaughan, 2007). There are three types of conglomerate mergers:

(i) Product Extension: In this type of mergers, firms that sell non-competing products and use related marketing channels of production processes merge.

(ii) Market Extension: In such mergers, merging firms manufacture the same products or services but market them in different territorial markets. That is to say it is a merging of two firms selling competing products in separate geographic markets. In this way the firms get the opportunity to market their products in a wider range.

(iii) Pure Conglomerate Mergers: In such mergers, there is no relationship between firms neither in respect to manufacturing nor in respect to marketing and mergers are realized between firms operating in entirely different fields.

2.2.3 A Brief History of Mergers and Acquisitions

Mergers and acquisitions (M & As) in the world have been occurring in waves, with different motives behind each wave. Four periods of high merger activity have taken place in the history of mergers and acquisitions. These periods were basically shaped by the activities of companies in United States. These periods are characterized by cyclic activity, that is, a high level of mergers is followed by a period of relatively fewer mergers. The first wave occurred in the early part of the 20the century, when companies undertook M&As with the explicit objective of dominating their industries and creating monopolies. The second wave coincided with the rising market of 1920s, when firms again embarked on M&A as a way of extending their reach into new markets and expanding their market share. The third wave occurred in 1960s and 1970s, when firms focused on acquiring firms in other lines of business, with the intent of diversifying and forming conglomerates.

The fourth wave occurred in the mid1980s, when firms were acquired primarily for restructuring assets. In some cases, acquisitions were financed by debt and were initiated by the managers of the firms being acquired. This wave ended as deals became pricier and it became more difficult to find willing lenders. The fifth wave occurred towards the end of 1990s when firms focused on the acquired firms with the aim of restructuring. In other words, a change in the company's ownership structure occurred either in order to address a debt problem or for achieving change in its line of business. (Gaughan, 2007). Currently, mergers and acquisitions are undertaken mostly as a part of strategic restructuring process by the companies that have the objective of being one of the top three companies in the world (Tanyılmaz, 2003).

In Europe, M&As have been a well-known instrument because of various developmental periods since the beginning of 20th century. However, the progress of mergers and acquisitions were different than that of America. The first wave was during 1920s, when companies used M&As with the aim of assuming and taking advantage of producing at a lower cost per unit, which resulted in a great increase in production. A second growth period of M&As occurred during 1960s due to the internationalization of the economy. The third boom was produced principally in UK during 1980s. During this wave, the key point was market evolution for corporate control. The fourth wave occurred in early 1990s, when companies focused on M&As to adapt the single European Market. The last wave in Europe started in recent years with the introduction of common currency, Euro, to the common market (Ensico & Garcia, 1996).

2.3 Mergers and Acquisitions: Theoretical Context

2.3.1 Neoclassical theory

In modern finance theory (e.g. Manne: 1965), shareholder wealth maximization that are in line with a company's business strategy is stated as the rational for investment and financing decisions made by managers. This means that firms should invest when the sum of the present values of future cash flows exceeds the initial project outlay. With M&A, the shareholder wealth maximization criterion is satisfied from the bidder's perspective when the added value by the acquisition of a target company exceeds the cost of acquisition i.e. the transaction costs and the acquisition premium.

Likewise, managers of targets would engage in M&A activity only if it results in gains to the target shareholders. The result is synergy: positive gains to the bidder and the target (Berkovitch and Narayanan, 1993). However, Bruner (2004) notes that "true synergies create value for shareholders by harvesting benefits from mergers that they would be unable to gain on their own". Therefore, managers as agents for shareholders should think like shareholders to create value and make a detailed analysis of possible synergy values. From an economic and operational perspective on mergers, synergies can be generated by combining the operational resources of two companies if a strategic fit is present. Costs reduction may be achieved through economies of scale, economies of scope, or reductions in assets (Porter: 1985). Revenue enhancements synergies are envisioned to arise from a sale and marketing point of view, while M&A also offers an alternative pathway to tangible, intangible and human resources and capabilities (Simmonds, 1990).

Financial synergies arise from value of leveraging M&A activities versus individual activities. This stands in sharp contrast to the early view of Miller and Modigliani (1958), who argued that in a well functioning efficient market without taxes, informational asymmetries, and default costs no financial synergy can be found because the market value of company does not depend on its capital structure. However, a firm's capital structure decision can matter if these assumptions are not true.

Another common cited reason for firms to be engaged in M&A is diversification, i.e. a reduction of risk. However, if the argument presented above by Bruner (2004) is true, then diversification is less likely to qualify as a pure financial synergy, as investors in perfect capital markets can combine a personal portfolio with the similar risk characteristics. In fact, empirical studies such as Lang and Stulz (1994) and Berger and Ofek (1995) found evidence that in an imperfect market, diversified firms have been worth less (measured by Tobin's q) than a portfolio of specialized firms. Thus, shareholders do not seem to benefit exclusively from diversification from a financial perspective. In summary, although financial synergies seems to be present and the combination of synergy are likely to shift the optimal point cost of capital, the economical and operating synergies seems to be the most dominant value-maximization motives for firms engaged in M&A activity.

2.3.2 Behavioral theories

The hubris hypothesis formulated by Roll (1986) postulates that managers systematically commit error of optimism in evaluating merger opportunities due to their excessive self-confidence. The higher valuation of the bidders, compared to the true value of the target, would not have been made by rational bidders. Thus, managerial motives are important determinants for the outcome of the M&A as manager may act to maximize their own utility and engage in 'empire building' (Trautwein: 1990, Zalewski: 2001) instead of their shareholders' value – the paramount goal of classical finance theory as discussed above. For example, Jensen (1986,1988) explains that managers may invest the free cash flow in projects such as acquisitions with negative NPV if that would lead to increased personal utility rather than maximize shareholder value. These free cash flows, which are generally found in the reserves, should rather be paid out as to shareholders in the form of dividends if the firm is to be effective and to maximize the stock price. (Jensen: 1986).

