EFFECT OF MERGERS AND ACQUISITIONS ON BANKS' PROFITABILITY IN NIGERIA

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Abstract

In recent times, the global economy has witnessed an increased incidence of mergers and acquisitions, particularly in the banking sector. This study examines the effect of mergers and acquisitions on the profitability of Nigerian banking sector. Data for the study were obtained from the audited annual reports of the selected banks in Nigeria. The results of the regression analysis conducted revealed that there is a significant difference between pre- mergers and acquisitions return on equity on one hand; and a significant difference between pre and post-mergers and acquisitions return on assets on the other hand. Specifically, the results of the study revealed a decline in financial performance at the post mergers and acquisitions when compared with that of the pre mergers and acquisitions dispensation. In other words, mergers and acquisitions in the Nigerian banking sector did not show any improvement in the profitability of the banks. It is recommended for banks' management to strategize so as to enhance profitability, stability and growth.

Key words: Mergers, Acquisitions, Profitability, Banking Sector, Nigeria.

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Background

In recent times, the global economy has witnessed an increased incidence of mergers and acquisitions, particularly in the banking sector (Muhammad, 2011). Muhammad (2011) observed that this can be attributed to various reasons such as: improving competitiveness of the companies through gaining greater market share, broadening the portfolio to reduce business risk, for entering new markets and geographies, and capitalizing on economies of scale. Focarelli, Panetta and Salleo (2002) also noted that banks have sought expansion through waves of mergers and acquisitions over the years, starting with the United States and Europe and then spreading to other countries around the world.

The Nigerian banking sector has not been left behind in the global waves of mergers and acquisitions. According to Elumilade (2010), the Nigerian banking system has undergone amazing changes over the years, in terms of the number of institutions, ownership structure as well as depth and breadth of operations. Elumilade (2010) observed that these changes have been influenced largely by challenges posed by deregulation of financial sector, globalization of operations, technological innovations and adoption of supervisory and prudential necessities that conform to international standards. The introduction of the new minimum capital base of twenty five billion naira in the Nigerian banking sector by the Central Bank of Nigeria in 2004 sparked off a new wave of mergers and acquisitions through which the total number of commercial banks fell from eighty-nine to twenty-five banks in January 2006. Thus, this study examines the profitability of the pre and post mergers and acquisitions in the Nigerian banking sector.

Literature reveals that mergers and acquisitons in the banking industry may be associated with increase in the efficiency of the system (Kaur & Kaur, 2010). Pautler (2003) also observed that the potential efficiency benefits from mergers and acquisitions could comprise of both operating and managerial efficiences. Pasiouras, Gaganis and Zopounidis (2006) opined that all firms mergers and acquisitions are embarked upon with the objective of maximising shareholders wealth. Nevertheless, Gattoufi, Sakr and Omran, (2008) reported that there remains an ongoing and an unresolved debate regarding whether mergers and acqisitions in the banking industry is always associated with better performance in general and financial performance and economic efficiency in particular. The recent reform in the Nigerian banking sector promoted series of mergers and acquisitions of some banks. There is a call therefore, for empirical evidence on whether or not any significant difference exists between the pre- mergers and acquisitions and post- mergers and acquisitions profitability of the banks. Thus, this study seeks to examine the effect of mergers and acquisitions on the profitability of Nigerian banks.

The general objective of this study is to investigate the difference between the pre- and post-mergers and acquisitions profitability of the Nigerian banking sector. Other specific objectives of the study are to:

1. Evaluate the significant difference between pre-mergers and acquisitions and post-mergers and acquisition Return on Equity (ROE).
2. To examine the significant difference between pre-mergers and acquisitions and post-mergers and acquisitions Return on Asset (ROA).

Furthermore, the following hypotheses were formulated:

H0i: There is no significant difference between pre-mergers and acquisition and post-mergers and acquisitions ROE in Nigerian banks.

