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THE EFFECT OF MERGER AND ACQUISITION AND CORPORATE PERFORMANCE OF THE NIGERIAN BANKING INDUSTRY.

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Abstract

The study examined the effect of merger and acquisition and corporate performance of the Nigerian banking industry. Four banks were selected out of the 21 existing merged banks using judgmental sampling technique. Secondary data were sourced from the financial statement of the four banks which covers 22 years pre and post consolidation periods. Variables (Gross Earning, Current Ratio, and Return on Capital Employed) were analyzed using the independent sample test technique. The study finds that there is non-significant negative difference in the performance of return on capital employed in the pre- and post-merger and acquisition periods. Current ratio shows significant positive difference between the pre- and the post-merger and acquisition periods. However, the result shows significant negative difference for Gross earning 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.

Keywords: Gross Earning, Current Ratio, Dividends per share and Return on Capital Employed

Introduction

In this present dynamic business world, growth is an inevitable target of every organization. Olaoye (2019), states that growth is not just an option for companies but a vital necessity. Thus, every company strived effectively to achieve qualitative growth in their earnings or turnover (profit) in terms of products and services delivery. Their focus is to excel in their field of operations in order to boost their overall performance. These can only be achieved through both internal and external growths. The internal growth could be through the process of discovering and developing new products or by expanding or enlarging the capacity of existing products or sustained improvement in sales or completely rebranding its existing products and mode of operations to wear a new improved looks while external growth could also be achieved through merging and acquiring other existing firms Odetayo, (2013). Merger and acquisition are quite important forms of external growth. In today's globalized economy, merger and acquisition are being increasingly used as a business strategy for achieving a larger assets base, for entering new markets, generating a greater market share/additional manufacturing capacities, and gaining complementary strength and competencies, to become more competitive in the market place (Okpanachi, 2011). It is a natural process in business restructuring and re-engineering that is now in vogue world over. Thus, in the last two decades, merger and acquisition had extensively being used as a business last resort in order to achieve sustainable competitive advantages in the business environment. The policy of business liberalization, decontrol and globalization of economy has really exposed the corporate sector to domestic, regional and global competition thereby making it a business global village (Akpan, 2013).

Merger and acquisition is a survival option for companies in distress and alternative means of recapitalization for repositioning. Companies used merger and acquisition extensively as strategic tools to grow and compete for foreign direct investments (Omer & Burak, 2018). Thus, it is a means to an end but not an end itself. It had become imperative and a major force in the prevailing ever changing business environment (Soludo, 2004). In light of its importance as a globally acceptable improved innovative business survival strategy, it was adopted in the 2004 Nigeria banking reforms and repositioning for better services delivery and corporate performance. The Central Bank of Nigeria (CBN) surveillance on banks in 2004 revealed deterioration in banks overall performance based on Capital, Asset, Quality management, Equity and Leverage (CAMEL) parameters, (CBN Briefs, 2004). It was noted that banks performance and efficiency rating was below the required regional and global standards (CBN Brief, 2005).The CBN opined that Nigeria banks needed an urgent surgical operation. For this reason, the banks were asked to recapitalize through consolidation. A minimum target of N25billion (Twenty five billion Naira) was set, and must be met by each bank as their new capital base. However, for this target to be met by the existing banks then, merger and acquisition was one of the required means used. Consequently, these led to the reduction of Nigeria's banks from 89 to 25 in 2005, 23 in 2006, 22 in 2007, 19 in 2009 and 21 till 2017, with the approval and addition of Suntrust and Jaiz banks respectively. Furthermore, early 2019, the number of the banks further dropped to 20 with the most recent acquisition of Skye Bank Plc by Polaris Bank Plc and Diamond Bank Plc by Access Bank Plc (olaoye, 2019) respectively. However, the new banks were designed to allow for a fresh start and rejigging of the banks business models and reconstruction of its credit portfolios (Okga, 2017).