Amihud and Lev (1981) and later Black (1989) argue that managers in conglomerate mergers face an "employment risk" because their future employment and earnings potential are highly correlated with the firm's risk. As a result, risk averse managers may undertake M&A to reduce their employment risk, rather than benefit shareholders, because such risk cannot be diversified in their own portfolio (Weston, Siu, and Johnson: 2001). In addition, Mueller (1969) developed a growth maximization model of M&A based on the argument that managers' bonuses, social status, salary, and promotions are related to the size of the firm. He argues that because of this relationship, managers are more likely to accept a return on the investment that is lower than shareholders requirements. Therefore, managerial hubris can be viewed as an agency problem that arises due to separation of ownership and control and the resulting divergence between the interest and motives of managers (the principles) and shareholders (the agents) (Rau, and Vermaelen, 1998; Jensen and Meckling, 1976).

Whether managers act to maximize their own utility or shareholder's wealth has been tested empirically in a small number of studies. Lewellen and Rosenfeld (1985) studied the stock returns of 191 acquiring firms during the period 1963-1981 and concluded that positive significant relationship between abnormal stock returns from M&A and the percentage of management ownership in the acquiring firm. He found that managers with large personal ownership in the firm were less like to be engaged in M&A that would reduce acquirer's shareholder's wealth. Similarly, Firth (1991) tested the relationship between executive reward and M&A and found that if shareholder value is increased then so are the executive rewards. Contrary, when shareholder wealth is destroyed then executives still seem to gain from M&A. These finding are interesting because they support the view that managers through M&A activities may seek to utilize their own utility at the expense of shareholders.

2.3.3 Value creation and redistribution theories

This section makes a distinction between value creation and redistribution theories. The *synergy motive* plays a major role in the value creation theories, while *agency* problems or *hubris* play a role in the redistribution theory.

Value creation theories: Merger and acquisitions make economic sense if the whole is worth more than the sum of its parts, or stated otherwise, if synergy exists. The surplus value of horizontal mergers can be attained by: economies of scale in production and distribution, access to new markets, having a combined maiden office, removal of inefficient management, greater financial possibilities and combined immaterial assets (patents, trademarks and licenses). Vertical mergers shorten the industrial chain and savings can be made in procurement, more efficient communication is possible, as well as production can be more focused to market developments. A definition of synergy formulated by Sirower (1997) is as follows: *Synergy is the enhanced competitive capacity and consequent greater cash flows in excess of what the individual companies would have attained.*

Sirower states that value-creating mergers are seldom. A merger is worthwhile when the synergy (surplus value) exceeds the incurred merger costs including the takeover premium. Other researchers (Healy, Palepu and Ruback, 1992) are more positive and conclude that in the post-merger phase there are significant improvements in the cash flows compared to other corporations in the industry.

Redistribution theories: A merger makes no sense if the additional cash flow is lower than the takeover premium and/or is lower than the costs incurred by integration. There are two major theories that explain the origin of merger activity, the *hubris*- and the *agency* theory. The *hubris* theory states that management strives for synergy having the goal to maximize profits for shareholders. Unfortunately, managers suffer conceit resulting in less value attained in the form of synergy. From research (Roll, 1986), it seems that synergetic benefits are attained in these mergers, however the pre-calculation of synergy is often too high to justify the takeover premium.

2.4 The Motives for Mergers and Acquisitions

Although the motives behind M & As are complex and present problem of classification, the underlying factor in all these motives is the concept of synergy. In physical sciences, synergy refers to the types of reactions that occur when two substances combine to produce a greater effect together than what the sums of the two operating independently account for. Simply stated, synergy refers to the phenomenon of 2+2=5 (Coyle, 2000). In M&A context, synergy translates into the ability of a corporate combination to be more successful than the sum of the individual successes of the two separate firms. That is, the combined firm is worth more than its parts. The explanation for this occurrence is that usually the firms were not performing up to their potential prior to merging or that benefits were achieved by the merger. Following this logic, companies are motivated to involve in M & As in order to create synergies (Coyle, 2000).

Economies of Scale: One of the main sources of synergy is the operating synergy, the cost reduction that occurs as a result of a corporate combination. This reduction may occur as a result of economies of scale –decreases in per unit costs that result from an increase in the size or scale of the company operations. Some sources of these gains arise from increased specialization of labor and management as well as the more efficient use of equipment and accesses to lower price input, which may not be possible at low output levels. A good example of economies of scale arises in the merging of two manufacturing companies (Gaughan, 2007). For example, whereas a small car producer firm might pay a higher price for its inputs, bigger companies buy their inputs in bulks for a lower price than a small firm that buys its inputs in small batches. Moreover, if a small car producer makes only a few hundred cars of a particular type, the producer must use production techniques that are much more labour-intensive and much less automated than those employed to make hundreds of thousands of cars in a particular model produced by bigger firms. That is, costs are high with low production runs and labor intensive production techniques. Thus, firms merge and take advantage of producing larger volumes of outputs in order to obtain lower costs.

Economies of Scope: Another type of operating synergy is economies of scope, the ability of a firm to utilize one set of inputs to provide a broader range of products and services (Gaughan, 2007). Scope economies are usually the most common motive in the bank M&As such that when financial institutions merge, they can share inputs to offer broader range of services such as trust department or economic analysis units. Smaller banks might not be able to afford the cost of these departments. Inputs such as computer systems can be shared to process a vide variety of loans and deposit accounts. Whether these benefits are true or whether they constitute a sufficient reason for the increased number of bank mergers that have taken place in the recent period of bank deregulations is a different issue (Günay, 2003).

Decrease in Cost of Capital: Another source of synergy is financial synergy, which refers to the impact of a corporate merger or acquisition on the cost of capital to the acquiring firm or merging partners. This is because a larger company has certain advantages. For example, it enjoys better access to financial markets, tends to experience lower costs of raising capital, probably because it is considered to be less risky than a smaller firm is (Gaughan, 2007).

