Factors of Mergers and Acquisition on the Financial Performance of Dairy Processing Industry in Kenya: Case Study of Brookside Dairies

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Abstract: **Mergers and acquisition have become amongst many the means of attaining higher performance which is the ultimate goal of every firm, including dairy processing. In the conduct of this research, it was found that acquisitions are more prevalent in the western world hence a local aspect research into this would be welcome. The study took a causal research design. This causal research design is consistent with the study's objective which is to determine the factors of mergers and acquisition on financial performance of dairy firms in Kenya, this can only be measured through profitability, leverage and liquidity .Gay and Airasian (2003) note that causal research designs are used to determine the causal relationship between one variable and another. The study mainly used secondary data from the published performance facts, Central Bureau of Statistics (CBS) and annual statutory reports derived from the dairy firm itself for the period in study. Also according to the study post-acquisition was found to have an effect on financial performance and the results of the study showed that there was positive correlation between financial performance and the firms leverage ratio and capital adequacy .The value of adjusted R square for Brookside Dairy was 0.821, this shows that there was 82.1% changes in the financial performance of the dairy firm after the merger was done between the two firms. This could be attributed to changes in liquidity, capital adequacy and the firms financing structure of the firm and firm size. The correlation co-efficient R of 0.943 denotes that there is a strong positive relationship between financial performance and profitability, capital adequacy and firms financing structure and firm size. Also the findings concludes that creation of economies of scale, need to gain a higher bargaining power, and business expansions are the main reasons as to why companies conduct M&A. Based on the findings the study recommends that there is need for companies to merge to enhance creation of economies of scale, a higher bargaining power, and business expansions.**

Keywords: **Mergers and acquisition, business expansions, financing structure of the firm and firm size.**

1. INTRODUCTION

M&A are used to diversify the company's portfolio as a risk management strategy. Additionally, to enable companies penetrate to new geographical markets to support growth by capitalizing on economies of scale and increase on customer base among other reasons (Kemal, 2011).

The logic behind any corporate merger is the synergy effect; two is better than one. Companies believe that by either merging or acquiring another company, the performance would be better than a single entity. This is attributed by the fact that shareholder value would effectively be maximized (Sharma, 2009).

Merger can be defined as a means of unification of two players into single entity. A merger is a process of combining two business entities to be under common ownership, Kaur and Gian, (2010).The term "acquisition" is used to refer to any takeover by one company of the share capital of another in exchange of cash, ordinary shares, or loan stock (Halpern, 1983).

Dairy Industry:

Kenyans are amongst the highest milk consumers in the developing world, consuming an Estimated 145 litres per person per year, more than five times milk consumption in other East African countries (SDP, 2005). Among all developing countries, only Mongolians and Mauritanians consume more milk per dollar earned than Kenyans do (ILRI, 2007). Kenyans Consumed about 3 billion litres of milk in 2005 with conservative milk demand estimates Suggesting an increase of milk consumption of between 3 and 4 percent per annum, which is Largely driven by increases in population, urbanization and incomes. At that time, it was expected that milk consumption would rise to 3.5 billion litres by 2010 and 4.2 billion litres by the end of the Strategy for Revitalization Agriculture (SRA) plan period (Government of Kenya, 2006).

Statement of the problem:

Mergers and acquisitions have become the main means of attaining higher performance which is the ultimate goal of every firm, including dairy firms in Kenya. Many studies carried out in the area of M&A have established inconsistent results. A study by KPMG International found that 75% to 83% of the mergers fail. Failure means lowered productivity, labor unrest, higher absenteeism and loss of shareholder value. In some cases, it means well-publicized dissolution of the combination. The fact is that it is much easier to make a deal than to make a deal work (Nguyen & Kleiner, 2002).Mergers and acquisition research has now been ongoing for over 30 years, and while it has been possible to mention only a few of the varied contributions in the space available, each disciplinary approach has made significant advances in our understanding. Yet, despite this robust academic interest, empirical data reveal that there has been little change in acquisition failure rates over the same time period. Kitching (1974) reported failure rates of 46–50%, based on managers' self-reports.

Objectives of the study:

To determine the influence of firms financing structure of M&A on financial performance of dairy firms in Kenya.

To determine the effect of firm size on the M&A on financial performance of dairy firms in Kenya.

2. LITERATURE REVIEW

This chapter builds on the background research problem and the research questions identified in the previous chapter. The chapter discusses relevant literatures from a broader and richer perspective to bring out the factors of mergers and acquisition on financial performance of firms in the dairy industry in Kenya special focus on Brookside dairies.

THEORETICAL LITERATURE:

Monopoly Theory:

This theory is viewed in the light that acquisitions were executed to achieve market power Trautwein (1990). The implications of this type of acquisition are; Conglomerates using cross-subsidized products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market.

