IMPLICATION OF BANK MERGERS AND ACQUISITION ON STABILITY AND COMPETITIVENESS OF THE TANZANIAN BANKING SECTOR

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NOVEMBER 2022

TABLE OF CONTENTS

1 INTRODUCTION 2
1.1 Background 2
1.2 Overview of Tanzania Banking Sector 2
1.3 Literature Review 3
1.3.1 Definition of Merger and Acquisition 3
1.3.2 Types of Mergers and Acquisitions 3
1.3.3 Motives for Mergers and Acquisitions 4
2 MERGERS AND ACQUISITIONS IN TANZANIA BANKING SECTOR 5
2.1 Regulatory Framework Governing Mergers and Acquisitions 5
2.1.1 The Banking and Financial Institutions Act, 2006 (BAFIA) 5
2.1.2 The Banking and Financial Institutions (Licensing) Regulations, 2014 6
2.2 Motives of Mergers and Acquisitions in Tanzania Banking Sector 6
2.3 Examples of Bank Mergers and Acquisitions in Tanzania 6
2.3.1 Merger of NIC Bank (T) Ltd and Commercial Bank of Africa (T) Ltd 7
2.3.2 Mwanga Community Bank Limited to Mwanga Hakika Bank Limited 7
2.3.3 TPB Bank Plc to Tanzania Commercial Bank Plc 7
2.3.4 Acquisitions of Exim Bank Tanzania Limited 7
2.3.5 Acquisition of Bank M Tanzania Limited by Azania Bank Limited 8
2.3.6 Acquisition of China Commercial Bank by NMB Bank Plc 8
3 IMPACT OF MERGERS AND ACQUISITIONS IN TANZANIA 8
3.1 Increased Market Share 8
3.2 Improved Financial Soundness 9
3.3 Enhanced Ability to Provide Lending to Private Sector 11
3.4 Protection of the Interest of Depositors and Other Stakeholders 11
4 CHALLENGES ENCOUNTERED DURING M&A IN TANZANIA 12
4.1 Data Integration 12
4.2 Contagion (Spill-over) Effect 12
4.3 Impact on Customer 12
4.4 Incompatibility 13
4.5 Impact on Employment 13
5 CONCLUSION AND WAY FORWARD 13
6 REFERENCES 15

1 INTRODUCTION

1.1 Background

The liberalisation of the Tanzanian banking sector in 1992 evidenced rapid increase in the number of banks operating in the country. This resulted into increased financial inclusion in the country, enhanced capacity of the banking sector to mobilize financial resources and lend to productive sectors of the economy, increased competition in the market, and enhanced quality and efficiency in credit allocation. Despite these successes, some banks failed to compete and resolved to be acquired by other banks or merged with other banks particularly during the year 2010 - 2020. Other banks decided to increase their competitive powers through merging with other banks or acquiring other banks in the market.

1.2 Overview of Tanzania Banking Sector

Banking sector is the largest component of the Tanzanian financial system contributing nearly 70% of the total assets. Other sectors include social security schemes, insurance, capital market and collective investment schemes. As at 30th September 2022, the banking sector consisted of commercial banks (34), community banks (5), development financial institutions (2) and microfinance institutions (4). Commercial banks dominate the sector by holding 94.3 percent of the total assets.

The assessment of the financial performance and condition indicates that the banking sector in Tanzania is safe and stable. As at 30th September 2022, the banking sector was adequately capitalised with capital adequacy ratios of 18.85% and 19.73% for core capital and total capital, respectively indicating sector's ability to absorb losses. Further, the sector was liquid as liquid assets were 27.48% of demand liabilities. Furthermore, the ratio of non-performing loans to gross loans was 7.27% implying that the quality of assets in the banking sector was satisfactory, though still higher than the ratio of 5% that can be tolerated by the Bank of Tanzania.

On the other hand, the sector is effectively supporting financial intermediation by connecting savers and borrowers. As at 30th September 2022, the sector had granted gross loans and advances to customers amounting to TZS 25.69 trillion and had mobilised customer deposits amounting to TZS 29.31 trillion. In terms of profitability, the banking sector was profitable, as it generated profit after tax of TZS 859.74 billion for the nine-month period ended 30th September 2022 compared to the profit of TZS 476.57 billion generated during the same period during the year 2021.

