AGJ ARABIAN GROUP OF JOURNALS

Social Development

NG-Journal of Social Development, VOL. 5, No. 5, October 2016

Journal homepage: www.arabianjbmr.com/NGJSD_index.php

NGJSD

EFFECT OF MERGERS AND ACQUISITIONS ON BANKING SECTOR PERFORMANCE IN NIGERIA

OKOYE, Lawrence Uchenna
Department of Banking and Finance, Covenant University, Ota, Ogun State
Email: lawrence.okoye@covenantuniversity.edu.ng
MODEBE, Nwanneka J.
Department of Banking and Finance, University of Nigeria, Nsukka
ACHUGAMONU, Uzoma
Department of Banking and Finance, Covenant University, Ota, Ogun State
ISIBOR, Areghan
Department of Banking and Finance, Covenant University, Ota, Ogun State

Abstract

Over the years, the Nigerian banking sector has undergone a series of reforms aimed at enhancing its capacity to support growth in the real economy. To achieve this aim, there is ample evidence that the Central Bank of Nigeria has relied heavily on bank capital reforms in tackling problems of under-performance in the sector. Implementation of these reforms has often led to a simultaneous reduction in the number of banks and increase in bank size, a process commonly referred to as consolidation. Mergers and acquisitions are common strategies adopted in the implementation of consolidation programmes. This study seeks to examine the extent to which banking sector performance differs between pre- and post-merger and acquisition periods. Return on assets, bank asset ratio and capital adequacy ratio were adopted as proxies for bank performance. The study employs ex-post facto research design and covers a period of nine (9) years before and nine (9) after the 2005 banking sector recapitalization exercise. Data on the variables were analyzed using the independent sample test technique. The study finds that there is non-significant negative difference in the performance of return on asset in the pre- and post-merger and acquisition periods. Bank asset ratio shows significant positive difference between the pre- and the post-merger and acquisition periods. However, the result shows significant negative difference for capital adequacy ratio between the periods. The study therefore concludes that mergers and acquisitions have significant impact on banking sector performance in Nigeria. We recommend that due diligence should adopted in the identification and selection of compatible partners in order to achieve synergy. In the case of policy-induced merger and acquisition, a reasonable time should be allowed for compliance and implementation should be closely monitored.

Introduction

Following incessant cases of bank distress in Nigeria (particularly between 1993-2003) with its attendant negative impact on public confidence and economic stability, the Central Bank of Nigeria raised minimum bank capital requirement from #2 billion to #25 billion with an implementation period of 18 months (July 6, 2004-December 31, 2005) in order to foster stability

in the sector as well as enhance its capacity to deliver quality service to the economy. An essential component of banking sector consolidation is the attainment of a strong, competitive and reliable banking system. Soludo (2004) posits that the major objective of the exercise is to strengthen the banking system and to ensure the achievement of a diversified strong and reliable banking sector that will guarantee safety of depositors' money and shareholders' fund as well as play active developmental roles in the Nigerian economy and the global financial market. According to Okafor (2011), the short compliance period created huge implementation difficulties and caused a major shock in the banking sector. At the conclusion of the exercise, 75 out of the 89 banks that existed prior to the announcement date fused (through mergers and acquisitions) into 25 banks while 14 others which could not meet the recapitalization deadline had their operating licenses withdrawn. Owing to the size of capital revision involved, implementation entails huge costs and enormous marketing efforts while the short implementation period denied the affected banks ample time to strategize and to weigh alternative courses of action before selecting the best and most cost effective implementation option.

Mergers and Acquisitions have been shown to promote synergy in business operations as the performance of the emerging organization is often better than the sum of individual performances prior to the consolidation. The fusion of two or more banks into a unified entity is expected to promote operational performance through improved competition, exploitation of economies of scale, facilitation of adoption of advanced technologies and higher level of operational efficiency. Ultimately, the goal is to strengthen the intermediation role of banks and to ensure that they are able to perform their traditional role of enhancing economic growth.