Acquisitions of specific Assets: The acquisition of specific assets is also often a reason for M&As. This asset may be a source of raw materials, a good management team or good research and development facilities. In addition, it is generally quicker and cheaper to acquire new products, new facilities or a national distribution network by merging with a company that already has developed them (Gaughan, 2007).

Risk Reduction: A company may reduce the cyclicality of its earnings and cash flow by acquiring or merging with another company whose earnings and cash flows exhibit a different cyclical pattern so that the probability of bankruptcy is reduced (Gaughan, 2007). For example, two firms, one producing swimming suits and the other producing winter skiing wear merge. Then, even if it is not snowing, the new entity can compensate the lack of cash flow by the sale of winter skiing wear for the cash flow from swimming suits. That is, the probability of bankruptcy for the merged entity decreases.

Managerial Motives: A manager's motive for merger is often to increase the acquirer's dominant position in the market and to defend existing market positions. Managers themselves might also be interested in M&As due to prestige, which is immeasurable but undoubtedly greater in a larger firm (Brouthers, van Hastenburg and van den Ven, 1998). In order to achieve the above objectives, corporations are increasingly involved in M&A activities such that in 2004 alone nearly 15,000 deals were consummated at a value of $1.9 in all over the world. Of this, 5765 and 6218 deals at values of $498.57 billion and $357.62 were realized in US and Europe respectively.

Merger activities are expected to be even more prevalent for the organizations all around the world, including Turkey during the next decade. According to the study conducted by Earnst& Young in 2004, the managers and owners of the biggest 250 companies expects that M&A activities will increase considerably in the next five years. (Earns &Young, 2004). Can Deldag, the manager of institutional financing department at Earns & Young states that "with the realization that Turkey will start negotiations with European Union, expectations about Turkey is increasing and foreign investors sees Turkey as a very profitable place to make investments.

2.4.1 Other motives for Mergers & Acquisitions

In response to the good growth prospects, mergers and acquisitions, just like internal investments, are the means for companies to increase their capital base, as concluded by Andrade, Stafford (2004). It is obvious that companies may grow within their own industry or they may expand outside their business category, which means diversification. If a company seeks to expand within its own industry they may conclude that internal growth is not an acceptable alternative. Synergy as a Reason for Mergers and Acquisitions Gaughan (2007) states that the term "synergy" is often associated with the physical sciences rather than with economics or finance. It refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than that which the sum of the two operating independently could account for. Simply stated, synergy refers to the phenomenon of 2 + 2 = 5. In mergers this translates into the ability of a corporate combination to be more profitable than the individual parts of the firms that were combined. The two main types of synergy are (DePamphilis 2003):

Operating synergy: which consists of both: economies of scale (or the spreading of fixed costs, such as depreciation of equipment and amortization of capitalized software; normal maintenance
spending; obligations such as interest expense, lease payments, and union, customer, and vendor contracts; and taxes, of over increasing production levels); and economies of scope (which refers to using a specific set of skills or an asset currently employed in producing a specific product or service to produce related products or services).

Financial synergy: which refers to the impact of mergers and acquisitions on the cost of capital of the acquiring firm or the newly formed firm resulting from the merger or acquisition? Theoretically, the cost of capital could be reduced if the merged firms have uncorrelated cash flows, realize financial economies of scare, or result in a better matching of investment opportunities with internally generated funds.

Access to Intangible Assets: the emergence of the knowledge era since the 1980s has brought significant change in both global and local markets. Knowledge, as a core organizational resource and the basis for the development of organizational capabilities, is playing a key role in driving changes in companies. Today the value of knowledge based, intangible resources has grown geometrically in companies. The intangible assets include (Saint-Onge, Chatzkel 2009):

Human capital: This is the sum of all the capabilities of everyone who is currently working in a company, i.e. the cumulative knowledge, experience, attributes, competencies, and mindsets of all employees, managers, and leaders. These individual capabilities of employees create value for the customers.

Customer capital: This consists of the strategies, structures, processes, and leadership that translate into a company's specific core competencies. These organizational capabilities leverage employees' individual capabilities to create value for customers. Structural capital also includes the organizational capacity and physical systems used to transmit and store intellectual material. Structural capital is composed in a large part of: company's organization (investment in systems,
operational philosophy, and supplier and distribution channels); innovation (capability to renew a company along with the outcomes of innovation, which include the ability to anticipate market needs and lead the market in responding; the ability to bring new products to market rapidly, intellectual assets and intellectual property (which include copyrights, patents, trademarks, and trade secrets), company's brand and theory of your business. Although the best-known innovation capital is usually intellectual property, these are even more critical to company's well-being); processes (comprises all the processes of the company that enable to create and deliver goods and services to both internal and external customers. These can be production, design, and product development processes; people development processes; communication processes; strategy making processes, and knowledge development, capture, and leveraging processes).

2.5 Empirical Review

In the 1980s, U.S. firms experienced a decrease in profitability and reacted by increasing their size through M&A in order to survive in the market. A number of economists started investigating motives for M&A. One of the questions they asked was: "What factors make firms more likely to be acquired?" We start the empirical part of the literature review with studies dedicated to developed countries and then proceed with analysis of developing countries.

2.5.1 Developed countries

We start our discussion with studies which employed *logit model*s and proceed with *alternative approaches*. Hannan, and Rhoades (1987) investigate the motives for firm acquisitions. They estimate the relationship between the probability of firm acquisition and the characteristics of both firm and the market. Considering large sample of 1,046 Texas firms and employing *multinomial logit procedure* to estimate this relationship, authors obtain negative relationship between probabilities of acquisition and capital /asset ratios. They also conclude that firms with operations in urban areas and large market shares are more likely to be acquired. In contrast, firms with low profits and low growth are not found to be attractive targets for acquisitions.

