

EFFECT OF MERGERS AND ACQUISITION ON BANK HEALTH:AN EMPIRICAL INVESTIGATION

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ABSTRACT: *Mergers and Acquisition has been described as a viable too for capital increase in businesses. The Nigerian business environment is not distant from this opinion as several mergers have been successfully conducted to date. Specifically, the banking scene had witnessed many prior to the last recapitalization exercise. This paper investigates the relationship between increasing share capital of banks through merger and acquisition and liquidity and profitability. The study conducts empirical investigation into the merger of Intercontinental Merchant Bank Limited and Equity Bank Limited. The analysis is divided into pre and post merger periods to specifically capture the impacts created by the action. The study observes that liquidity is not significant in the relationship while profitability is very good in explaining the relationship. The paper concludes that profitability of banks is enhanced with capital increase, though not necessarily the liquidity level.*

KEYWORDS: Mergers and Acquisition; Bank Health.

INTRODUCTION

Mergers and Acquisition is not a new phenomenon to all parts of the world. It is a strategic tool in use by firms in many places towards repositioning themselves for the challenges posed by the current globalization trend around the world. Over the years, it has often been argued that banks in Nigeria are not well positioned to garner the gains of globalization. According to Adegbite (2005), for a country that does not want to be marginalized globally, the financial sector must be positioned in such a way that it can compete globally. She used the exposition of Abdulai, the Director General and Chief Executive Officer of OPEC in 1983 when most of the bank executives approached them for a share in the deposits of OPEC.

According to Adegbite, these banks were hampered because there was a minimum capital base required for any bank to qualify to hold OPEC deposits. No single Nigerian bank qualified. It was then alleged that the capital base of all Nigerian banks put together does not still meet up with the minimum required capital base. To address this imbroglio, the Central bank in 2005 announced a minimum capital base of N25billion for all banks in the country. In order to meet up with this requirement, many banks were forced to embrace what I call “corporate marriage” known as Mergers and Acquisition, This tool is not new in the country. Several mergers have taken place in the past mostly in the oil and gas sector. However, one notable merger and acquisition prior to this reform agenda in the financial sector was that of Intercontinental Merchant Bank Limited and Equity Bank Limited in 1996.

Similarly, the Nigerian banking system is believed to be battling with poor credit. According to Iyiegbuniwe (1998), the industry became enfeebled by pervasive distress after a decade of financial deregulation. This no doubt calls for regulatory organs activity to protect depositors' funds, ensure monetary stability, enhance populace banking habit, and encourage competitive and efficient financial system. Soludo (2004) stated that Mergers and acquisition has been suggested as an instrument for banking soundness, especially in the light of global and emerging market trend which reflect increasing case of mergers and acquisition in the banking industry.

This study intends to examine the impact of mergers and acquisition using the case study of Intercontinental bank limited and Equity bank Nigeria limited over a period of eight (8) years to appraise the effect of mergers and acquisition in ensuring profitability and liquidity. The paper makes deductions from Oluitan (2004) who empirically analyzed these two variables as core ingredients for bank health. Both pre and post merger analysis will be explored using simple linear regression method. Though the case study was not part of the current reform agenda of the government, but it is an issue that will posit situations to be expected with the prevailing mergers and acquisition within the industry.

LITERATURE REVIEW

Mergers and Acquisition is often described as a strategic decision for maximizing the company's growth by enhancing its production and marketing operation. To many Scholars it is a reform tool for strategic repositioning. According to Omotayo (2005) it will create strong banks that will be able to face keen competition in the financial markets both locally and globally and also guarantee good returns. He suggests that it will make the banks more competitive and be positioned to focus more on customer service delivery that is efficient and of high quality. This he opines will bring out economies of scale that will lead to greater efficiency, enhanced ability to source foreign currency lines, reduce desperation for deposits, thereby reduce interest rate and enhance productivity in the economy.

This view was corroborated by Aluko and Adebisi (2005) who said that because the financial forces in the sector are so dynamic, it becomes imperative for the players to embark on the use of the most viable strategic tools to survive the tides and challenges. To them, Mergers and Acquisition and harnessing the benefits of globalization are truly viable tools that can enhance aggregate economic growth when applied with caution and great expertise. They concluded that the corporate marriage should not be in haste so as to achieve better strategic standing, high market share and synergy. El Amin (2006) also supported the use of mergers and acquisition as a strategic tool. He opined that it saves companies from bankruptcy and plant closures. It also leads to increased new owners capture productivity gains through increased economies of scale. Ollinger, et al (2005) were of the view that Mergers and Acquisition decreased the likelihood of small and large plant closures over 1977-82 and 1982-87 respectively. Mergers And Acquisition is useful for banks to effect continuous changes that will ultimately result in development of the industry. It also assists the banks to spread their risks while still retaining rate of return. The studies by Banwo & Adetiloye (2005) and Dada & Awoyemi (2005) supported the above exposition. They affirm that Mergers and Acquisition are tools for bank survival which will go a long way in making the banks stronger, apart from improvement in market discipline within the

market. They concluded that the action is in the right direction and will result in better performance of the institutions. Oloyede and Afolabi (2005) also supported the above postulations. They however recommended that banks should realize both economic and social inputs of merger from the onset, ensure adequate and proper enlightenment of the banking public in terms of its attendant implications, complications and advantages by the regulatory agencies namely Central Banking of Nigeria, Nigeria Deposit Insurance Corporations and the Security and Exchange Commission. Lastly they suggested that both statutory and legal requirements involved in mergers and acquisitions should be flexible and without abuse.