H0ii: There is no significant difference between pre-mergers and acquisition and post-mergers and acquisitions ROA in Nigerian banks.

Extant Literature

According to Okonkwo (2004), a merger occurs when two or more companies transfer their businesses and assets to a new company (or to one of themselves) and in consideration, their members receive shares in the transferee company. Okonkwo (2004) also observed that an acquisition occurs when one company acquires adequate shares in another company so as to give it control of that company.

Lynch and Lind (2002) describe mergers and acquisitions as being one of the central techniques for organizational growth, meanwhile, Hurtt, Kreuze and Langsam (2000) observed that growth is one of the primary reasons for mergers and acquisitions. Perry and Herd (2004) highlight the critical role of strategic planning when using mergers and acquisitions to grow an organization. They suggest that in the 1990s companies shifted the focus for undertaking mergers and acquisitions from a cost saving viewpoint to using mergers and acquisitions as a strategic vehicle for corporate growth, which was regarded as an inherently more complicated challenge.

Mergers and acquisitions take place for many tactical business reasons, but the most common reasons for any business combination are economic at their core. The following are some of the various economic reasons as observed by Schlachter and Hildebrandt, (2012): increased capabilities, larger market share, products/services diversification, leadership replacement, costs cutting, and survival.

According to Liargovas and Repousis (2011) the theoretical literature of mergers and acquisitions can be divided into three major categories. The first category includes synergy or efficiency, in which total value from the combined firms is greater than the sum of values of each firm. Increased value arises from increased efficiency (output or input) and increased market power. Hubris is the second category and it is the result of winner's curse, causing bidders to overpay while value is unchanged. The third category comprises those in which total value is decreased as a result of mistakes or managers who put their own preferences above firms' (principal-agent problem), "building empires" for self-interest opposed to the self-interest of the principal and the shareholders.

Appah and John (2011) conducted a study on the efficiency effects of mergers and acquisitions in the Nigerian banking industry. Data was collected from the financial statements of all the sampled banks within the study period. The population of the study comprised all the (24) banks operating in the Nigerian banking industry as at 31st December 2010. Simple random sampling technique was used to select the (10) banks used for the analysis. About 3 year (2003-2005) pre merger and acquisition mean return on equity was compared with the 3 years (2006-2008) post merger and acquisition mean. Using descriptive analysis and paired sample t-test statistics, the findings revealed no significant difference between the return on equity of banks pre and post merger and acquisition. On the basis of the findings, it was recommend among others that mergers and acquisition in the banking industry in Nigeria must be driven by market forces to give room for efficiency and effectiveness and that researchers should develop new framework and models for banks performance, stability and growth as opposed to merger and acquisition.

Badreldin and Kalhoefer (2009) examined the performance of Egyptian banks that have undergone mergers or acquisitions during the period 2002-2007. The study was carried out by calculating the return on equity of the banks using the Basic ROE Scheme in order to determine the degree of success of banking reforms in strengthening and consolidating the Egyptian banking sector. The results of the analysis indicate that not all banks that have undergone deals of mergers or acquisitions have shown significant improvements in performance and return on equity when compared to their performance before the deals. In other words, no significant difference was observed between the pre mergers and acquisitions return on equity and post mergers and acquisitions return on equity of the banks. It was concluded that mergers and acquisitions have not had a clear effect on the profitability of banks in the Egyptian banking sector. They were only found to have minor positive effects on the credit risk position.

Akben-Selcuk and Altiok-Yilmaz (2011) conducted a study on the impact of mergers and acquisitions on acquirer performance in Turkey. Sixty companies which involved in mergers and acquisitions deals between 2003 and 2007 were included in the sample. The analysis of both stock market and accounting data weakly support the hypothesis that acquirer companies are negatively affected by mergers and acquisitions activities.