Foracelli, Panetta, and Salleo (1999) study the efficiency motives for mergers and acquisitions in Italy. Analysing post-merging period, they argue that in Italy branching was liberalized in 1990 which implied the rise of number of mergers and acquisitions. The authors distinguish between terms mergers and acquisitions because they believe that they may have distinct motivations and lead to different results. *Multinomial logit* is also used in this study. In particular, mergers, that involve significant organizational problems in integrating two independently run firms, might have different goals from acquisitions, which involve only a transfer to control. Using a relatively small sample, authors test hypothesis that mergers and acquisitions are followed by improvements. They conclude that mergers are driven by strategies aimed at selling more services, while acquisitions can be referred to strategies based on credit management. After an acquisition, the authors discover a long-increase in profitability for acquired firms. They explain this by more efficient monitoring and screening which results in constant decrease in bad loans. The authors also note that mergers appear to affect a change in the financial structure of a bank by decreasing equity and increasing lending.

Rosen, Smart, and Zutter (2005) investigate characteristics that make firms more likely to be acquired as well. Using sample that includes a group of banks that had an initial public offering between 1981 and 2002 and group of similar firms that did not, the authors run *logistic regressions* and do not find that institution size, returns on assets, equity-to-assets ratio, or firm age are significantly related to the likelihood of being acquired. In a study by Akhigbe, Madura, and Whyte (2004) the likelihood of acquisitions is examined and *logit* is used as well. Authors state that the probability of a bank being acquired is greater if it has lower return on assets, more assets, and a higher capital-to-assets ratio. It seems to be the only study that finds the positive relationship between capital levels and likelihood of acquisition.

Previously, studies that use *logit estimation* have been discussed. Now let us turn to *alternative approaches* found in the literature. Other methods can be also found in literature besides logit model. Hannan and Pilotoff (2006) go back to the question of acquisitions. They use a large sample of individual banking organizations, observed from 1996 to 2003 and by employing *Cox (1972) proportional-hazard duration models with time-varying covariates* obtain that less profitable firms are more likely to be acquired, and banks with higher capital-asset ratios are less likely to be acquired.

Wheelock and Wilson (2000) use large sample of 4,000 banks observed between 1984 and 1994 to determine likelihood of bank being acquired and likelihood of failing (a competing risk). They also use *proportional-hazard models with time-varying covariates*, estimated by maximizing the partial-likelihood function to examine the disappearance of banks. *Parametric stochastic frontier model* is used to estimate cost efficiency, and *nonparametric distance functions* – to estimate input and output technical efficiency. Similarly many other researchers obtain that bank's capital-asset ratio is inversely related to the likelihood of acquisition. They also obtain a negative relationship between the likelihood of acquisition and the return to assets.

Benston, Hunter, and Wall (1995) develop and estimate a simple *model of the price bid* and examine the prices bid to acquire target banks in the early to mid-1980s. They conclude that banks would bid more for merger partners that offered potential cash flow enhancements because of earnings diversification, while acquirers would bid more for targets that offered opportunities to increase risk to fail or become too big or important to fail. One more study which is worth mentioning here is the study by Ogarkova (2007) in which firms that make many acquisitions are considered and price of corporate takeover is examined. Using a sample of 1,345 domestic U.S. M&A deals, the author reports that there are no reliable differences in terms of success paid by multiple acquirers. *Heteroscedasticity robust OLS* was used to predict premium, and success rates were modelled with *probit*. The last international study we want to mention here is by James and Wier (1987). They also investigate the question of M&A by examining the effect of competition in the market for bank acquisitions on the acquirers' stock returns, and conclude that the returns to acquirers are positively related to the number of other potential bidders. The authors use *standard event study methodology*.

2.5.2 Developing countries

This part is extremely interesting for our study as methodology used in papers on developing countries may be applied to the case of Kenya. Emerging markets have experienced a rapid growth in foreign investments during last 15 years. Such investments improved efficiency and stability of developing counties. The latter can be classified into 3 groups: Central and Eastern Europe (Bulgaria, Czech Republic, Estonia, Hungary, Poland, etc.), Emerging Asia (China, Hong Kong, India, Korea, Malaysia, Singapore, Thailand), and Latin America (Argentina, Brazil, Chile, Mexico, Peru, Venezuela). Detailed description of FDI growth into these countries was made by Domanski (2005). A lot of economists were trying to find the reasons that attract foreign investors to developing countries. The study by Clarke, Cull, Peria, and Sanchez (2001) focuses on foreign investors' motivations of entering the emerging markets and other problems by answering the following questions: "What draws foreign banks to a country? Which banks expand abroad? What do foreign banks do once they arrive? How do mode of entry and organizational form affect foreign bank behaviour?" It is concluded that foreign banks are willing to enter a developing country's markets because of large opportunities for growth, less restrictions on entry and bank activity.

Sourossa (2004) summarizes main literature findings on factors that drive foreign investments into developing economies. It is stated in the study that the following factors are likely to affect FDI location: considerations about regulatory environment, the degree with which the host country is economically integrated with the home country, the information costs involved in operating in the host country, and the profit opportunities available in the host country. Tsahelnik (2006) looks at factors that attract foreign banks to enter countries of the Commonwealth of Independent States and concludes that economic reforms, wealth of the country, political risks and financial sector size are the most crucial factors.

2.6 Conclusions

The study of mergers and acquisitions provides one bridge between the neoclassical theory of the firm (profit maximization) and more recent theories of the firm, namely, the degree of efficacy of the capital (stock) market discipline. With a perfect capital market the neoclassical theory and more recent theories of the firm ought to yield the same predictions in that the level of merger activity would be quite low or non-existent. The differences and possibly the degree to which there is divergence from the perfectly competitive profit maximizing market is the degree to which mergers occur.