Process Theory:

This approach hinges on rationalization and it indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory, the central role of organization routines, or political power in the decision process rather than completely rational choices. Duhaime and Schwenk (1985) identified the limitations of information processing capacities in acquisition decisions. He found that the managers’ behavior was over-optimistic in the acquisition decision process. They proposed a systematic acquisition process perspective. He found that political and structural matters affect the acquisition process and outcome, whereas argued that cultural distances between two companies have enormous impacts on acquisition and the post-acquisition integration process. The conclusion is that “the evidence on the process theory can best be described as ambiguous. The available evidence is largely supportive.

Firms financing structure:

In the quest to optimize their objective, which hinges primarily on quantifiable performance, financial managers have adopted various capital structures as a means to that goal. A firm can finance its investment by debt and/or equity. The use of fixed-charged funds, such as debt and preference capital along with the owner's equity in the capital structure is described as firms financing structure or gearing (Dare and Sola, 2010). An unlevered firm is an all-equity firm, whereas a levered firm is made up of ownership equity and debt. Firms financing structure takes the form of a loan or other borrowing (debt), the proceeds of which are (re)invested with the intent to earn a greater rate of return than the cost of interest. If the firm's marginal rate of return on asset (ROA) is higher than the rate of interest payable on the loan, then its overall return on equity (ROE) will be higher than if it did not borrow (Laurent, 2005). On the other hand, if the firm's return on assets (ROA) is lower than the interest rate, then its return on equity (ROE) will be lower than if it did not borrow. Leverage allows a greater potential returns to the investor than otherwise would have been available, but the potential loss is also greater: if the investment becomes worthless, the loan principal and all accrued interest on the loan still need to be repaid (Andy *et al.*, 2002).

Firm Size:

The size of a firm plays an important role in determining the kind of relationship the firm enjoys within and outside its operating environment. The larger a firm is, the greater the influence it has on its stakeholders. Again, the growing influences of conglomerates and multinational corporations in today's global economy (and in local economies where they operate) are indicative of what role size plays within the corporate environment. Refocusing the importance of size in corporate discourse, Bhayani, (2010) argue that an interesting aspect of economic growth is that much of it takes place through the growth in the size of existing organizations. They cite Rajan and Zingales (1995) whose study in the sample of 43 countries show that two-thirds of the growth in industries over the 1980s, comes from the growth in the size of existing establishments, while only one-third trickled in from the creation of new ones. As the popularity of corporate size phenomenon continues to rise within the external business environments, more attentions are being pushed to its real effects on the internal structures of corporations and the specific impact on the relationship between the firm and its key stakeholders. One of the most popular areas where the influence of firm size has been much queried is the area of practice of corporate finance. By this reason, analyzing the factors determining firm profitability or, to put it in another way, identification of the sources of variation in firm-level profitability has been regarded as an important research theme. In this context, size has been considered as a fundamental variable in explaining firm profitability by the researchers and a number of studies investigate the effects of size on firm profitability (Serrasqueiro et al, 2008; Wu, 2006). Here, it should be stated that according to the conclusions of various studies the impacts of size on profitability can be negative or positive (Serrasqueiro et al, 2008). It is also argued that larger firms are more stable and mature and they can generate greater sales because of the greater production capacity that will enhanced capital cost savings with the economies of scale (Ravenscraft and Scherer, 1987)

Empirical Review:

Firth (1979) examined merger and takeover activity in the United Kingdom specifically, the impact of takeovers on shareholder returns and management benefits was analyzed, and some implications for the theory of the firm are drawn from the results. The study showed that mergers and takeovers resulted in benefits to the acquired firms' shareholders and to the acquiring companies' manager, but that losses were suffered by the acquiring companies' shareholders. The results were consistent with takeovers being motivated more by maximization of management utility reasons, than by the maximization of shareholder wealth.

The study concur with Rotich (2005), in his study concluded that the profitability of the commercial banks that merge and acquire others depends heavily on the net of income generating activities and the related activities expense. Due to the problem of profitability and stiff competition and some wanting to have a control and expand their market share in the industry, thus in this study the dairy firm sought to integrate and changed its behavior of income sources, by increasingly diversifying into non-intermediation income generating activities as opposed to the traditional inter-mediation income generating activities and that the profitability of the firm improved after the merger and acquisition process.

3. RESEARCH METHODOLOGY

This research was to establish if the operating and financial performance improve after Mergers and Acquisitions in the Kenya's Dairy sector. The research methodology employed a causal research design, population and sample size of the study, data collection and analysis techniques, and the analytical model was used in the study.

The population under study consisted of the Brookside dairy firm in Kenya. The main focus is on Brookside dairies that have engaged in mergers and acquisitions in this sector between the years 2002-2014. These include; acquiring of

Ilara Dairy, Tuzo and Buzeki Dairy firms and a complete merger with Spin Knit Dairy. The research study was mainly centered on its main goal by using the developed financial model to examine the relation existing between different indicators that resulted from the firm's financial statements and expressed through the financial performance.