The NDIC (2009) outlined major reasons for adopting the consolidation option to include curtailing incessant episodes of bank distress, promotion of competitiveness and transparency in the sector, enabling the sector to effectively play its developmental role in the economy, strengthening the sector to be an active participant in the regional and global financial system, and enhancing public confidence in the banking industry.

Though the exercise was adjudged successful because it led to huge increases in the capital and asset base of the consolidated banks as well as their liquidity levels, stability of the sector was shot-lived as serious signs of systemic capital inadequacy and illiquidity was observed in the sector within three years of implementation of the programme. One school of thought argued that the inability of the sector to sustain the gains of the exercise was hinged on the mode of implementation. They argue that the strong banks acquired potentially profitable prospects leaving the weak ones that do not strongly appeal to "suitors" to merge into single entities. Another school also argues that the short implementation period led to "marriage of strange bed-fellows" due, largely, to poor evaluation of prospects. There were instances of "window dressing" or willful concealment of material facts to present an attractive but deceptive corporate image to prospective buyers leading to the acquisition of weak banks by stronger ones.

In spite of the "successful" implementation of the consolidation programme, the performance of the banking sector in Nigeria cannot be said to be optimal as some of the unions that were consummated through mergers and acquisitions have not been efficient leading to interventions by the Central Bank of Nigeria. Against this background this study seeks to examine the performance of the Nigeria banking sector in the pre- and post-merger and acquisition periods in order to ascertain whether or not the exercise led to significant difference in the performance of the banking sector between the periods.

Review of Related Literature

Mergers and acquisitions, according to Mai-Lafia (2005), are largely prompted by increasing wave of globalization and pressure for increase in returns to shareholders. The increasing trend towards

consolidation, therefore, is a direct consequence of the wave of globalization that has swept through Europe, Asia, America and lately and Africa. Realizing that marginal players have bleak future in the internalization of business processes in line with changing economic landscape, firms across the world have embarked on massive consolidation programmes. These programmes have often been implemented through mergers and acquisitions. Bank consolidation is an economic reform that targets a reduction in the number of banks and other deposit-taking institutions with a simultaneous increase in the size and concentration of the remaining entities in the sector (Bank for International Settlements, 2001).

To enhance the performance of the Nigerian banking sector, the Central Bank of Nigeria (CBN) through a capital reform initiative raised minimum capitalization for banks operating in the country from #2 billion to #25 billion. According to Soludo (2004) the underlying objective of the capital reform was to develop a diversified, strong and reliable banking sector capable of playing active developmental roles in the local economy and of being competent and competitive players in the African regional and global financial system. The reform had obvious implementation difficulties partly because it has the highest rate of capital revision (about 1,150 per cent) and partly on account of its short implementation period (18 months). Okafor (2011) argues that implementation of the high rate of capital revision within the short transition period involved huge costs and marketing efforts in addition to inadequate time to strategize and to weigh alternative courses of action before selecting the best and most cost effective implementation option.

A major fall-out of the capital reform was the fusion of 75 out of the 89 banks that were in operation before the reform date through mergers and acquisitions. However 14 others which could not recapitalize within the stipulated period had their operating licenses withdrawn. The exercise led to phenomenal increase in the operating fundamentals of banks in the immediate post-implementation period but this initial success was not sustained. Barely three years post-consolidation, the sector witnessed severe deterioration in asset quality, rising level of non-performing loans, erosion of capital base and liquidity stress, prompting the intervention of the Central Bank of Nigeria to salvage the sector. This outcome, though not anticipated, suggests that the huge capital inflow into the sector created temporary liquidity glut which most of the banks did not seem to have had sufficient management capacity and professional discipline to handle. A special diagnostic examination of deposit money banks by the Central Bank of Nigeria in the post-implementation period shows that massive capital inflow into the system got many banks unduly exposed to high risk investments and margin lending to speculative equity share traders.