This chapter has explored the theoretical basis for merger activity and reviewed the reasons for the occurrence of mergers and acquisitions that have been offered such as growth, economies of scale and scope, controlling sources of supply and distribution, marketing synergies, expected financial benefits and access to capital markets, improved management skills and management pride as well as tax reasons. Mergers and acquisitions occur due to the various forces that cause firms to undertake merger activity such as economic disturbances, prevailing legal and regulatory frameworks and government taxation policies. The possible motives/factors behind merger activity have been reviewed and used in light of Gammelgaard's (1999) categories for merger motives and the implications of each motive for wave/cyclical behavior. Further Weston, Mitchell and Mulherin (2004) postulate that merger and acquisition activity represents and reflects modern speculative economic activity that unduly increases the level of risk and erodes the level of equity, resulting in an economy highly vulnerable to economic instability.

2.7 Conceptual Framework

The conceptual framework for this study is depicted in figure 2.1 below.

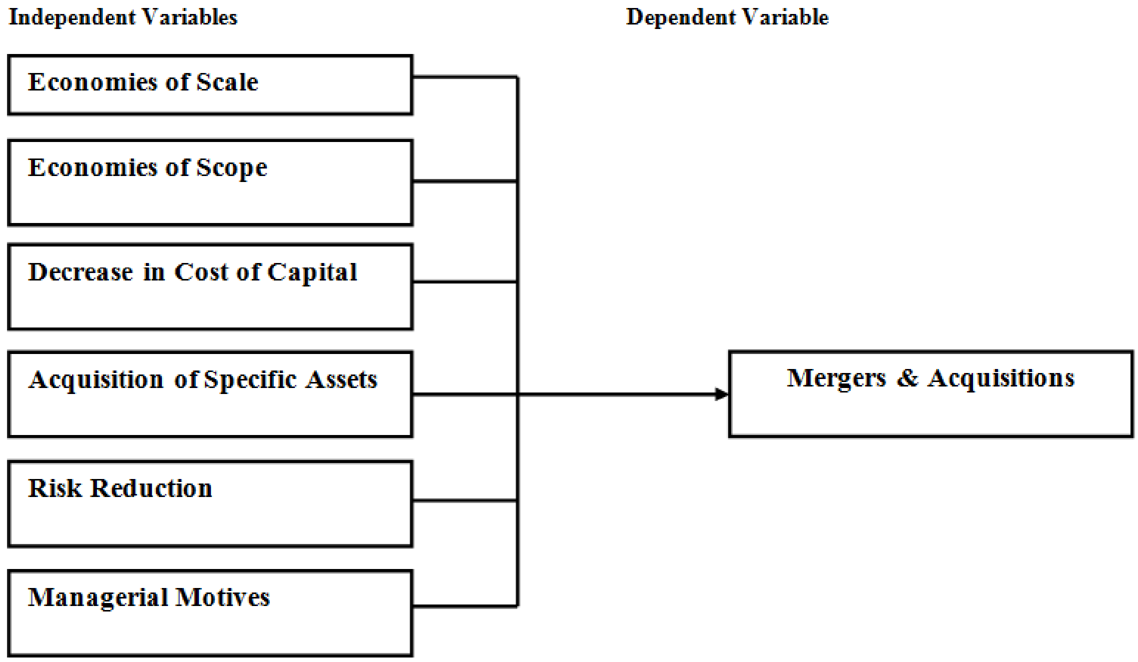

Figure 2.1: Conceptual Framework

3.0 METHODS

3.1 Introduction

This chapter articulates methodology for the research. In the previous chapter, literature pertaining to the study was reviewed and research gaps identified. This chapter discusses the criteria for determining the appropriate methodology for a study. The chapter covers a description of the study design, population of the study, sample design, data collection methods, research Procedures and data analysis and presentation. The following sections provide a detailed description of the methodology to be utilized in the survey. The following sections provide a detailed description of the methodology to be utilized in the survey.

3.2 Research design

According to Brown *et al.* (2003), research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the project, which include the samples or groups, measures, treatments or programs, and methods of assignment that work together to try to address the central research questions. A descriptive survey was undertaken. Descriptive designs result in a description of the data, whether in words, pictures, charts, or tables, and whether the data analysis shows statistical relationships or is merely descriptive. Census surveys based on the whole population of firms listed on the Nairobi Stock Exchange can produce results that are broad, credible and generalisable to the whole population in Kenya; It is preferred to draw findings from the analysis of numerical data, in which case a survey becomes handy. Survey is preferred as a result of financial constraints; and Surveys focus on data rather than theory. In this case, it was possible to administer the data collection tools to the respondents in their workstations, which was relatively easy, and played a great role in increasing the response rate.

3.3 Population
The population of this study was all the firms listed on the Nairobi Stock Exchange that have been involved in mergers and acquisitions, whose number stood at five (5) as at June 2011. A census of all these firms was conducted.

3.4 Data collection
Primary data was collected from the Heads of Finance function with the aid of semi-structured questionnaires. The questionnaires were administered by drop-and-pick method. Self-addressed envelopes were enclosed in letters to the respondents. A letter of introduction and questionnaire was enclosed in each. Telephone calls to the respective respondents to further explain the purpose of the study and set a time frame for the completion of the questionnaires was necessary.

Prior to launching the full-scale study, the questionnaire was pre-tested on 10 respondents to ensure its workability in terms of structure, content, flow, and duration. According to Cooper and Schindler (2000) a pre-test is defined as the testing of the questionnaire on a small sample of respondents preferably 10 or more. After the pre-testing of the questionnaire, modifications were made in the questionnaire to reduce the possibility of ambiguity of some of the before administering to the sampled respondents. Two procedures were followed during the pre-testing of the questionnaire. Cooper and Schindler (2000) observed that the researcher may rely on experts when piloting the instrument to identify changes that can be made with confusing items. Experts and colleagues who are experienced in research were also requested to examine the questionnaire to check whether there will be any items that need to be changed or rephrased, as well as the appropriateness of the time set for completing it. At the end of the exercise, the items in the questionnaire that will be considered to be satisfactory in term of both wording and format.