1.3 Literature Review

1.3.1 Definition of Merger and Acquisition

Mergers and acquisitions (M&A) has been one of the very important strategic tool used to achieve specific business objectives in the 21st century (Sudarsanam, 2003). M&A plays a key role in advancing firm competitive advantage, renewal, and growth (Junni and Teerikangas, 2019). Merger and acquisition involves two concepts, which may be defined together or separately depending on the form. They are generally defined together, as mergers and acquisitions happen when the assets and liabilities of two legal entities are combined to form one legal entity (Frantlikh, 2003).

If merger and acquisition are to be defined separately, merger refers to the combination of two or more companies in creation of a new entity or formation of a holding company (European Central Bank, 2000, Gaughan, 2002, Jagersma, 2005, Awasi Mohamad and Vijay Baskar, 2009). Merger is generally used to reflect consolidation of two companies on an equal status basis; however, in reality, pure merger or mergers in equal basis do not happen very often.

On the other hand, acquisition is defined as the purchase of shares or assets and liabilities on another company to achieve a managerial influence (European Central Bank, 2000, Chunlai Chen and Findlay, 2003, Awasi Mohamad and Vijay Baskar, 2009), not necessarily by mutual agreement (Jagersma, 2005, Awasi Mohamad and Vijay Baskar, 2009). Acquisition also means one company referred to as “acquirer” purchasing a majority of the shares of another company (“target”) or parts of it, such as a division or business unit (Ahern & Weston, 2007).

Acquisition usually carries a negative connotation and could possibly be demoralising the morale of staff in the company being acquired, hence damaging future synergies expected from the merger and acquisition (Kotter and Schlesinger, 2005). Therefore, despite all kinds of theories and definition to differentiate merger from acquisition, the acquirer companies usually prefers to call it M&A, that leads to the word “merger and acquisition” being used interchangeably in most cases.

1.3.2 Types of Mergers and Acquisitions

Mergers and acquisitions (M&A) can generally be classified as congeneric M&A and conglomerate M&A. Congeneric M&A involves entities in the related industries, while conglomerate M&A involves entities in unrelated industries. Congeneric M&A can be further breakdown to horizontal M&A and vertical M&A.

Horizontal M&A happens when the two companies merging are from same industry, and most probably are competitors (Chunlai Chen and Findlay, 2003) with the motive to achieve cost saving, increase market and to tap into new market segment. Vertical M&A happens when the two entities have business relationships of upstream supplier and downstream buyer in the value chain (Chunlai Chen and Findlay, 2003) with the intention to reduce dependencies and overhead costs and gain scale of economies.

A conglomerate M&A occurs when two companies involved in the M&A are from unrelated industry, with the purpose to diversify capital investment hence diversifying risk, and also to achieve scale of economies (Gaughan, 2002). For example, a banking entity involved in M&A with the soft drinks manufacturing company.

1.3.3 Motives for Mergers and Acquisitions

Motive of M&A is a very important aspect in explaining M&A and assessing whether they are successful. Various literatures have placed significant effort in elaborating M&A motives, as the intention that ignited the effort to start an M&A, would determine the whole process of M&A, post M&A process, and also will determine whether that particular M&A been successfully implemented or not. M&A motives can be categorically classified as financial, strategic, and managerial motives (Faulkner, Teerikangas, & Joseph, 2012, pp. 686–696; Napier, 1989).

a) Financial Motives

Financial motives are associated with the need to increase firm value through cost-based synergies (e.g., economies of scale or scope) or revenue-based synergies that enhance sales or asset growth (Eccles, Lanes, & Wilson, 1999). Cost based synergies involves economies of scale, that is reduction of average cost per unit by increasing volume of production and economies of scope, which is the cost saving by producing variety of offerings through sharing common resources. Revenue-based synergies are often focused on collaboration between the merging entities and stem from combining assets and processes through knowledge or resource sharing (Capron, 1999).

M&A financial motive is derived from gaining increased market power. Greater market power, through individual or repeated acquisitions and/or mergers, allows acquirer to extract more value from customers by better controlling the price, volume, or quality at which its products or services are sold (Haleblian et al., 2009; Seth, 1990b), and by deterring potential market entrants (Trautwein, 1990). However, this will only depend on the exiting competition in the market after M&A.

b) Strategic Motives

Strategic motives appear in different forms such as geographic roll-up M&A to expand geographical presence; product or market extension M&A to enlarge the firm product portfolio and international reach; research and development (R&D) M&A as an alternative to internal R&D; and industry convergence M&A where acquirers intend to grow by entering a new, emerging industry through acquiring firms from adjacent converging industries (Bower, 2001).