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2.0 Review of Related Literature

2.1. Conceptual Framework

Corporate Restructuring

According to Pandey (2011) corporate restructuring is of the best available survival option which includes mergers and acquisitions, amalgamation, take over, spin-offs, cover aged bug-outs, buy-back of shares, capital reorganization, sales of business units and assets etc. It is the most popular of all the corporate restructuring or business combination which had contributed immensely to the external growth of a many leading firms globally. Also, corporate restructuring equally means changes in ownership, asset mix, business mix etc with an objective of increasing firms and the shareholders' value. This would eventually lead to an increase in the return on investment. Corporate restructuring can also be termed business combination and it includes merger and acquisition, amalgamation, takeover, leveraged buyouts, capital reorganization, sale of business units and assets.

2.1.2 Merger and Acquisition

In the present day business world, merger and acquisition has always been one of the very important strategic tool used to achieve specific business objectives (Srinivasan, 2003). Merger and acquisition happens when two legal entities assets and liabilities are combined to become one legal entity (Linder, 2003).

If merger and acquisition are to be defined separately, acquisition generally means a larger company absorbing a smaller company, with the smaller firm either becoming a subsidiary of the larger firm, hence losing its identity, and larger company will take control of smaller company's asset and liabilities. Merger on the other hand, generally used to reflect consolidation of two companies on an equal status basis. Merger and acquisition are often used interchangeably and this is because they both basically lead to the same outcome whereby two entities become one.

In reality, pure merger or mergers in equal basis do not happen very often but more common in acquisition. The trick and consideration in acquisition usually carries a negative perception and could be discouraging and demoralizing to the morale of the company being acquired as members of staffs are likely to lose their jobs or experience a reduction of there income, hence damaging future synergies, expected post-merger and acquisition(Houston, J. F., & Ryngaert, M. D. 1994) . So therefore, despite all kind of theories and definitions to differentiate merger from acquisition, the acquirer firms usually prefers to call it merger and acquisition, which brought about the usages of merger and acquisition interchangeably today. Unless the deal is being generally recognized as a hostile takeover by the acquirer, where then it would be seen as a pure acquisition and in any other cases they both would be seen as same.

2.1.2.1 Merger

Merger has being defined by the companies and Allied matters Act; CAMA (1990 as amended) as any amalgamation of two undertakings or interest of two or more companies and so or the undertakings of one or more companies and so or more corporate bodies. A merger could therefore, be simply defined as coming together of two or more separate entities to form a single entity. In other words, it is the complete amalgamation of the assets and liabilities as well as shareholders interest and businesses of the merging entities. Thus, all in all, a new company must emerge that which would swallow up all other merging ones. Other words that are synonymous to merger are absorption, consolidation, amalgamation, combination and synergy. Osanwonyi (2003) sees Merger as the pooling together of the resources of two or more companies, resulting in one surviving company while the other is absorbed and ceases to exist as a legal entity or remains a subsidiary if it survives. Also, Mohammed (2010) explained merger as the combination of two or more companies in creation of a new entity or formation of a holding company.

2.1.2.2 Acquisition

Acquisition and Take-over are often used interchangeably. CAMA (1990) defines a Take over as the acquisition by one company of sufficient shares in another company to give the acquiring company control over that of the other company. Acquisition means an act of acquiring effective control over asset or management of a company by another company without any combination of businesses or companies. It is also defined as the process of taking a controlling interest in a business. An acquisition may also arise through the purchase of the assets (rather than shares) of the target entity. Usually, an acquisition will occur where an individual offered company acquires all the assets of another company and becomes the new owner. Pandey, (2011) defines Acquisition also to means acquiring effective control over assets or management of a company by another firm devoid of combination of business or businesses However, when another firm acquires a substantial share or assets or voting right of a target company it will definitely affect the control of the target company. Again, European Central Bank (2000) defines acquisition as the purchase of share or assets on another company in order to achieve a managerial influence and not necessarily by mutual agreement.