Validity refers to the extent to which a test measures what we actually wish to measure: it is based on the adequacy with which the items in an instrument measure the attributes of the study (Nunnally, 2000). Patton (2002)'s solution for assuring construct validity is: use multiple source of information; establish chain of evidence, and have key informants review the report. Multiple sources of information will be used in the form of three kinds of sources: literature review on previous empirical research; primary data in the form of questionnaires, and direct observation. Establishing a chain of evidence was be performed in three steps: first, there was literature review, which provided an emerging framework; then pilot study, which aimed to fill the gap between emerging conceptual framework and later field study, and finally, the questionnaire as an instrument of data collection. Also these findings were validated in statistical studies.

Reliability is the degree to which measures are free from error and therefore yield consistent results (Zikmund, 2003). The extent to which the instrument will provide the same results on subsequent administration, known as reliability, was statistically obtained. The researcher will rely on the guidance of the supervisors for reliability of the data collection tool. Reliability analysis will be conducted in this study to ensure that the measures of variables have internal consistency across time and across the various items that measure the same concept or variable (Sekaran, 2000).

3.5 Data Analysis and presentation
The collected data from the questionnaire and secondary sources was systematically organized in a manner to facilitate analysis. Data analysis involved preparation of the collected data - coding, editing and cleaning of data so that it may be processed using Statistical Package for Social Sciences (SPSS) package – version 18.0. The coded data was keyed into the SPSS program where it was developed into a database and hence analyzed. SPSS is preferred because it is very systematic and covers a wide range of the most common statistical and graphical data analysis. The data pertaining to profile of the respondents and their respective organizations was analyzed using content analysis. Cooper and Schindler (2000) states that content analysis may be used to analyze written data from experiments, observations, surveys and secondary sources. Data pertaining to the study objectives of

the study was conducted using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others. According to Mugenda and Mugenda (1999) descriptive statistics enable meaningful description of a distribution of scores or measurements using a few indices or statistics.

In order to meet the objective of the study, "to establish the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange", the respondents were provided with a listing of possible factors motivating mergers and acquisitions and asked the extent to which they agreed or disagreed that each of the factors motivate mergers and acquisitions, along a five-point scale. Measures of central tendency gave us the expected score or measure from a group of scores in a study. Measures of variability, such as standard deviation, inform the analyst about the distribution of scores around the mean of the distribution. Frequency distribution shows a record of the number of times a score or record appears. Factor analysis was performed by examining the pattern of correlations (or covariance's) between the observed measures. Measures that were highly correlated (either positively or negatively) are likely influenced by the same factors, while those that are relatively uncorrelated were likely influenced by different factors. Confirmatory Factor Analyses was used to determine the ability of the adopted conceptual model in fitting the observed set of data.

4.0 RESULTS AND ANALYSIS

4.1 Introduction

The current study sought to investigate the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange. Quantitative techniques were used in data collection. Out of the 47 questionnaires that were distributed to the respondents, 42 of them were returned completed (89.4%) response rate. The high response rate could be attributed to the personal efforts of the researcher, who made a follow up of every questionnaire sent out. Descriptive statistics were used to data analysis. Computation of frequencies and percentages, standard deviations and mean scores were used in data presentation. The information is presented and discussed as per the objectives and research objectives of the study.

4.2 Factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange

4.2.1 Motives for mergers and acquisitions

Respondents were asked to indicate the extent to which they agreed/disagreed that entering into mergers/acquisitions would be based on each of the listed motives responses are summarized and presented in table 4.1 above.

Table 4.1: Motives for mergers and acquisitions

Motives for mergers and acquisitions		(SA)	(A)	(SA)	(D)	(SD)	Mean	Standard Deviation
Economies of scale	Frequency	1	3	1	-	-	2.00	.707
	Percentage	20.0	60.0	20.0				
Economies of scope	Frequency	1	2	2	-	-	2.20	.837
	Percentage	20.0	40.0	40.0				
Decrease in cost of capital	Frequency	3	2	-	-	-	1.40	.548
	Percentage	60.0	40.0					
Acquisition of specific Assets	Frequency	2	2	1	-	-	1.80	.837
	Percentage	40.0	40.0	20.0				
Risk reduction	Frequency	1	3	1	-	-	2.00	.707
	Percentage	20.0	60.0	20.0				
Managerial Motives	Frequency	1	2	2	-	-	2.20	.837
	Percentage	20.0	40.0	40.0				
N = 5								

4.2.4 Other Motives for Mergers & Acquisitions

Respondents were asked to indicate the extent to which they agree/disagree to the listed other Motives for Mergers & Acquisitions responses are summarized and presented in table 4.2 below.

Table 4.2: Other Motives for Mergers & Acquisitions

Other Motives for Mergers & Acquisitions		(SA)	(A)	(SA)	(D)	(SD)	Mean	Standard Deviation
Increase in capital base								
Good growth prospects	Frequency	2	3	-	-	-	1.60	.548
	Percentage	40.0	60.0					
Diversification	Frequency	1	3	1	-	-	2.00	.707
	Percentage	20.0	60.0	20.0				
Operation synergy	Frequency	2	2	1	-	-	1.80	.837
	Percentage	40.0	40.0	20.0				
Financial synergy	Frequency	2	3	-	-	-	1.60	.548
	Percentage	40.0	60.0					
Access to Intangible Assets								
Human capital	Frequency	1	3	1	-	-	2.00	.707
	Percentage	20.0	60.0	20.0				
Customer capital	Percentage	1	2	2	-	-	2.20	.837
	Frequency	20.0	40.0	40.0				
N = 5								

4.3 Summary of findings

Findings of the study further show that the following are the factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange (according to the importance attached to each factor) are: Decrease in cost of capital, as indicated by a mean score of 1.40; Acquisition of specific Assets, as indicated by a mean score of 1.80; Economies of scale as indicated by a mean score of 2.00; Risk reduction, as indicated by a mean score of 2.0; Managerial Motives, as indicated by a mean score of 2.20; and Economies of scope, as indicated by a mean score of 2.20. The findings also show that other factors motivating mergers and acquisitions among firms listed on the Nairobi Stock Exchange (according to the importance attached to each factor) are: *Financial synergy,* as indicated by a mean score of 1.60; *Good growth prospects*, as indicated by a mean score of 1.60; *Operation synergy*, as indicated by a mean score of 1.80; *Diversification,* as indicated by a mean score of 2.00; *Human capital*, as indicated by a mean score of 2.00; and *Customer capital*, as indicated by a mean score of 2.20.