This is part of the M&A inorganic growth where the number of customers increases not by capturing new customer, but by inheriting customers from company being acquired (Larsson, 1990). This is very important especially when the market in that particular industry is relatively saturated. Generally, M&A strategic motive intends to achieve growth of the entity to new markets, geographically or product wise.

c) Managerial Motives

Evidence suggests that M&A are not always purely rational choices aimed to benefit corporate shareholders (Junni and Teerikangas, 2019). It has been noted that managerial opportunism such as empire-building motives can induce managers to promote sub-optimal M&A (Sudarsanam, 2012; Trautwein, 1990). From an industry perspective, such motives may cause "herd-like" firm behaviour that over time influences frequent M&A in an industry, leading to cycles of growth and decline in M&A activity or so-called "M&A waves" (Faulkner et al., 2012, pp. 686–696; Kolev, Haleblian, & McNamara, 2012; Ryan, 2012).

2 MERGERS AND ACQUISITIONS IN TANZANIA BANKING SECTOR

2.1 Regulatory Framework Governing Mergers and Acquisitions

In Tanzania, mergers and acquisitions of banks and financial institutions must obtain prior approval of the Bank of Tanzania before implementation. These powers of the Bank are derived from the Banking and Financial Institutions Act, 2006 and the Banking and Financial Institutions (Licensing) Regulations, 2014.

2.1.1 The Banking and Financial Institutions Act, 2006 (BAFIA)

Section 30 of the BAFIA restricts voluntary mergers without obtaining prior written authorisation of the Bank of Tanzania. This section stipulates that:

1) *"No bank or financial institution shall, without prior written authorization of the Bank effect any voluntary merger, consolidation or other reorganization of its business or affairs with another bank or financial institution; transfer to any other institution the whole or any of its assets or liabilities in the United Republic…."*

2) *"Notwithstanding the provisions of any other law, the Bank may in respect of any bank or financial institution advise the merger of that bank or financial institution with any other bank or financial institution, if the financial condition of the concerned bank or financial institution so requires".*

2.1.2 The Banking and Financial Institutions (Licensing) Regulations, 2014

Similarly, *regulation 37 of the Banking and Financial Institutions (Licensing) Regulations, 2014* requires bank's acquisition of another bank or non-bank institution to be authorised by the Bank of Tanzania. The regulation allows banks or financial institutions with a core capital of not less than 90 billion shillings to acquire majority or all of the equity of another bank or financial institution.

The Bank of Tanzania will consider several factors before authorising mergers or acquisitions of banks and financial institutions. The factors include shareholding structure of the bank or financial institution, corporate governance, capital adequacy, compliance with legal and regulatory requirement, risk concentration, risk management profile, and financial performance and condition.

2.2 Motives of Mergers and Acquisitions in Tanzania Banking Sector

The reasons for mergers and acquisitions (M&A) of banks in Tanzania depend on the party initiating the M&A. historically, the mergers and acquisitions have been initiated by either banks themselves or the regulator. Banks' self-initiated M&A intend to achieve rapid growth, while those initiated by the regulator intend to ensure safe exit of inefficient banks from the market. The two reasons for M&A are elaborated below.

a) Growth

Banks undergo M&A to gain synergy, access to assets, diversification, financial capabilities, operational efficiency, market share and reshaping competitive advantage within the industries. M&A results into increased balance sheet size and expansion to new markets (both product wise and geographically).

b) Organised Exit of Inefficient Banks from the Industry.

Banks which suffer financial difficulties may be forced to exit the market through merger and acquisition by invoking regulatory powers of the Bank of Tanzania provided under the Banking and Financial Institutions Act, 2006. Similarly, banks may wish to exit the market by opting for mergers and acquisition. This intend to ensure organised exit from the market without affecting its stakeholders.

2.3 Examples of Bank Mergers and Acquisitions in Tanzania

During the previous decade up to 2020, Tanzania experienced a number of mergers and acquisitions. Mergers included NIC Bank Tanzania Limited with Commercial Bank of Africa Tanzania Limited; TPB Bank Plc with Twiga Bancorp Limited, Tanzania Women's Bank Plc and TIB Corporate Bank Ltd; and Mwanga Community Bank Ltd with Hakika Microfinance Bank Limited. On the other hand, Exim Bank (T) Limited acquired UBL Bank (T) Limited and First National Bank (T) Limited; Azania Bank Ltd acquired Bank M Tanzania Ltd; Mwanga Community Bank Ltd acquired EFC Microfinance Bank Ltd; and NMB Bank Plc acquired China Commercial Bank Ltd.