Granted that consolidation through mergers and acquisitions could raise performance through efficiency gains from enhanced revenue and cost reductions, risk reduction through elimination of weak banks, and better diversification opportunities for emerging banks (Berger, 2000), it could also increase the propensity to take on higher risks levels through increased leverage and off-balance sheet engagements (Berger, 2001; Demsetz and Strahan, 1997). Unregulated quest for economies of scale through implementation of mergers and acquisitions may also generate inefficient entities that are complex and costly to operate or become “too big to fail”, liquidate or sanction thereby promoting inefficiency (De Nicolo et al, 2003). Thus, consolidation may not automatically translate to improved performance.

Empirical Literature

Studies have been conducted to provide empirical evidence on the impact of mergers and acquisition on banking sector performance.

Iloh, Okolo and Ani (2013) examined the impact of bank consolidation on the credit delivery capacity of the Nigerian banking sector. They find that though there is evidence that bank deposit impacted lending to SMEs, there is no evidence of significant effect of bank consolidation on credit

delivery to SMEs, an indication that deposit money banks may have favoured blue chips in their financing decision. Babajide, Olokoyo and Taiwo (2015) analyzed bank consolidation and small business financing in Nigeria using panel data over the period 2004-2011. The study covered the 23 banks that emerged from the consolidation exercise. They find a significant increase in asset base and profitability of banks in the post-consolidation period. Emeni and Okafor (2008) examined the effects of bank mergers and acquisitions on small business lending in Nigeria using data from cross-sectional survey of Nigerian banks. The study adopted the ordinary least squares analytical method. They find that bank size, financial characteristics and deposits of non-merged banks are positively related to small business lending while the reverse is the case for the merged banks. The study concludes that mergers and acquisitions have both static and dynamic effects on small business lending. Samuel (2010) conducted a study on the effect of the 2005 banking sector reforms on economic growth in Nigeria using ordinary least square regression technique. He finds that interest rate margins, parallel market premiums, total banking sector credit to the private sector, inflation rate, size of banking sector, capital and cash reserve ratios are significantly related to economic growth.

Okpanachi (2010) did a comparative analysis of the impact of mergers and acquisitions on financial efficiency of banks in Nigeria. The paper adopted gross earnings, profit after tax and net assets of the selected banks as indicators of financial efficiency. A comparison of the pre- and post-merger and acquisition bank performance based on the independent sample test was undertaken. The result shows that banks were more efficient in the post-merger and acquisition period. Basu, Druck, Marston and Susmel (2004) examined the effect of bank consolidation on the performance of Argentine banks using panel data on over 100 banks. The study covered the period 1995-2000. They find that consolidation increases bank returns and reduces risk of insolvency. There are further evidence in literature that bank mergers lead to efficiency improvements in both cost and profits (See for instance, Huizinga et al (2001); Ayadi and Puyals (2005). Craig and Santos (1997) compared the pre- and post-merger performance of a sample of United States bank holding company mergers. They find evidence of higher profitability and lower risk in the post-merger period. Another US study by Cebesoyan and Strahan (2002) finds that sophistications in loan management practices by US banks, often associated with scope and size, do not reduce risk. Also, Boyd and Graham (1998) present evidence of higher risk-taking and failure rates in the post-consolidation period.

De Nicolo et al (2003) examined the relationship between consolidation and conglomeration of financial firms and firm and systemic risk potential of banks. They find a positive association between them. Viverita (2008) studied the effect of mergers on bank performance in Indonesia between 1997 and 2006. The study shows positive impact of bank mergers on the performance of Indonesian banks during the period. Several studies across the US and Europe, particularly from the 1990s, have provided evidence in support of efficiency impact of bank mergers. For instance, the US studies by Knapp, Gart and Chowdhry (2006), Cornett, McNutt and Tehranian (2006) and Kwan and Wilcox (2002) find evidence of efficiency improvements in the post-merger periods. Also, Ashton and Pham (2007), in a study of 61 UK firms, find evidence of efficiency improvements in post-merger costs and profits. A German study by Koetter (2005) and another by De Guevara and Maudos (2007) for Spain also shows evidence of efficiency improvements. Carbo and Humphery (2004) find evidence of profitability improvements in Spanish post-merger banks.