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents conclusions drawn from the research findings and the recommendations for practice and for further studies.

5.2 Conclusions

Findings of the study show that M & As is a source of synergy, the cost reduction that occurs as a result of a corporate combination and the ability of a firm to utilize one set of inputs to provide a broader range of products and services. The findings also show another source of synergy is financial synergy, which refers to the impact of a corporate merger or acquisition on the cost of capital to the acquiring firm or merging partners. This corroborates the finding by Gaughan (2007) who noted that a good example of economies of scale arises in the merging of two manufacturing companies, scope economies are usually the most common motive in the banks M & As while decrease in cost of capital occurs because larger companies have better access to financial markets. The findings also show that acquisition of specific assets is also often a reason for M&As since the asset acquired may be a source of raw materials, a good management team or good research and development facilities. In addition, risk reduction is a motive for M & As since it enables a company to reduce the cyclicality of its earnings and cash flow by acquiring or merging with another company whose earnings and cash flows exhibit a different cyclical pattern so that the probability of bankruptcy is reduced. These findings also corroborate the findings by Gaughan.

The findings also show that managerial interests are a motive for M & As since the managers seek to increase the acquirer's dominant position in the market and to defend existing market positions. In addition, the managers themselves might also be interested in M&As due to prestige, which is immeasurable but undoubtedly greater in a larger firm. This is in line with the finding by (Brouthers, van Hastenburg and van den Ven (1998). Other motives for M & As include financial synergy, diversification, operating synergy, human capital, customer capital and good growth prospects.

5.3 Limitations of the Study

The scope of the study could be a limiting factor in that only 42 out of the total of 47 firms listed on the Nairobi Stock Exchange participated in the study. The findings may thus not be representative of the whole population. Though the researcher was determined to undertake the study to completion within the given time frame, various constraints were encountered as earlier envisaged. The time allocated for data collection may not have been sufficient to enable the respondents complete the questionnaires as accurately as possible, considering that they were at the same time carrying out their daily duties and priority is of essence. The researcher preferred to administer the data collection tools to only the Heads of Finance, however, this was practically not possible as some of them delegated this request since they were either too busy or were away on official duties. The competitive nature of the business sector in Kenya also meant that some of the information sought was of confidential nature and could not be divulged for fear of giving a potential competitor an upper hand. The respondents were however re-assured that all information provided would be treated confidentially.

5.4 Recommendations

5.4.1 Recommendations for policy and practice

The reasons given by companies for this recent wave of M & As have included cost cutting through economies of scale, strengthening the company's market position, gaining access to new markets, global expansion, gaining a talented workforce, acquiring new knowledge and expertise, gaining a new customer base, and pursuing new technologies. However, although mergers and acquisitions are being aggressively pursued by companies, recent studies have indicated that 60-80% of all mergers are financial failures when measured by their ability to outperform the stock market or to deliver profit increases (Noe, 2002). The sections below present the key factors that are required to ensure a smooth and effective merger process:

Extensive and Regular Communication: Communication at various levels is crucial during all stages of the merger process, and is the key to its success. Even when communication is given high priority, the manner in which it is used is often less than ideal. To be effective, the communication process has to be carried out in such a way as to avoid confusion and mixed messages. It needs to be honest and to focus on positive messages. If not, it can encourage rumors that can have a negative impact both within the organization and externally. It is very important for management to communicate clearly and regularly to all employees the implications of the merger, including the planned changes to working practices and organizational processes.

If management is unable to discuss the merger while negotiations are taking place, then it needs to make up for it immediately in the post-merger phase. The communication process should include stating the merging company's goals and objectives to all employees and keeping them informed of progress during the implementation and integration phase of the merger. The communication process should also encourage two-way feedback between management and employees to make employees feel that they are contributing to the solution. By involving people at all levels of the organization, the merging companies are encouraging widespread acceptance of the merger process and reducing feelings of insecurity.

Effective Planning: Success in mergers and acquisitions correlates directly with the level of planning that goes into them. Careful and early planning has been shown to influence the success of a merger. Plans need to include realistic goals and reasonable timeframes, and should cover all the key aspects of an organization including people, systems and organizational processes. They should also focus on ways to align systems, work structures and processes between the merging organizations, and on implementing structures and procedures that will allow the organization to handle the changes brought about by the merger. Effective planning leads the way to a smoother implementation process and maximizes the chances of success of the merging organization.

Retaining Key People: The retention of a talented workforce, which is often a major reason behind the decision to merge, should take priority during the merger process, and management needs to adopt measures to improve the retention rate of the best people in the merging companies. Truthful and thorough communication with employees can play a significant part in management's retention strategy. If the communication process is performed effectively, it can reduce employees' sense of insecurity and give them a better picture of what the future holds for them. If, however, managers are not honest about the true implications of the merger, they will lose the trust of their employees, causing them to leave the company. As for the remaining employees, they may no longer feel motivated to produce their best work.