2.3.1 Merger of NIC Bank (T) Ltd and Commercial Bank of Africa (T) Ltd

The merger of NIC Bank Tanzania Limited and Commercial Bank of Africa Tanzania Limited to form NCBA Bank Tanzania Limited was approved by the Bank of Tanzania effective 14th February 2020. The merger was a result of the merger of the parent banks, Commercial Bank of Africa Limited (Kenya) and NIC Group PLC (Kenya) that was approved by the Central Bank of Kenya effective from 30th September 2019. According to the banks' application for merger, the objective was to strengthen both institutions and leverage on their combined market share in East Africa.

2.3.2 Mwanga Community Bank Limited to Mwanga Hakika Bank Limited

Mwanga Hakika Bank Limited is a commercial bank that was initially a community bank known as Mwanga Community Bank Limited. The bank grew through mergers and acquisition to become one of the commercial banks in the country. At first, Mwanga Community Bank Limited acquired EFC Tanzania Microfinance Bank Limited on 12th September 2019, which subsequently merged with Hakika Microfinance Bank Limited to form Mwanga Hakika Microfinance Bank Limited on 7th January 2020. The bank's shareholders injected additional capital to comply with the requirement for licensing of the commercial bank and later changed its name to Mwanga Hakika Bank Limited on 7th January 2022. The aim of the mergers and acquisition was to enhance compliance with capital requirements, efficiency and performance of the banks.

2.3.3 TPB Bank Plc to Tanzania Commercial Bank Plc

TPB Bank Plc has undergone a number of mergers and acquisitions that has resulted into its growth of the bank to be one of the largest banks in Tanzania. A series of mergers began with the merger of the bank with Twiga Bancorp Limited and Tanzania Women's Bank Plc in May 2018 and August 2018, respectively. These were followed by merger of the bank with TIB Corporate Bank Limited to form Tanzania Commercial Bank Plc (TCB) in June 2020. The mergers aimed at strengthening the capital position and operational efficiency of Government owned banks and increase their competitive powers.

2.3.4 Acquisitions by Exim Bank Tanzania Limited

Exim Bank Tanzania Limited is one of the largest banks operating three subsidiaries in Uganda, Djibouti and Comoros. Despite being large in size, the bank has been acquiring other banks in the region to strengthen its competitive powers. To expand its existence in the region, the bank acquired 58.6 percent shareholding in Imperial Bank Uganda Limited in March 2016 and re-branded the name to Exim Bank (Uganda) Limited. The bank acquired UBL Bank (Tanzania) Limited in May 2019 in order to strengthen the existing network and expansion of market share within the country. Later on April 2022, the bank acquired specified assets and liabilities of First National

Bank (Tanzania) Limited. The acquisition intended to strengthen the existing network and expansion of market share within the country.

2.3.5 Acquisition of Bank M Tanzania Limited by Azania Bank Limited

The banking sector in Tanzania has also witnessed the growth of Azania Bank Limited to be one of the largest banks in Tanzania after acquiring assets and liabilities of Bank M Tanzania Plc effective from 15th January 2019. The acquisition was initiated by the Bank of Tanzania following liquidity and capital challenges that were facing Bank M Tanzania Limited during the time. As a resolution option, it intended to ensure the bank's problems are not causing losses to its depositors and other creditors. The acquisition of Bank M Tanzania Limited resulted into a significant growth of the total assets of Azania Bank Limited and expansion of its branch network.

2.3.6 Acquisition of China Commercial Bank by NMB Bank Plc

NMB Bank Plc acquired all assets and liabilities of China Commercial Bank Limited that was under statutory management of the Bank of Tanzania. The acquisition was as a resolution option implemented effective from 4th March 2021 to protect the interests of depositors and other creditors as well as maintain stability of the banking sector. Since the acquired bank was still small, it had insignificant contribution on the size of the bank in terms of total assets, branch network and customer deposits.