2.1.2.3 Takeover

Taken over, thus, means acquisition of a total or tangible control over the assets, and liabilities, shares of another company which depends largely on percentage of the controlling share acquired thus, take over also means the acquisition of not less than 25% of the voting power in a company however, there are some situation where there is total take over/acquisition which means outright purchase of 100 % of the controlling assets/shares of target company. Takeover can be said to be an acquisition. A takeover occurs when the acquiring firm takes over the control of the target firm. In some case it can be said to be an assumption of control of a corporation achieved by buying a majority of its shares, a takeover can also be a conglomerate merger. Also, an acquisition or take over does not necessarily entail full, legal control. A company can have effective control over another company by holding minority ownership.

Takeover versus acquisition sometimes, a distinction between take over and acquisition is made. The term takeover may connote hostility, that is, when the acquisition is a forced or unwilling acquisition, it is called a Takeover. In a force takeover, the management of the target firm would oppose the move of being takeover by the acquiring firm, but, when the management of the target firm and the shareholders of the acquiring firms mutually and willingly agreed to the takeover, it is called acquisition or Friendly takeover (Pandey, 2011).

Mergers and acquisition usually occurs and achieved through a process of negotiation between the holders of a majority or all of the shareholders of the offeror and the offeree of the two or more companies. Those who initiate mergers and acquisition usually premise their actions on economic or business considerations. More often than not, a company under economic pressure or in distress usually seeks or initiate a merger ship with another better firm as a bail out from distress and if not it will definitely go into total extinction.

Theoretical Framework

Information and Signalling Theory

Lintner developed Information and Signalling Theory in 1956. The theory suggests that two different investors behave differently when they have different information. The merger announcement is a source of information and signal to market participant about the possible impact of deal on firm value. The announcement of merger event would signify that the value of target would increase or double or the management team would be removed by the new owners. It also sometimes signifies that there would be an increase in the cash flows and future values. Thus, the announcement of a merger or acquisition would signal that in future there would be increase in future value of the bidder firm (Weston, 2010). There is an extension to the signal theory which states that because of information asymmetries, targets enhance the sellers gain by reducing the acquirer's offer price. The implication is that since the target engages in inter-organizational relationships, there is gain to sellers, as it acts as a signal (Linder, J. C.2003), . The target shares and assets may be undervalued because of their higher value for an alternative owner who may place assets at a higher and better use. . If one outsider can add value, then another potential new owner may also add value. When managers learn about the potential for the discipline of a merger, they institute pre-emptive steps to initiate the discipline by themselves. The form of mergers can be used to glean information about bidders and targets. A bidder that uses common stock rather than cash may signal that the bidder's own stock may be overvalued, or it may signal that the bidder is unsure of the target' value and wishes target shareholders to share in the risk of potential miss-estimation of the target's value.

2.2.2 Synergy Gain Theory

Synergy Gain theory was propounded by Gunther in 1955. Merger occurs broadly because mergers generate 'Synergy' between the acquirer and the target and Synergy in turn increases the value of the firm (Kathy 2005). Merger and acquisition are done to get synergistic benefits out of the combined firms that are acquirer and target together. The value of combined firm is likely to be greater than the acquirer and target firm separately. The gains arise out of the financial or operating synergies though economies of scale of operations. It means when the two firms combine, their fixed cost is distributed among the large scale of productions leading to less fixed cost. Apart from the economies of scale, there is another variant of it which is called as economies of scope where the complementary resources of the acquirer and target firm are combined to bring synergy gains. Most of the merger and acquisition have a motive to increase the size of the company. This is possible when two firms combine to get the benefits of economies of scale and scope. Economies of scale occur in various ways. It may occur because of the huge scale of operation or it may occur by holding inventories or through specialization. Economies of scope occur when a company manufactures some related goods at lower cost as it enjoys the experience of dealing with the existing products. Kathy (2005) posited that Synergies are efficiencies that can only be achieved by merging, that is, they are merger specific. Synergy takes the form of revenue enhancement and cost savings, operating efficiency is also a form of synergy. Gaughan (2007) presents operational and financial synergy. According to Gaughan (2007) operational synergy appears in the form of revenue enhancements and cost reductions. Financial synergy is achieved when the cost of capital is or may be reduced through the combination of two or more companies.