Managing Cultural Differences: Companies that are merging need to be aware of cultural differences between them and need to find practical ways of reconciling those differences. Conducting a cultural audit is a useful way of obtaining useful information about the two companies' differing cultures and helps to evaluate differences and similarities in work standards and practices. That information can raise awareness of potential difficulties and issues in the merging process, and allows the merging company to take steps to minimize culture clashes by building an effective communication structure. Part of the communication process should involve bringing together people in both organizations and encouraging them to take part in both social and professional activities together.

Training and Development: Training and development should be provided to senior and middle management and should focus on all aspects of the merger process. Such interventions will facilitate more effective leadership on the part of managers, who will have a better understanding of the key issues that arise during the course of a merger. Training should focus on the implications of the merger for the company, its effects on employees at all levels of the organization and its impact on working practices and organizational structures. Training should also educate managers on what each stage of the merger process entails for them and for the company as a whole. Ideally, training on M&A issues and activities should take place even if a merger is not being considered, so that managers are prepared in the event of a future merger or acquisition. Training managers on how to communicate M&A implications and issues to the rest of the organization is also required. Managers need to be able to engage employees at all levels of the organization in order to make them feel part of the decision-making process and to cultivate their support.

Post-Merger Integration Teams: One way of ensuring that post-merger integration will run smoothly is to set up a post-merger integration team in all the critical areas of the organization, including finance, sales and marketing, human resources, and operations. It is a question of identifying where value is being created, and then making sure you protect it during the integration process. You have to be selective when deciding exactly what to integrate, and how quickly.

5.4.2 Recommendations for further research

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researches. The following areas of further research are thus suggested: Whereas the current study focused on the motives for mergers and acquisitions, future studies should seek to establish the challenges encountered in mergers and acquisitions, possible interventions that may be used to address the challenges and the effect of mergers and acquisitions on firm performance.

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APPENDIX I: QUESTIONNAIRE

This questionnaire has been designed to collect information from Heads of Finance function of firms listed on the Nairobi Stock Exchange and is meant for academic purposes only. Please complete each section as instructed. Do not write your name or any other form of identification on the questionnaire. All the information in this questionnaire will be treated in confidence.

FACTORS MOTIVATING MERGERS AND ACQUISITIONS

1.0 Motives for mergers and acquisitions

Listed below are some of the motives for mergers and acquisitions. If your organization has implemented mergers and acquisition/would consider entering into mergers and acquisitions arrangements, please indicate the extent to which you agree/disagree that such decision was/would be based on each of the listed motives (please tick one as appropriate)

Scale: Strongly agree (5)
Agree (4)
Somehow agree (3)
Disagree (2)
Strongly Disagree (1)

2.1 Economies of Scale: Decreases in per unit costs that result from an increase in the size or scale of the company operations (Firms merge and take advantage of producing larger volumes of outputs in order to obtain lower costs).

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.2 Economies of Scope: The ability of a firm to utilize one set of inputs to provide a broader range of products and services

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.3 Decrease in Cost of Capital: The impact of a corporate merger or acquisition on the cost of capital to the acquiring firm or merging partners because a larger company has certain advantages, including better access to financial markets, tends to experience lower costs of raising capital, because it is considered to be less risky than a smaller firm is

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.4 Acquisitions of specific Assets: The acquired assets may be a source of raw materials, a good management team or good research and development facilities (It is quicker and cheaper to acquire new products, new facilities or a national distribution network by merging with a company that already has developed them)

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.5 Risk Reduction: A company may reduce the cyclicality of its earnings and cash flow by acquiring or merging with another company whose earnings and cash flows exhibit a different cyclical pattern so that the probability of bankruptcy is reduced - for instance, two firms, one producing swimming suits and the other producing winter skiing wear merge. Then, even if it is not snowing, the new entity can compensate the lack of cash flow by the sale of winter skiing wear for the cash flow from swimming suits. That is, the probability of bankruptcy for the merged entity decreases.

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.6 Managerial Motives: A manager's motive for merger is often to increase the acquirer's dominant position in the market and to defend existing market positions (Managers themselves might also be interested in M&As due to prestige, which is immeasurable but undoubtedly greater in a larger firm).

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7 Other Motives for Mergers & Acquisitions

2.7.1 Increase in capital base

2.7.1.1 In response to the good growth prospects, mergers and acquisitions, just like internal investments, are the means for companies to increase their capital base

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7.1.2 Companies may grow within their own industry or they may expand outside their business category, which means diversification. If a company seeks to expand within its own industry they may conclude that internal growth is not an acceptable alternative.

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7.2 ***Operating synergy:*** which consists of both: economies of scale (or the spreading of fixed costs, such as depreciation of equipment and amortization of capitalized software; normal maintenance spending; obligations such as interest expense, lease payments, and union, customer, and vendor contracts; and taxes, of over increasing production levels); and economies of scope (which refers to using a specific set of skills or an asset currently employed in producing a specific product or service to produce related products or services).

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7.3 ***Financial synergy:*** the cost of capital could be reduced if the merged firms have uncorrelated cash flows, realize financial economies of scare, or result in a better matching of investment opportunities with internally generated funds.

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7.4 ***Access to Intangible Assets:*** Knowledge, as a core organizational resource and the basis for the development of organizational capabilities, is playing a key role in driving changes in companies. Today the value of knowledge based, intangible resources has grown geometrically in companies. The intangible assets include:

2.7.5 ***Human capital:*** This is the sum of all the capabilities of everyone who is currently working in a company, i.e. the cumulative knowledge, experience, attributes, competencies, and mindsets of all employees, managers, and leaders. These individual capabilities of employees create value for the customers.

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

2.7.6 ***Customer capital***: This consists of the strategies, structures, processes, and leadership that translate into a company's specific core competencies. These organizational capabilities leverage employees' individual capabilities to create value for customers. Structural capital also includes the organizational capacity and physical systems used to transmit and store intellectual material.

(a) Strongly agree [ ] (b) Agree [ ] (c) Somehow agree [ ]
(d) Disagree [ ] (d) Strongly Disagree [ ]

END

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