3 IMPACT OF MERGERS AND ACQUISITIONS IN TANZANIA

This section assesses whether motives of mergers and acquisitions of banks that experienced in Tanzania in the past decade were achieved. Generally, M&A was one of the resolution options undertaken by the Bank of Tanzania for failed banks when liquidation of the bank is considered to have significant impact on the stability of the banking sector such as causing loss of public confidence on the banking sector.

For banks that failed to survive due to high competition, voluntary M&A enabled the acquiring bank to increase market share (competitive power), enhance ability to provide lending to private sector and improve its financial performance. All these enhance stability of banking sector and financial system at large. Good examples are mergers of NIC Bank (T) Ltd and Commercial Bank of Africa (T) Ltd and acquisition of UBL Bank (T) Ltd and First National Bank (T) Ltd by Exim Bank (T) Ltd.

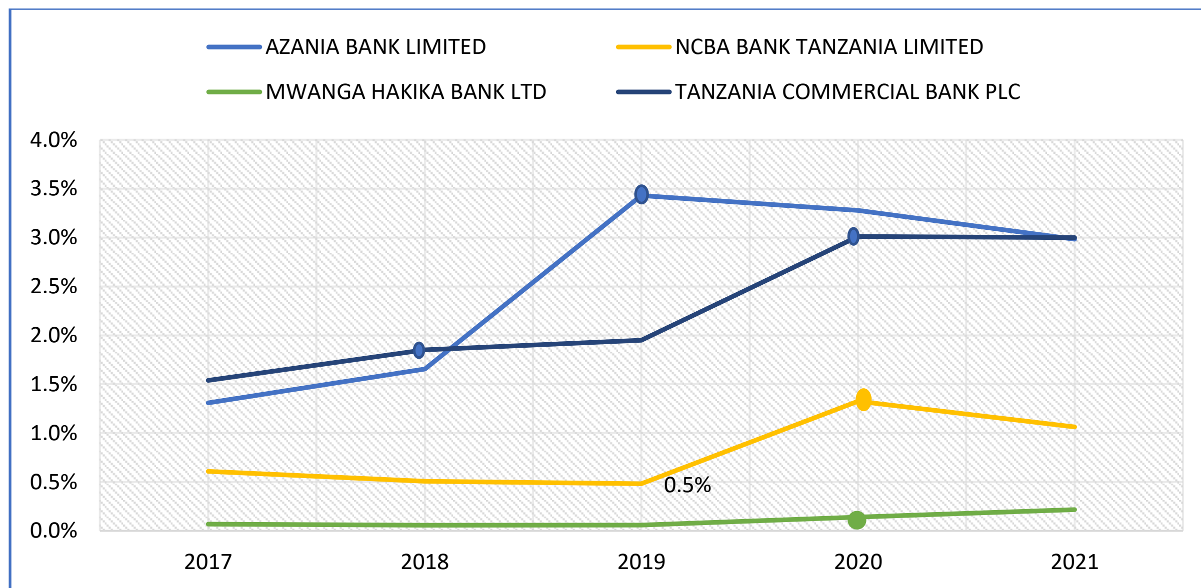
3.1 Increased Market Share

Mergers and acquisition gives the acquiring bank an opportunity to grow market share by acquiring new customers, penetration in new geographical region and growing bank's assets instantly. M&A increase the banks' balance sheet size by acquiring assets at a purchase price which is less than the fair market value of the target's net

assets. It also improves working capital which usually increases lending and investment activities resulting into increase in profitability of the bank.

For example, mergers and acquisitions of the former TPB Bank Plc (currently Tanzania Commercial Bank Plc) and Azania Bank Limited enabled them to increase its balance sheet and be among the largest commercial banks in Tanzania. The assessment of market shares (bank's balance sheet size as a percentage of industry balance sheet size) of Azania Bank Ltd, NCBA Bank (T) Ltd, Mwanga Hakika Bank Ltd and Tanzania Commercial Bank Plc indicates increased market share (**Graph 1**).