Theory of Managerial Discretion

Jensen in 1986 developed the theory of managerial discretion claims that it is not over-confidence that drives unproductive acquisitions, but rather the presence of excess liquidity or free cash flow. Firms whose internal funds are in excess of the investments required to fund positive net present value of projects it suggested, are more likely to make quick strategic decisions, and are more likely to engage in large-scale strategic actions with less analysis than their cash-strapped peers. High level of liquidity increases managerial discretion, making it increasingly possible for managers to choose poor acquisitions when they run out of good ones (Korn, D, & Bradley, H.2008). Indeed, several empirical studies demonstrated that the abnormal share price reaction to takeover announcements by cash-rich bidders is negative and decreasing in the amount of free cash flow held by the bidder. Moreover, it is suggested that the other stakeholders in the firm will be more likely to give management the benefit of the doubt in such situations, and to approve acquisition plans on the basis of fuzzy and subjective concepts such as managerial 'instincts', 'gut feelings' and 'intuition', based on high past and current cash flows . Thus, like the Hubris theory, the theory of free cash flow suggests that, otherwise well-intentioned mangers make bad decisions, not out of malice, but simply because the quality of their decisions are less challenged than they would be in the absence of excess liquidity.

Empirical Review

Rewane, B. (2010) conducted an empirical analysis of financial reforms in Pakistan to examine whether it affects economic growth. It explored correlation among economic growth, deposits, lending, real interest rate, savings, and inflation, taking data of thirty-six years (1973-2008). The regression analysis showed a positive impact of financial reforms on the growth of Pakistani economy.

Maija. K., (2018) examines the impact of mergers on the ratio of net income before extraordinary items to assets and non-interest expenses to assets. He runs profit analysis in which a dummy variable distinguished non acquired bank from banks acquired by muiti-bank holding companies is the dependent variable performance measures and several control variables serve as the independent variables. The study found out that neither income nor non-interest expenses were affected by merger activity.

Mwenda and Mutoti (2011) investigated the effect of marked based financial sector reforms on the competitiveness and efficiency of commercial banks and economic growth in Zambia. The results shows that the reforms in phase II and III had significant positive effects on bank cost efficiency, financial depth, phase II and III financial sector reforms, degree of economic growth. Phase II policies and inflation rate have adverse effects while the rest of the variables have positive on economic growth.

Rehana and Irum (2011) a research was carried out on effect of business combination on financial performance; evidence from Pakistan's banking sector. It explored the effects of merger using 6 different financial ratio(Gross Profit Margin, Operating Profit Margin, Net Profit Margin, Return on Capital Employed, Return on Net Worth & Debt Equity Ratio) extracted from the annual report of 10 commercial banks that faced merger and acquisition during the period 1999 to 2010. Analysis was done using the paired T-Test and the result revealed that there was a decline in all 6 ratios; it concluded that there is a negative impact of merger and acquisition on bank's performance after merger and acquisition.

Umoren and Olokoyo (2007) analysed the impact of consolidation on performance of banks with focus on their profitability, liquidity and solvency. The study analysed 7 mega banks covering a period of 3years (2yrs pre & 1 year post). Correlation analysis was used to test the impact of the performance ratios. Variables used to review the financial statement include; Asset profile, capital structure, credit risk, cost controlling, liquidity risk, Return on Asset, Return on Equity, and Size was used as measuring variables. Findings support the hypothesis that on average, strategically similar institution tend to improve performance to a greater extent than dissimilar institution.