$Y_i = \beta_0 + \beta_1 \; Ffs + \beta_2 \; S + \varepsilon$………………………….*1*

4. RESULTS AND DISCUSSION

This chapter entails the data analysis, relationship among the study variables as well as results of the analysis. The data analysis method utilized is the ratio analysis, descriptive research design as well as the as a regression model. In addition, the relation between variables is determined by performing a correlation between the variables and finally the results of the analysis are discussed.

Regression coefficients after the merger:

Table 4.1 Regression Coefficient after M&A

model	Unstandardized B	Coefficient std error	Standardized coefficients Beta	Sig.
(constant)	**1.884**	**0.00**	**0.00**	**0.00**
Firms financing structure	**0.133**	**0.00**	**0.480**	**0.003**
Firm size	**0.190**	**0.00**	**0.758**	**0.001**
Dependent variable :ROA				

ROA= $\beta_0 + \beta_1 \; Ffs + \beta_2 \; S + \varepsilon$………………………….*1*

$Y=1.884+0.133X_1 +0.190X_2 +0.00$

From the above regression model, if firms financing structure of the dairy firm approaches a constant of zero. The financial performance of dairy would be 1.884. It's established that a unit increase in firms financing structure of the dairy would result to an increase in financial performance of the dairy firm by 0.133, further a unit increase in firm size also contributed to the increase in financial performance by a factor of 0.19.This is an indication that financial performance of the dairy firm was positively associated with firms financing structure and the increase in the size of the firm. The study further indicates that the P-value was less than 0.05 in all the variables, which showed that all the independent variables were statistically significant and thus in position to make conclusion for the study.

Table 4.2 ROE Regression Coefficient after M&A

model	Unstandardized B	Coefficient std error	Standardized coefficients Beta	Sig.
(constant)	**1.839**	**0.00**	**0.00**	**0.00**
Firms financing structure	**0.116**	**0.00**	**0.102**	**0.003**
Firm size	**0.105**	**0.00**	**0.998**	**0.001**
Dependent variable :ROE				

ROE= $\beta_0 + \beta_1 \; Ffs + \beta_2 \; S + \varepsilon$……………………………………..…….*ii*

$Y=1.839+0.116X_1 +0.105X_2 +0.00$

From the above regression model, if firms financing structure of the dairy firm approaches a constant of zero. The financial performance of dairy would be 1.839. It's established that a unit increase in firms financing structure of the dairy would result to an increase in financial performance of the dairy firm by 0.116. a further increase in the firm size which results to an increase in the financial performance by a factor of 0.105.This is an indication that financial performance of the dairy firm was positively associated with firms financing structure of the firm and the increase in size of the firm. The study further indicates that the P-value was less than 0.05 in all the variables, which showed that all the independent variables were statistically significant and thus in position to make conclusion for the study.

5. SUMMARY

From the findings the study found out there was an increase in the return on equity after merger depicted by an increase in the t- value from 6.740 to 9.456. There was also notable increase in the mean difference from 0.2126 to 0.3897 which is a clear indication of increase in return on equity, from the above findings the study found that there was an increase in the return on equity which was found to be statistically significance since the significance value was found to be 0.001 which was less than 0.05.The study also found an increase in the return on assets after merger and acquisition, from the results it was found that there was an increase in t value from 5.181 to 6.077, which is an indication on the increase in the return on assets. This was also evident on the notable increase in the mean difference from 0.221to 0.335, all the increase were found to be statistically significance as their p-value were found to be 0.004 which is less than 0.05.

6. CONCLUSIONS

From the study it can concluded that there was a significant effect on financial performance which can be attributed to profitability which increased after the M&A of the dairy firm as well has the firm's firms financing structure changed hence have an effect on financial performance. The study also found that there was general increase in the profitability of the dairy firms after M&A and decrease in debt ratio and increase in firm size of the dairy firms after M&A, the study thus concludes that there was improvement in financial performance after dairy firm completed the acquisition and mergers. From the regression analysis it was revealed that there was a greater improvement on the financial performance of dairy firms after acquisition, this could have been highly attributed to by changes in firms financing structure and the firm size of the dairy firms, and this is an indication that the M&A had an effect on the financial performance.

7. RECOMMENDATIONS

Recommendations over years on ways to revitalize the dairy industry with a view to empower the producer have never been implemented fully including the lukewarm participation of the market regulator KDB and the Government. Thus KDB should ensure that they enforce the national standards for the dairy sector and ensure that even if there are mergers they should be regulated to avoid the case of having one processor controlling the market thus have a major influence in the market prices for the dairy products. Ensure that there are no hostile takeovers in the dairy sector which has been the case lately.

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