CORE
Metadata, citation and similar papers at core.ac.uk
Provided by International Institute for Science, Technology and Education (IISTE): E-Journals

European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.9, No.29, 2017
www.iiste.org

Effect of Mergers on Financial Growth of Commercial Banks in Kenya

Evalyne Munyiva Mshabaa* Jamal A. Mohamed Noor
School of Business, Jomo Kenyatta University of Agriculture and Technology, PO box 81310-80100, Mombasa, Kenya

Abstract
Mergers perform a critical role in corporate finance in enabling firms achieve varied objectives and financial strategies. Firms merge due to various reasons but most do so to increase their profitability and gain a greater market share. The study examined the commercial banks that have merged in Kenya from 2005 to 2016. The primary objective of the study was to establish the effect of mergers on the financial growth of commercial banks in Kenya and was guided by the following variables; loan portfolio, interest income, operating expenses and bank deposits. The findings confirm whether mergers of commercial banks leads to increased profitability. The study was also based on the theory of financial synergy, free cash flow, the theory of efficiency and market power hypothesis. The research adopted a descriptive survey research design to establish the relationship between mergers and the financial growth of commercial banks in Kenya.
Keywords: Financial growth, mergers, synergy, loan portfolio, interest income, synergy.

1. Introduction
Many banks have extended their branch networks through mergers. Mergers become possibly the most important factor in the realm of business for altogether different reasons. Mwangi (2014) notes that the extremely basic reason is the point at which you've chosen it bodes well to unite with another organization to receive the benefits that originated from your consolidated qualities. For an economy to accomplish its potential development, components must exist to viably assign capital (rare asset) to the most ideal uses; representing the peril of the open door accessible. Markets and Institutions have been made to encourage the exchange of assets from financial specialists with surplus assets to monetary operators needing reserves. These organizations should likewise manage the intrigue and certainty of the general population by being adequately receptive to their necessities, respecting developing commitments and evading activities/inactions that would prompt misery and disappointment in the framework (Luypaert, 2008). Despite the fact that mergers remain the most unmistakable system for accomplishing development, their achievement in making long haul investor esteem still stays challenged. There is a solid confidence in many organizations that converging with another organization will come about into better financial performance (Waweru 2015). Numerous nations are moving towards uniting their saving money framework and Kenya can't be a special case. Because of changes in the working condition, a few authorized establishments, chiefly business banks, have needed to consolidate (join their operations in commonly concurred terms). A portion of the reasons advanced for mergers are: to meet the expanded levels of offer capital; grow circulation system and piece of the overall industry; and to profit by best worldwide practices among others. Financial growth is the way toward enhancing some measure of an endeavor's prosperity. Business banks are a critical factor in the financial advancement of a region. They are a noteworthy provider of credit and the main wellspring of interest store administrations which help encourage business exchanges. While banks of all sizes give credit to people and littler organizations, just expansive banks have adequate funding to meet the credit requests of vast companies and work at a scale where more particular managing an account administration can be given proficiently (Hideaki, 2006).

1.1 Objectives of the study
The main objective of the study was to establish the effect of mergers on the financial growth of commercial banks in Kenya.
The specific objectives are;
- To examine loan portfolio as an effect of merger on financial growth of commercial banks in Kenya.
- To determine interest income as an effect of merger on financial growth of commercial banks in Kenya.
- To assess operating expenses as an effect of merger on financial growth commercial banks in Kenya.
- To investigate bank deposits as an effect of merger on financial growth of commercial banks in Kenya.

2. Literature review
Mergers have turned out to be progressively famous as organizations search for higher returns and prevailing business sector position in the worldwide market. Mergers intends to gain skill, innovation and items. In the course of recent decades, mergers have turned into a worldwide marvel and a well-known key decision for

organization development and extension (Marangu, 2007).

Aside from giving operational advantages, for example, economies of scale, resource rebuilding, specialized and administrative aptitude exchange, bank mergers apparently enhance the financial position by decrease in risk, expanded debt limit and lower loan costs and also tax savings. In spite of the fact that in principle the aftereffect of a merger may sound promising, such positive results are still rare in light of a few exact discoveries. Some exploration demonstrates that cost lessening and effectiveness picks up are not altogether identified with mergers others show that both productivity and non-intrigue cost are unaffected by merger action. Reliably some offer some sign that interstate mergers don't enhance operating income while others presumes that mergers don't cut cost on the non-interest costs of the financial organizations (Bunyasi, 2014).

The theories relating to the effects of mergers include financial synergy theory which highlights reduced costs that could occur when firms merge as a result of reduced external financing. At the point when the two firms merge, their consolidated debt limit might be more noteworthy than the entirety of their individual limits before the merger. Tax saving is another contemplation of when two firms merge.

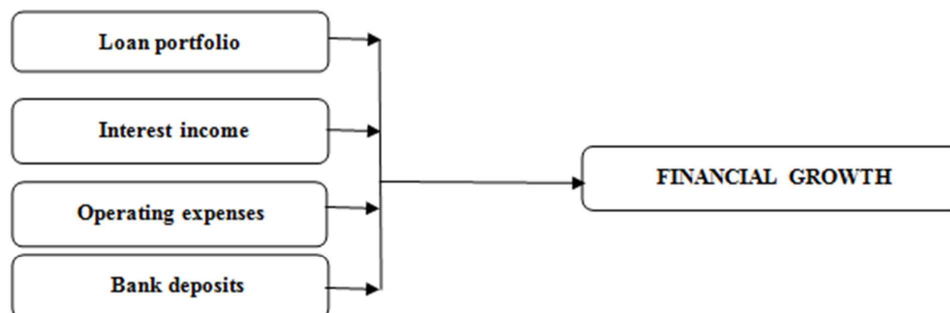
Free cash flow theory denotes that debt is subsequently a suitable substitute for profits since by issuing obligation rather than stock, supervisors can warrant the guarantee to pay out future trade streams out a way that they couldn't achieve by expanding profit.