Mishra and Chandra (2010) evaluated the experience of Indian pharmaceutical industry on mergers and acquisitions. Data for the study were obtained from a sample of 52 firms over the period of 2000 to 20008 by using the multi-directional structure-conduct-performance-policy relationships. The results of the regression analysis revealed that mergers and acquisitions do not have any statistically significant influence on profitability of Indian pharmaceutical companies. In other words, firms do not necessarily benefit from mergers and acquisitions in terms of profitability in the long-run.

Yeh and Hoshino (2000) investigated the impact of mergers and acquisitions on both the acquiring firms' stock prices and financial performance by using a sample of 20 Taiwanese corporations during 1987-1992. They have examined accounting measures of profitability, financial health and growth of the acquirers. They have observed that the stock market reacts positively to the announcements of mergers and acquisitions, but profitability shows a downward change from pre-merger to post-merger periods.

Rani, Yadav and Jain (2013) investigated on post-mergers and acquisitions operating performance of Indian acquiring firms. The sample for the study consisted of 383 mergers and acquisitions companies between 2003 and 2008. The study measured and compared the pre-and post merger and acquisition financial performance of acquiring companies in terms of operating cash flows. The results of the analysis revealed that mergers and acquisitions have been beneficial for the acquiring companies in the long-run with regard to their operating performance. The findings indicated that profitability of acquiring firms improved during post-mergers and acquisitions phase. Mergers and acquisitions have resulted to better and improved performance.

Liargovas and Repousis (2011) conducted an event study on the impact of mergers and acquisitions on the performance of the Greek banking sector during 1996-2009 periods. In their analysis, the market model was used and residuals were tested whether merger events provide positive or negative abnormal returns to the participants. The results from event study methodology, using a 30-day event window indicated that stock prices showed significant positive cumulative average abnormal returns before the announcement for a period of ten days (for targets and bidders banks). Moreover, cash deals created more significant positive cumulative average abnormal returns for bidder shareholders than do stock deals, ten days before announcement. Also the results show that significant positive cumulative average abnormal returns are gained upon the announcement of horizontal and diversifying bank deals for target's shareholders. The overall results (the weighted average of gains to the bidder and target bank), indicated that bank mergers and acquisitions have no impact and do not create wealth.

Beitel and Schiereck (2001) examined the value implications of 98 large mergers and acquisitions of publicly traded European banks that occurred between 1985 and 2000. They found that for the entire sample the shareholders of targets earned significant positive cumulated abnormal returns in all intervals studied, while the shareholders of the bidding banks did not earn significant cumulated abnormal returns. From a combined view of the target and the bidder, European bank mergers and acquisitions were found to significantly create value on a net basis.

The study of Beitel, Schiereck and Wahrengoug (2002) builds on and extends the study of Beitel and Schiereck (2001) by examining the same data set but with a different objective. They analyzed the impact of 13 factors that include relative size, profitability, stock efficiency, market-to-book ratio, prior target stock performance, stock correlation, mergers and acquisitions experience of bidders and the method of payment on mergers and acquisitions success of European bank mergers and acquisitions, in an attempt to identify those factors that lead to abnormal returns to target shareholders, bidders shareholders, and the combined entity of the bidder and the target around the announcement date of mergers and acquisitions. Results showed that many of these factors have significant explanatory power, leading the authors to the conclusion that the stock market reaction to mergers and acquisitions announcements can be at least partly forecasted.

Methodology

Using a correlational research design, the study examined the effect of mergers and acquisitions on the profitability of Nigerian banking sector. Secondary data were extracted from audited annual reports of ten randomly selected banks from a population of twenty-two. The analysis was carried out using the regression analysis.

Results and Discussions

This section presents the analysis of the data obtained in the course of this study. The two hypotheses formulated were also tested for significance.

Test of Hypothesis 1

H0i: There is no significant difference between pre-mergers and acquisition and post-mergers and acquisitions ROE in Nigerian banks.