Graph 1: Market Shares of Selected Banks over Time



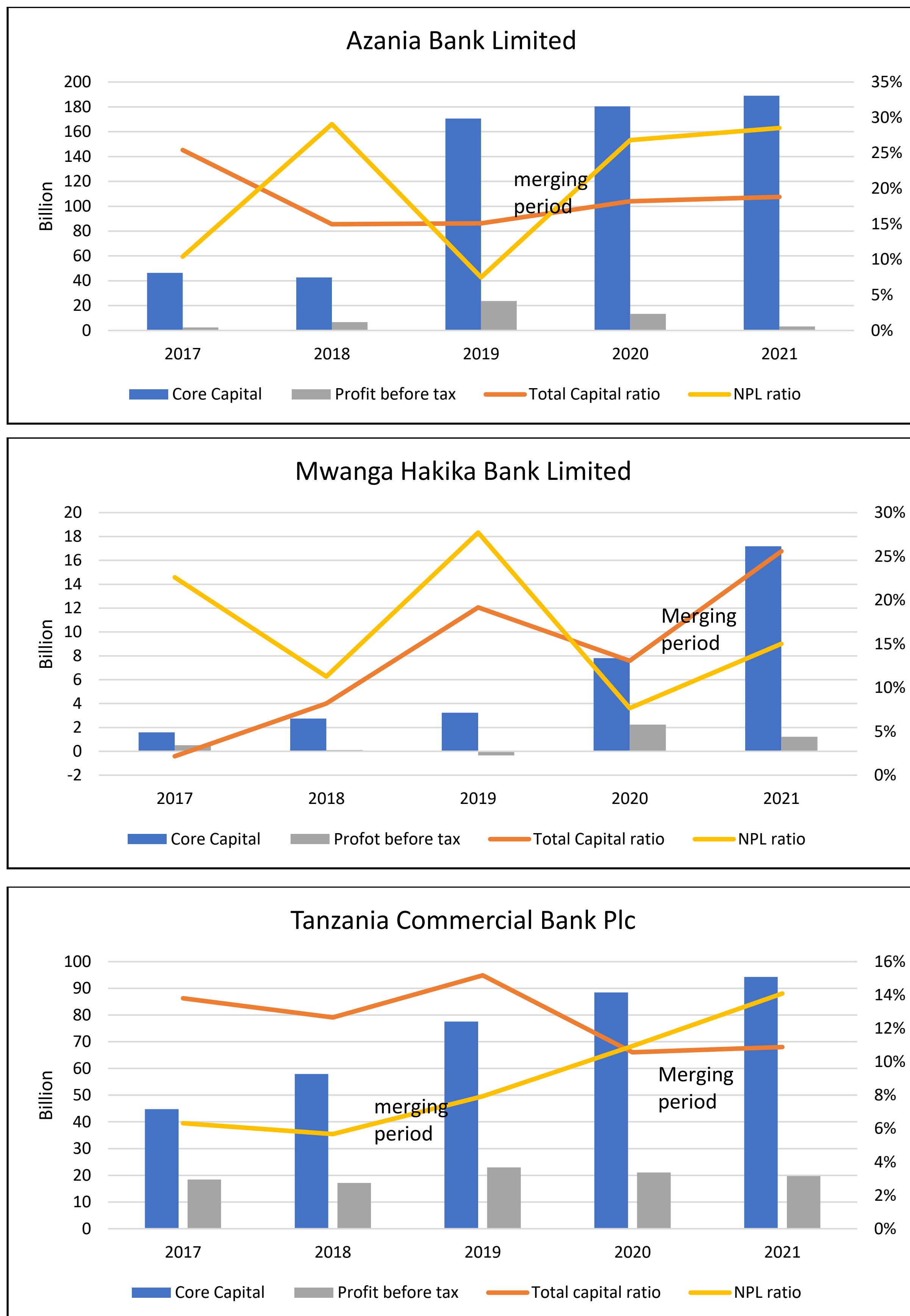
Source: Bank of Tanzania

3.2 Improved Financial Soundness

Mergers and acquisitions result in economies of scale, access to new technologies, obtaining competent staff and high reduction of significant redundant operating costs mainly by eliminating overlapping branches & integrating back office, administrative & marketing functions. All these improve operational efficiency of the banks resulting into improved financial performance (profitability) and internal capital growth.

The financial soundness indicators (such as capital, asset quality, profitability and liquidity) of some banks improved after merger and acquisition. However, in some instances, there was temporary decline of the Financial Soundness Indicators (FSIs) due to in-depth scrutiny of the bank's assets during due diligence, which causes additional impairment loss of assets. The trend of profitability and ratios of capital, non-performing loans and liquidity for NCBA Bank (T) Limited, Tanzania Commercial Bank Plc, Azania Bank Limited and Mwanga Hakika Bank Limited provide an evidence of positive impact of M&A in Tanzania (**Graph 2**).