On the other hand there are several other scholars who do not believe that mergers and acquisition is a viable tool for strategic repositioning. According to Uwuigbe (2005), there is no statistically significant gain in value or performance from merger activity and that there is no positive relationship between merger activity and gains in either performance or stake holders wealth. They opine that mergers will enhance value, if only the level of bank diversification is raised. In like manner, G.10 in 2004 stated that the risk of systemic crisis has been increased by consolidation in recent years. They posited that systemic financial risk is most likely to be transmitted to the real economy through the wholesale activities of financial institutions and markets, including payment and settlement disputes. According to them, Mergers and Acquisition activity has shown little evidence of improved efficiency and may destroy competition. They concluded that the view that liquidating a bank which gets into trouble would be difficult and disorderly may not necessary hold. This assertion was buttressed by Kinsey (2000) who stated that a lot of the big mergers, acquisition and alliances fail to create significant value.

Buono (2003) also argued against mergers and acquisitions due to the operational risk arising from the difficulty of integrating different risk management system as well as different accounting and control measures. He concluded that the application in Nigeria will only result in lay-off and kill competition thereby increasing the cost of credit, inject unintended crisis of loss of confidence in the system that could lead to system failure through massive deposit withdrawal and investor flight.

MODEL SPECIFICATION

As earlier stated, the merger and acquisition experience between Intercontinental Merchant Bank Limited and Equity Bank Nigeria Limited will be used for the analysis. The data is obtained from the research carried out by Ojo and Oloyede (2001). Though they made use of ratio and simple percentage analysis to measure profitability return on capital employed, return on owner's investment, operating income per staff and branch, rate of loans and advances to total deposits and capital position ratio, this study intends to use a simple linear regression method to examine the impact of shareholders fund on profitability and liquidity.

According to Oluitan (2004) the duo of liquidity and profitability are important variables to explain bank health. It is necessary to establish whether the acquisition of Equity Bank Limited by Intercontinental Bank Merchant Limited is indeed profitable. The critical questions are:

- Whether Mergers and acquisition enhances the profitability of a bank

- If Mergers and Acquisition improves the liquidity position of the bank
The model tested in this study is

$$Y_t = f(\Omega_t) \text{ ----- (1)}$$

In the model, Y_t represents Shareholders fund while Ω_t represents the two explanatory variables i.e bank liquidity and bank profitability.. Three separate models are analysed for the pre-merger estimation and same applies for the post merger estimation. For the first model, the two explanatory variables are included in the estimation while is subsequently introduced in different estimations later. The same procedure is adopted for the post merger estimation. The result is presented in the table below.

Regression Result with Shareholders Capital as the Dependent Variable for Pre And Post-Merger Analysis

Variable	PRE-MERGER ANALYSIS			POST MERGER ANALYSIS		
	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
Constant	-48.71559 (18.0173)	-22.31068 (25.21161)	-45.35637 (20.97398)	614.0911 (460.3383)	2179.949 (206.895)	232.8645 (209.0134)
Liquidity	.0507042 (.0381685)	.1106162 (.0507948)		-.0035916 (.0038316)	-.0144728 (.0055545)	
Profitability	.2530219 (.108309)		.3496978* (.0943139)	.9841804 (.2847828)		1.203543*** (.1572843)
R²	0.9541	0.7034	0.8730	0.9824	0.7724	0.9670
Adj. R²	0.8622	0.5551	0.8095	0.9473	0.6587	0.9505
F Stat	10.38	4.74	13.75	27.94	6.79	58.55
P-Value	0.2143	0.1613	0.0657	0.1326	0.1211	0.0167

EMPIRICAL FINDINGS AND INTERPRETATION

The first model estimated for the pre-merger does not have any of the variables significant. Even the p-value for the F Statistics is not significant. This suggests that the model is not appropriately specified. The same applies to the second estimated bi-variate model where liquidity is the only explanatory variable. It therefore suggests that liquidity is not able to exert any significant impact on share capital. When bank profitability is introduced to the bi-variate model as the explanatory variable, the variable is weakly significant at 10%. The coefficient suggests not less than 34% variations in share capital can be explained by bank profitability. This is a huge positive impact. The regression in this instance is equally weakly significant at 10% as denoted by the p-value of the F Statistics while both R Squared and Adjusted R Squared are 87% and 81% respectively. With this result, it can be deduced that bank profitability exerts very strong impact on share holders capital.