Altunbas and Ibanez (2008) and Diaz, Olalla and Azoefa (2004) introduced a new dimension to merger studies. For instance, Altunbas and Ibanez (2008) examined the post-merger performance of banks that adopt similar operational strategies. The study shows mergers involving banks that adopt similar strategies in their operations record higher efficiency and profitability improvements

than those that adopt different strategies. Diaz, Olalla and Azorfa (2004) also show that bank-to-bank mergers out-perform bank-to-non-bank mergers. Emerging from the empirical review is an observation that evidence-based findings on the subject predominantly relate to the experiences of developed economies, an indication of inadequate empirical evidence for developing economies like Nigeria. Equally important is that most of the Nigerian studies did not compare the performance of the banking sector in the pre- and post- consolidation periods to determine performance-related impact of consolidation. This study finds relevance in this area.

Theoretical Foundation

Over the years scholars have put forward theoretical arguments both in support and against the adoption of merger and acquisition as a veritable strategy for performance enhancement in business organizations. This study is particularly built on two theoretical constructs namely, the concentration theory and shareholder value maximization theory. Proponents of the concentration theory argue that mergers and acquisitions promote and profitability while at the same time reducing fragility. They posit that through consolidation, weak and inefficient banks are eliminated thereby enhancing efficiency. Critics, however, argue that concentration of business firms can be counter-productive and may lead to inefficiency through reduced competition. They aver that inefficiency may arise from size, incompatibility of corporate or organizational cultures, etc., thereby compromising performance. It is also argued that a major motivational factor for business consolidation is the enhancement of shareholder value maximization (Allen and Gale, 1999). However, critics argue that this is not often attainable because top management is, in most cases, mainly concerned with the interest of majority shareholders who often do not show sufficient interest in the affairs of business.

Methodology

The study adopted the quantitative research technique based on *ex-post facto* design. Measures of bank performance analyzed in the study are return on assets (ROA), bank assets ratio (BAR) and capital adequacy ratio (CAR). ROA measures the ability of a firm to generate positive net income from its investments in assets. BAR is an indicator of the size of the banking sector relative to the economy. CAR, according to Cannon (1921), is a measure of long-term lending capacity of the banking sector. Secondary data on the variables (return on assets, bank asset ratio, and capital adequacy ratio for the period 1996-2014 were sourced from the annual reports of the Nigeria Deposit Insurance Corporation (NDIC). The independent sample t-test was used to determine the extent to which the performances of these indicators differ between the pre- and post-consolidation periods. The independent sample test technique of data analysis was adopted because it is a robust method of comparative analysis.

Discussion of Results

Table 1a: Group Statistics

	Year	N	Mean	Std. Deviation	Std. Error Mean
Return on Assets	Pre-merger	9	2.9311	.98170	.32723
	Post-merger	9	1.0911	4.13	1.37712

Source: Authors' computation from NDIC Report, 2014

The result presented in table 1a shows a decrease in the mean performance of return on assets from the pre-merger and acquisition value of 2.93 to 1.09 in the post-merger and acquisition period. This is an indicator of negative performance. To determine whether or not this difference is significant, the result of the independent sample test, presented in table 1b is analyzed.

Table 1b: Independent Sample Test

		Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Diff.	Std. Error Difference	95% Conf Interval	
									Lower	Upper
Return on Assets	Equal variances assumed	3.354	.086	1.300	16	.212	1.84000	1.41547	-1.16066	4.84066
	Equal variances not assumed			1.300	8.901	.226	1.84000	1.41547	-1.36747	5.04747

Source: Authors' computation from NDIC Report, 2014

The independent sample test result does not show evidence of significant difference between pre- and post-merger and acquisition means of return on assets. This result suggests that consolidation through mergers and acquisitions did not lead to significant reduction in the performance of the Nigerian banking sector.