Graph 2: Trend of Financial Soundness Indicators of Banks Involved in M&A

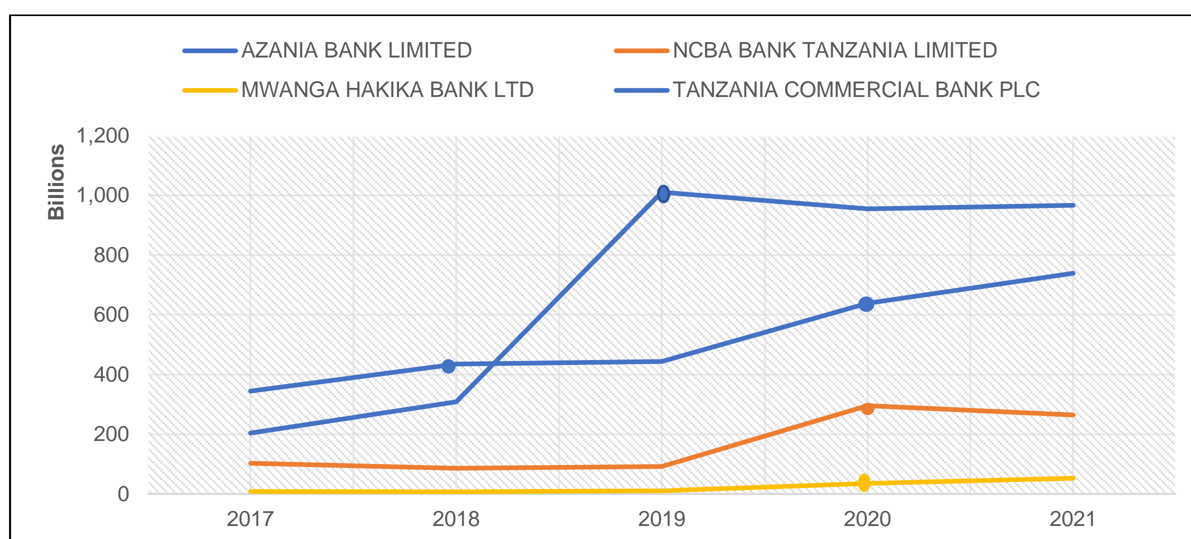


Source: Bank of Tanzania

3.3 Enhanced Ability to Provide Lending to Private Sector

One of the key functions of the banking sector is financial intermediation in which banks mobilize funds from those with surplus and allocate to productive sectors of the economy. M&A enhance financial strength of banks, which enables to issue large tickets of loans due to enhanced *single borrower's limit*[1], but also to provide credit facilities to large number of borrowers especially MSMEs in the private sector. The analysis of the trend of gross loans for banks involved in M&A indicates an increasing ability of the banks to provide loans to customers (**Graph 3**).

Graph 3: Trend of Gross Loans for Merged Banks



Source: Bank of Tanzania

3.4 Protection of the Interest of Depositors and Other Stakeholders

Not only do mergers and acquisitions ensure organised exit of inefficient banks from the market, but also ensure depositors' funds are protected. By doing this, depositors are ensured that banking sector is safe and that their savings cannot be lost, which enhances trust of the depositors and the public in general. Similarly, mergers or acquisitions in which all assets and liabilities are acquired by another bank ensure all stakeholders including creditors and borrowers are protected and are ensured continuity of the services. To large extent, banking sector and the financial system in general depends on the trust of depositors and other stakeholders.

[1] Single borrower's limit (SBL) is the maximum loan that the bank can grant to a single customer and its related parties, which is usually expressed as a percentage of core capital of the bank.

4 CHALLENGES ENCOUNTERED DURING M&A IN TANZANIA

Despite the fact that M&A is beneficial, its implementation usually faces challenges, which might threaten survival of the acquiring bank. In this case, care should be taken during implementation of M&A in order to prevent a collapse of the much larger bank (with larger number of customers) than before M&A. Specific challenges encountered during implementation of the M&A in Tanzania are highlighted below.

4.1 Data Integration

M&A involves integration of data (such as deposits, loans, etc.) from core banking systems of two banks, acquired and acquiring bank. In some instances, banks use different core banking system, which makes it difficult to obtain all useful data from the acquired bank and integrate into the acquiring bank's core banking system. Without a clear plan, collaboration of the two banks and proper supports from system vendors, it might be difficult for banks to ensure successful integration of data. In some cases, system related problems delays the merging process of the two banks.