As for theory of efficiency, it clearly states that mergers will only occur if it is expected that it will result in value creation for both firms. The efficiency advantages gather from working cooperative energies which are accomplished through the exchange of learning, economies of scale and economies of degree. The blend of at least two organizations may bring about more than the normal benefit because of cost decrease and effective use of assets.

Market power hypothesis theory refers to gaining of a large market share which is a major motive for most firms wanting to merge. Firms with greater market share benefit from greater margins through the appropriation of consumer surplus.

2.1 Conceptual framework

The structure below discusses the independent variables which are effect of mergers and the dependent variable which is the financial growth of commercials banks in Kenya.



2.2 Review of effects of mergers

Loan portfolio

This comprises of advances that have been bought and are being held for reimbursement. This are what generates interest income of the banks thus are a source of revenue. In that capacity it is one of the best wellsprings of hazard to a monetary foundation's security and soundness.

Interest income

This is the contrast between the income that is produced from a bank's benefits and the costs related with paying out its liabilities. Banks benefit comprises of all types of individual and business credits, home loans and securities. Banks always strive to reduce their costs at the same time increasing their benefits so as to boost their revenue through interest income.

Operating expenses

This is a cost a business brings about through its typical business operations. It incorporates advance misfortune arrangements, staff costs, lease, and marketing costs among others. One of the obligations that the administration must fight with is deciding how low operating costs can be decreased without fundamentally influencing a company's capacity to compete with its rivals (Odunga, 2016).

Bank deposits

This is the positioning of assets in an account with a bank or other financial institution. The more the client base

inside a bank, the more noteworthy will be the deposits. With mergers it is normal that the quantity of clients will increment henceforth an expansion in deposits (Allen, 2014).

Financial growth

This is where the banks produce positive cash flow. It can be measured through return on assets and return on equity. Return on assets demonstrates what the organization can do with what it has while return on equity measures enterprise's profitability by uncovering how much benefit an organization creates with the cash investors have contributed. It is the ultimate financial growth of any firm is its determinant to whether it will be able to sustain its existence or not. Banks strive to achieve a higher net profit margin and return on assets because as such positive cash flows are expected to be generated and the firm becomes a going concern.

3. Conclusion

The study concludes that mergers do have an impact on the financial growth of commercial banks in Kenya. Some of the effects of mergers like loan portfolio, interest income and bank deposits increased as firms merge, however an increase in operating costs was not as significant probably because the firms could have decided to lay off some employees to reduce their staff costs or even conduct restructuring that enabled them save on costs.

The study recommends that the banks that have a weak or lower capital base should opt for mergers. This might help them regain strength to and concentrate on being profitable by investing in products and increasing their customers to generate more revenue.

The study recommends that merged commercial banks should concentrate on improving customer experience by giving personalized communication. This will lead to higher response, brand loyalty and increased relevance.

In a bid to increase efficiency and reduce on operational costs, banks need to adopt the use of technology like the integration with mobile application platforms and internet banking to increase bank deposits and loan disbursement. Agency banking is yet another technology that can be a major distribution channel for majority of the bank products to the consumers.

There is need to further this study by exploring other factors that are important in the merging process in order to increase the knowledge base. Other sectors of the economy and the perspective of the shareholders about the merger process and what this meant on the cost and profitability of the company should also be studied in future.

References

Bunyasi, J. (2014). effect of mergers and acquisitions on growth of commercial banks in Kenya. Nairobi: Unpublished.

CBK. (2015, June 25). Central bank of Kenya. Retrieved February 20, 2017, from Central bank of Kenya: http://www.centralbank.go.ke

Franklin Allen, E. C. (2014, May 12). Deposits and Bank Capital Structure.

Hideaki, Y. a. (2006). Factors behind M&A activity. Research Institute of Economy, Trade & Industry Publication., pp. 50-67.

Lillian Kerubo Onuko, M. M. (2015, July). Effect of Credit Risk Management on Loan Portfolio: Quality of Tier one commercial banks in Kenya. International Journal of Business and Management Invention, 4(7), 46-53. Retrieved from www.ijbmi.org

Luypaert. (2008). Determinants of Growth through M&As. The US evidence Journal of financial economics, Vol.13, pp.187-221.

Marangu. (2007). The effects of mergers and acquisition on financial performance of non-listed commercial banks in Kenya. Nairobi: Unpublished.

Mwangi. (2014). The effect of mergers and acquisition on financial performance of commercial banks in Kenya. Nairobi: Mwangi.

Odunga, R. M. (2016). Specific Performance Indicators, Market Share and Operating Efficiency for Commercial Banks in Kenya. International Journal of Finance and Accounting, 135-145.

Omayio. (2012). The information content of mergers and acquisitions announcement for companies quoted at the Nairobi Securities Exchange. Nairobi: Omayio.

Richard Tuyishime, D. F. (2015). The Effects Of Deposits Mobilization On Financial Performance In Commercial Banks In Rwanda. A Case of Equity Bank Rwanda Ltd. International Journal of Small Business and Enterpreneurship Research, 44-71.

Waweru, N. M. (2015, June). Merger Restructuring and Financial Performance of Commercial Banks in Kenya. pp.337-350.