Table 2a: Group Statistics

	Year	N	Mean	Std. Deviation	Std. Error Mean
Bank Asset Ratio	Pre-merger	9	33.5578	10.79191	3.59730
	Post-merger	9	45.9111	15.70624	5.23541

Source: Authors' computation from NDIC Report, 2014

The statistics presented in table 2a shows that the mean of bank asset ratio increased from a pre-merger value of 33.5578 to 45.9111 in the post-merger and acquisition period. This result indicates an increase in the size of the banking sector relative to the entire economy, an indication of positive performance.

Table 2b: Independent Sample Test

		Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Diff	Std. Error Diff.	95% Conf Interval	
									Lower	Upper
Bank Asset Ratio	Equal variances assumed	2.525	.132	-1.945	16	.070	-12.35333	6.35218	-25.81935	1.11268
	Equal variances not assumed			-1.945	14.177	.072	-12.35333	6.35218	-25.96145	1.25479

Source: Authors' computation from NDIC Report, 2014

The independent sample test for equality of means presented in table 2b shows that the difference between pre- and post-merger and acquisition means of bank asset ratio is significant at 10 per cent level of significance. This implies a significant improvement in this performance indicator due to the implementation of the exercise.

Table 3a: Group Statistics

	Year	N	Mean	Std. Deviation	Std. Error Mean
Capital Adequacy	Pre-merger	9	36.6667	12.34585	4.11528
	Post-merger	9	17.4489	8.53486	2.84495

Source: Authors' computation from NDIC Report, 2014

For capital adequacy, table 3a shows a decline from the pre-merger and acquisition mean of 36.6667 to 17.4489 in the post-merger and acquisition period. This result is rather worrisome. It suggests that rather than enhance capital adequacy mergers and acquisitions that characterized the 2004/2005 programme led to a decline in capital adequacy ratio.

Table 3b: Independent Samples Test

		Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Diff.	Std. Error Diff.	95% Conf Interval	
									Lower	Upper
Capital Adequacy	Equal variances assumed	1.369	.259	3.841	16	.001	19.21778	5.00293	8.61204	29.82352
	Equal variances not assumed			3.841	14.225	.002	19.21778	5.00293	8.50345	29.93210

Source: Authors' computation from NDIC Report, 2014

Table 3b shows that consummation of merger and acquisition agreements in the banking sector led to significant deterioration in capital adequacy level. The result suggests that inefficiency attended the implementation of the exercise and clearly explains the inability of the massive capital inflow into the banking sector, as a result of the upward capital review, to guarantee some measure of stability in the sector.

Summary of Findings, Conclusion and Recommendations

Evidence emanating from the study shows that (i) there is no significant difference in the profit performance of the banking sector (as measured by return on assets) between the pre- and post-merger and acquisition periods (ii) there is evidence of significant increase in the pre- and post-merger and acquisition means of bank asset ratio (iii) there is a significant reduction in capital adequacy ratio between the periods. Following from the above findings, the study concludes that mergers and acquisitions have significant impact on the performance of the Nigerian banking sector. We therefore recommend that due diligence should adopted in the identification and selection of compatible partners in order to achieve synergy. In the case of policy-induced merger and acquisition, a reasonable time should be allowed for compliance and implementation should be closely monitored.

References

Allen, F. & Gale, D. (2003), Competition and financial stability, *Journal of Money, Credit and Banking*, 36: 433-480

Altunbas, Y. & Ibanez, D.M. (2008), Mergers and acquisitions and bank performance in Europe: The role of strategic similarities, *Journal of Economics and Business*, 60(3): 204-222

Ashton, J.K. & Pham, K. (2007), Efficiency and price effects of horizontal bank mergers, retrieved from http://papers.ssrn.com/so13/papers.cfm, October 10, 2016

Ayadi, R. &Pujals, G. (2005), Banking mergers and acquisitions in the EU: Overview, assessment and prospects, retrieved from http://www.suerf.org, October, 9, 2016

Babajide, A.A.; Olokoyo, F.O. & Taiwo, J.N. (2015), Bank consolidation and small business financing in Nigeria, *International Journal of Advances in Management and Economics*, 4(2):37-47

Bank for International Settlements (2001), The banking industry in the emerging market economies: Competition, consolidation and systemic stability, *BIS papers*, 4, Basel: Bank for International Settlements