4.2 Contagion (Spill-over) Effect

Contagion (spill-over) effect in this case refers to the situation whereby the problems of the acquired bank are transmitted to acquiring bank leading to negative perception of the bank. M&A implemented in Tanzania involved acquisition of banks with financial problems such as capital deficiencies, high level of non-performing loans and liquidity shortages. After M&A, some acquiring banks experienced similar problems that were facing acquired banks; however, challenges were later solved. The duration for which problems lasted depended on the strength of the acquiring bank's management.

4.3 Impact on Customer

M&A involves transfer of assets and liabilities from one bank to acquiring bank. By nature, assets are largely made up of loans and advances granted to borrowers and liabilities are made up of customer deposits. Customers usually choose banks based on the customer services, product offered, culture of the bank, its accessibility and bank charges and other costs. In some cases the acquiring bank may decide to seize some of product or branches which might negatively impact customer satisfaction and accessibility of services. This implies that customers (borrowers and depositors) will be transferred to another bank with different attributes, which affect customers.

4.4 Incompatibility

Banks are different in the ways they operate, have different corporate culture that affects how they serve customers. Similarly, different banks have varied products and customers, which differentiates one bank from another. In this case, when two banks merge or one bank acquires another, incompatibility occurs, which affects service delivery and implementation of the strategic direction of the acquiring bank. In Tanzania, we have witnessed a retail bank merging with or acquiring a corporate bank and community bank merging with microfinance bank, all these would not be possible without changes of the strategic plan that clearly defines the corporate culture, organisational setup and workable initiatives to drive the new bank.

4.5 Impact on Employment

In most cases, M&A are associated with loss of employment for some staff of the involved banks. When two banks merger, it might mean duplication of positions especially for Head Office staff, which usually lead to retrenchments of some staff to eliminated duplication. Further, in acquisition, banks may decide to acquire only assets and liabilities of the acquired bank and leave the staff unemployed. In some cases, M&A results into one area having two branches, which necessitates closure of some branches and loss of employment of most of the staff.

5 CONCLUSION AND WAY FORWARD

Tanzanian banking sector is characterised by large number of small banks with minimal contribution to the economy. This is due to the fact that most of these banks cannot finance establishment of large scale factories to support the Government's industrialisation agenda and construction of large scale infrastructures such as Nyerere hydropower project and Standard Gauge Railway (SGR). Due to their small size of capital, most of these banks are concentrated in urban areas (mostly Dar es Salaam) and cannot expand its services to rural areas to support rural economy.

In order to increase the number of large banks in the country and get away with weak (unstable) banks, the Bank of Tanzania as a regulator of the banking sector embarked on encouraging mergers and acquisitions. M&A were aimed at increasing the number of strong banks that can compete effectively with other large banks in the market, especially the top layer that has its own competition. It was also expected that the market will achieve the benefits of high competition in the market such as suitable products and services and reduced lending rates.

Assessment of the M&A in Tanzania indicates that most of the banks had achieved the M&A motives of growth and organised exit of inefficient banks in the market. Tanzania Commercial Bank Plc and Azania Bank Plc have grown to be Tier 1 banks as a result of M&A, while China Commercial Bank Limited and Bank M Tanzania Limited properly exited the market through acquisitions. To greater extent, M&A in Tanzania have also achieved financial and strategic motives covered in the quoted literatures. Financial motives have been associated with the growth recorded by banks in terms of increased market share. On the other hand, strategic motives have been achieved by banks such as Exim Bank Tanzania Limited and Azania Bank Limited.

To benefit from M&A, banks should be careful in handling the processes. If M&A is mishandled, it may result into collapse of the larger bank with significant losses. McKinsey[2] in one of its papers titled "*Seeds of outperformance: How M&A can help banks thrive in the next normal*" issued in July 2021 highlighted six keys to success in consolidation-driven banking M&A. These keys included having a clear strategic rationale for acquisition, using integration to transform the bank (adapting to shifting in consumer behaviour and preferences, need for new branding, etc.), and making clear and early decisions on integration architecture and scope. The use forward-looking performance indicators to safeguard business continuity and momentum, planning for IT and cybersecurity, and managing the integration quickly and seamlessly, involving senior leaders are other keys to success.

[2] McKinsey & Company is a global management consulting firm founded in 1926 by University of Chicago professor James O. McKinsey, which offers professional services to corporations, governments, and other organizations.

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