The first model estimated for the post-merger does not have any of the variables significant. Similar to the pre-merger estimation, the p-value for the F Statistics is equally not significant.

This suggests that the model is not appropriately specified. The same applies to the second estimated bi-variate model where liquidity is the only explanatory variable. It therefore suggests that liquidity is not able to exert any significant impact on share capital. When bank profitability is introduced to the bi-variate model as the explanatory variable, the variable is highly significant at 1%. The coefficient suggests not less than 120% variations in share capital can be explained by bank profitability. This is a very huge impact and even much larger than the pre-merger estimation result. The regression in this instance is equally highly significant at 2% as denoted by the p-value of the F Statistics while both R Squared and Adjusted R Squared are 96% and 95% respectively. This affirms that there is a stronger relationship between the shareholders fund and profitability during the post acquisition period. With this result, it can be deduced that bank profitability exerts very strong impact on shareholders capital. The impact is much stronger than the pre-merger estimation hence the exercise has had significant impact on the profitability of the bank in question.

From the foregoing, merger and acquisition experience in the Nigerian banking industry which pre-dates the last recapitalization exercise has had tremendous and significant impact on the industry. This study opines of the duo of bank liquidity and bank profitability, only bank profitability is able to explain the relationship and the impact exerted is huge and significant. From the above analysis, no doubt Equity bank was far better off with the acquisition programme than before it. It also confirms the importance of size which in this case is depicted by shareholders fund as very important in the generation of both profitability and liquidity (essential) variables for the determination of bank health (Oluitan 2004). The outcome of the study also supports the findings of Ojo and Oloyede (2001).

RECOMMENDATIONS AND CONCLUSION

This paper has explained using analytical tools the importance and positive impact of mergers and acquisition for a bank that experienced same prior to the recent reform programme. The study has confirmed the importance of size in the generation of profitability which is essential in the determination of bank health (Oluitan 2004)

However in as much as size is relevant, the avenues for the application of the funds must be in existence such that banks do not have to pursue volatile and high risky ventures. This therefore means that a lot is at the disposal of regulatory agencies to ensure sound banking practice. The fall of the big is mightier than that of a small person. Also, according to Ojo (2004), the CBN needs to improve the quality of bank personnel, especially bank management so as to make them sufficiently re-oriented to adhere less to alien or maladapted banking techniques and culture; and be more suited to the country's special development needs

Banks should be encouraged to partake in equity of their customers as it happened in China, Korea etc and be less particular about profit. A bank that finances any SME's that fails should be black listed while robust motivation should be provided for successful ventures. The growth of industries should henceforth be the pride of our banks. The utilization of funds in this direction will promote productive investment and growth of industrial project. Similarly, CBN has to engage professionals in retail banking who can read below the lines when inspecting the banks.

This study suggests those with retail banking experience to form the core of inspectors for those banks

According to Ojo (2004), the CBN needs to design and develop strategies for utilizing long term funds for investment purposes. The past records of investment in the country have been made into highly speculative and unproductive sectors. Banks prefer to finance foreign exchange bidding at the expense of loans and advance that will be utilized for productive purpose. Of particular references is the finance SMIE's. A large chunk of these entrepreneurs depend on a number of informal sector for savings mobilization and credit advancement.

The regulatory institutions should focus very well on the issue of manpower development within the industry. What is pertinent is "The bigger the head, the more it aches". Therefore any distress of the enlarged banks will be highly disastrous. Regulatory institutions should not prolong cases of distress which on the long run endanger the funds of the investing public. This paper is advocating for a case of quick intervention and an adoption of certain bail out strategies that will word off distress from our banking institution.

Similarly CBN needs to embark on proactive measures that will reveal cases of illiquidity rather than insolvency. The method should be made to reveal even the hidden parts of the bank balance sheet for immediate attention. A situation of chasing the shadow syndrome needs to be thoroughly examined. Tough and severe measures should be put in place for bank management that exploits their organization. They should not be allowed to go free irrespective of their status. All thanks to Independent Corrupt Practices Commission (ICPC) and Economics and Financial Crimes Commission (EFCC) in the country.

Nigerians deserve a breathing space with regards to money kept in banks hence the current recapitalization drive should work in that direction. It should inculcate banking habit and assist to reduce the chunk of money currently outside the bank coffers rather than working in the contrary. Similarly, the country should also through this directive engage in trans-border banking activities and reap the benefit of financial globalization. However, where any of the above mentioned points are down played the end could be worse than the beginning. A lot lies with the regulatory authorities and we sincerely hope they will not only live up to our expectation but even beyond it.

Having stated the above points, one can conclusively say that the regulatory institutions have taken a right decision towards improving the financial sector in Nigeria and we continue to reap the gains both in the short and long run.

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