Table 1: One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
PRE ROE	10	.1547708	.10264495	.03245918
POST ROE	10	.1412952	.11365912	.03594217

Source: Researcher's Computation (2013)

In Table 1 above, the N = 10 (where N is represented as the number of banks), the Pre ROE has a mean of 0.1548, standard deviation of 0.1026 and standard error of 0.0325 while the Post ROE mean of 0.1413, standard deviation of 0.1137 and standard error of 0.0359.

Table 2: One-Sample Test

	Test Value = 0					
	T	Df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
PRE ROE	4.768	9	.001	.15477084	.0813431	.2281986
POST ROE	3.931	9	.003	.14129523	.0599884	.2226021

Source: Researcher's Computation (2013)

Table 2 above showed that there is statistically significant difference between pre and post merger and acquisition return on asset, as the probability (or significance) of the t-calculated is equal to 0.001 which is less than 0.05 or 5%. Hence, the result of the test of hypothesis shows that the null hypothesis is rejected and the alternative hypothesis that says that there is a significant different between pre and post mergers and acquisitions return on return on equity is accept. Thus, it could be concluded that there is a significant difference between pre- mergers and acquisitions return on equity, and post- mergers and acquisitions return on equity in the Nigerian banking sector.

Testing Hypothesis 2

H0ii: There is no significant difference between pre-mergers and acquisition and post-mergers and acquisitions ROA in Nigerian banks.

Table 3: One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
PRE ROA	10	.0352643	.03219116	.01017974
POST ROA	10	.0311334	.03339617	.01056080

Source: Researcher's Computation (2013)

In Table 3 above, the N = 10 (where N is represented as the number of banks), the Pre ROA has a mean of 8.6845, standard deviation of 18.2889 and standard error of 5.7834 while the Post ROA mean of 0.0311, standard deviation of 0.0334 and standard error of 0.0106.

Table 4: One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	T	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
PRE ROA	3.464	9	.007	.03526430	.0122361	.0582925
POST ROA	2.948	9	.016	.03113341	.0072432	.0550236

Source: Researcher's Computation (2013)

Table 4 above showed that there is statistically significant difference between pre and post merger and acquisition return on asset, as the probability (or significance) of the t-calculated is equal to 0.007 which is less than 0.05 or 5%. Hence, the result of the test of hypothesis shows that the null hypothesis is rejected and the alternative hypothesis that says that there is a significant difference between pre and post mergers and acquisitions return on return on asset is accepted. Thus, it could be concluded that there is a significant difference between pre and post mergers and acquisitions return on return on asset in the Nigerian banking sector.

Discussions

The results of this study revealed a significant difference between the pre and post mergers and acquisitions return on equity on one hand; and pre and post mergers and acquisitions return on assets on the other hand. The profitability of the banks fell after the exercise of mergers and acquisition. This result aligns with the report of previous studies, particularly, those of Yeh and Hoshino (2000), Akben-Selcuk and Altiok-Yilmaz (2011), and Mishra and Chandra (2010) amongst others. On the other hand, the results of the current study contradict the reports of Rani, Yadav and Jain (2013) who reported an improved financial performance in the post mergers and acquisitions dispensation.

Conclusion and Recommendations

This study examined the effect of mergers and acquisitions on the profitability of Nigerian banks. The results of the regression analysis conducted revealed that there is a significant difference between pre- mergers and acquisitions return on equity on one hand; and a significant difference between pre and post- mergers and acquisitions return on assets on the other hand. Specifically, the results of the study revealed a decline in financial performance at the post mergers and acquisitions when compared with that of the pre mergers and acquisitions dispensation. In other words, mergers and acquisitions in the Nigerian banking sector is yet to show any improvement in the profitability of the banks.

Based on the findings of this study, it is recommended that when it comes to mergers and acquisitions, the regulatory authorities, particularly the Central Bank of Nigeria should allow the various banks make their decisions on the parties to merge with. Mergers and acquisitions should go beyond meeting minimum capital base requirement, but rather, it should be market driven. Banks' management also needs to strategize on ways to enhance their firms' profitability, stability and growth after mergers and acquisitions exercises.

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