Basu, R.; Druck, P.; Marston, D. & Susmel, R. (2004), Bank consolidation and performance: The Argentine experience, *IMF Working Paper*, 04/149, Washington: International Monetary Fund

Berger, A.N. (2001), The integration of the financial services industry: Where are the efficiencies? *North American Actuarial Journal*, 4(3): 25-52

Boyd, J.H. & Graham, S.L. (1998), Consolidation in US banking: Implications for efficiency and risk. In Amihud, Y. & Miller, G. (ed) *Bank Mergers and Acquisitions*, London: Kluwer Academic Publishers

Carbo-Velverde, S. & Humphrey, D.B. (2004), Predicted and actual costs individual bank mergers, *Journal of Economics and Business*, 56(2): 137-157

Cebenoyan, A. & Strahan, P. (2002), Risk management, capital structure and lending at banks, Philadelphia: University of Pennsylvania, Financial Institution Centre, The Wharton School

Cornett, M.M.; McNutt, J.J. & Tehranian, H. (2006), Performance changes around bank mergers: Revenue enhancements versus cost reductions, *Journal of Money, Credit and Banking*, 38(4): 1013-1050

Craig, B. & Santos, J. (1997), The risk effects of acquisitions, *Federal Reserve Bank of Cleveland Economic Review*, 33: 25-35

Diaz, B.; Olalla, M. & Azorfa, S. (2004), Bank acquisitions and performance: Evidence from a panel of European credit entities, *Journal of Economics and Business*, 56(5): 377-404

De Guevara, J.F. & Maudos, J. (2007), Explanatory factors of market power in the banking system, *The Manchester School,* 75(3): 275-296

Demsetz, R.S. & Strahan, P.E. (1997), Diversification, size and risk at bank holding companies, *Journal of Money, Credit and Banking,* 29(3)

De Nicolo et al (2003), Bank consolidation, internationalization and conglomeration: Trends and implications for financial risk, *IMF Working Paper,* 03/158, Washington: International Monetary Fund

Emeni, F.K. & Okafor, C. (2008), Effects of bank mergers and acquisitions on small business lending in Nigeria, *African Journal of Business Management,* 2(9): 146-156

Huizinga, H.P.; Nelissen, J.H. & Vander Vennet, R. (2001), Efficiency effects of bank merger and acquisitions in Europe, *Ghent University Working Paper,* 106

Iloh, J.V.; Okolo, V.C. & Ani, W. (2013), The effect of bank consolidation on lending to small and medium enterprises in Nigeria, 3rd Management Conferece, Hydro Hotel, Penang, Malaysia.

Knapp, M.; Gart, A. & Chowdhry, M. (2006), The impact of mean reversion of bank profitability on post-merger performance in the banking industry, *Journal of Banking and Finance,* 30(12): 3503-3517

Kwan, S.H. & Wilcox, J.A. (2002), Hidden cost reductions in bank mergers: Accounting for more productive banks, *Research in Finance,* 9: 109-124

Koetter, M. (2005), Evaluating the German bank merger wave, retrieved from http:// papers.ssrn.com/so13/papers.cfm, October 10, 2016

Mai-Lafia, D.I. (2005), Impact of banks' consolidation on financial risk, payment system and monetary policy in Nigeria, *Business Guardian,* January 03: 43

Okafor, F.O. (2011). *50 years of Banking Sector Reforms in Nigeria (1960-2010. Past Lessons): Future Imperatives,* Enugu: Ezu Books Ltd. 52-57

Okpanachi, J. (2011), Comparative analysis of the impact of mergers and acquisitions on financial efficiency of banks in Nigeria. *Journal of Accounting and Taxation,* 3(1),

Soludo, C. (2004), Consolidating the Nigerian banking industry to meet the development challenges of the 21st century. Address by the CBN Governor to the bankers committee July 6

Viverita (2008), The effect of mergers on bank performance: Evidence from bank consolidation policy in Indonesia, *International Review of Business Research Papers,* 4(4): 368-380