Suberu and Aremu (2010) conducted a study on corporate governance and merger activities in the Nigerian Banking Industry using twenty-five (25) successful mergers arising from the regulatory demand for consolidation. The major finding revealed that the banking sector is partly responsible for the poor state of the Nigerian economy through its support for the import dependence nature of the economy rather than financing of sustainable economic development through shareholder values maximization.

Appah and John (2011) analysed the profit efficiency effects of merger and acquisition in the Nigerian banking industry. The Study used ex-post research design with data drawn from the annual reports of sampled banks for the period 2003-2008 using Return on Equity as proxy for profit efficiency while the sample size consist of 10 banks. The paired sample T-test statistics and descriptive analysis was used for analysis. Findings revealed that sampled banks performed better during the Pre-merger and acquisition period (2003-2005). The study concluded that there is no significant difference in Return on Equity of all banks combined between the pre and post-merger period.

Data and Methods

The study adopted the quantitative research technique based on ex-post factor design. Measures of corporate performance analyzed in the study are Gross earning, current ratio, return on capital employed and dividends per share. Current ratio shows the ratio of current asset to current liabilities. While return on capital employed shows company profitability and efficiency.

Secondary data on the variables (return on capital employed, current ratio, and Gross earnings for the period 1996-2014 were sourced from the financial statement of banks. 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.

Table 1a

RETURN ON CAPITAL EMPLOYED	YEAR	N	MEAN	STD DEVIATION	STD ERROR MEAN
	PRE MERGER	11	3.9422	.99892	.42638
	POST MERGER	11	2.0824	5.02	2.47812

Source: Researcher's computation 2019

The result presented in the above table shows a decrease in the mean performance of return on capital employed from the pre-merger and acquisition value of 3.94 to 2.08 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.

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	95% Conf Interval Upper
Return on capital employed	Equal variances assumed	5.354	.086	3.500	20	.212	2.84000	2.41547	-1.56066	5.84066
	Equal variances not assumed			3.500	89901	.226	2.84000	1.41547	-1.76747	6.04747

Source: Researcher's computation 2019

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 corporate performance of the Nigerian banking sector.

Table 2a: Group Statistics

	Year	N	Mean	Std. Deviation	Std. Error Mean
Current Ratio	**pre-merger**	11	53.5578	12.79191	4.59730
	Post-merger	11	65.9111	15.70624	6.23541

Source: Researcher's computation 2019

The statistics presented in table 3 shows that the mean of current 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 Samples Test

		Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	Df	Sig. (2-tailed)	Mean Diff.	Std. Error	95% Conf	
									Lower	Upper
Current ratio	Equal variances assumed	1.369	.259	3.841	17	.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: Researcher's computation 2019

Table 3b shows that consummation of merger and acquisition agreements in the banking sector led to significant deterioration in current ratio. 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.

Table 3a: Group Statistics

	Year	N	Mean	Std. Deviation	Std. Error Mean
Gross EARNINGS	Pre-merger	11	36.6667	12.34585	4.11528
	Post-merger	11	17.4489	8.53486	2.84495

Source: Researcher's computation 2019

For gross earning, 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.

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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	95% Conf Interval	
									Lower	Upper
EARNING PER SHARE	Equal variances assumed	1.369	.259	3.841	16	.001	18.21778	5.00293	8.61204	29.82352
	Equal variances not assumed			3.841	14	.002	18.21778	5.00293	8.50345	29.93210

Source: Researcher's computation 2019 *from NDIC Report, 2014*

Table 3b shows that consummation of merger and acquisition agreements in the banking sector led to significant deterioration in earning per share. 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 capital employed) 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 current ratio (iii) there is a significant reduction in earning per shares between the periods. Following from the above findings, the study concludes that mergers and acquisitions have significant impact on the corporate 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.

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