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Financial efficiency of banks in the pre and post mergers and acquisitions era of banks in Nigeria: a comparative analysis

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Abstract

Mergers and acquisitions in the Nigerian banking sector are reform strategies recently adopted to reposition the banking sector. These were done to achieve improved financial efficiency, forestall operational hardship and expansion bottlenecks. It is against this backdrop that this paper made a comparative analysis on the financial efficiency of banks in the pre and post merger and acquisitions era in Nigeria. This paper used gross earnings, profit after tax and net asset of the selected bank as indices to determine financial efficiency by comparing the pre-mergers and acquisitions indices for the period under review for this paper, three Nigeria banks were selected using convenience and judgment sample selection methods. Data were collected from the published annual reports and account of the selected banks and were subsequently analysed applying t-test statistics through statistical package for social science. It was found that the post-mergers and acquisitions period was more financially efficient, the study recommend that the banks should be more aggressive in their profit drive for improved financial position to reap the benefits of post mergers and acquisitions.

Keywords: financial efficiency, banks, pre-merger, post-merger, acquisitions

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1. INTRODUCTION

Banks play a crucial role in propelling the entire economy of any nation, of which there is need to reposition it for efficient financial performance through a reform process geared towards forestalling bank distress. In Nigeria, the reform process of the banking sector is part and parcel of the government strategic agenda aimed at repositioning and integrating the Nigerian banking sector into the African regional and global financial system. To make the Nigerian Banking sector sound according to Akpan (2007), the sector has undergone remarkable changes over the years in terms of the number of institutions, structure of ownership, as well as depth and breadth of operations. These changes have been influenced mostly by the challenges posed by deregulation of the financial sector, operations globalisation, technological innovations, and implementation of supervisory and prudential requirements that conform to international regulations and standards.

Similarly, a strong and virile economy depends to a very large extent on a robust, stable and reliable financial system including the banking sector. This explains the frequency with which the Nigerian banking sector has witnessed repeated reforms aimed at fine-tuning it to meet the challenges for economic stability and developmental goals which are not only limited to domestic savings mobilisation and financial intermediation, but also the elimination of inefficiency to enhance financial efficiency. The financial efficiency parameters are determined and measured by gross earnings, profit after tax and net assets.

Soludo (2004) opines that the Central Bank of Nigeria (CBN) choose to begin the Nigerian banking sector reform process with the consolidation and recapitalisation policy through mergers and acquisitions. This is done in order to arrest systems decay, restoration of public confidence, building of strong, competent and competitive players in the global arena, ensuring longevity and higher returns to investors. Considering the inability of most Nigerian banks to perform well due to operational hardship, expansion bottlenecks as a result of heavy fixed and operating costs coupled with volatility between deposits and lending rates. Charles Soludo the governor of CBN on July, 6, 2004, increase the capital base of banks to twenty five billions naira (#25billion) from two billion (#2 billion), with the objective of creating a sound and more secure banking system that depositor can trust the banking system in Nigeria through mergers and acquisitions which enhanced operational capital base. These and many more, act as a spring board to achieving improved efficiency.

The recent mergers and acquisitions in Nigeria are attracting much attention partly because of the heightened interest in what motivate firm to merge and how merger and acquisition affect competition. One often held the view of mergers and acquisitions,

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especially those involving banks, is that firms are merging just to get bigger. Accompanying this notion is a fear that as merging firm grab greater market share, individual freedom and competition are threatened, because bigger is perceived as greater concentration of power. While mergers and acquisitions have certainly reduce the number of banks nationwide, concentration of power in local banking market have not increased. And the very force of regulatory changes that spurred bank mergers and acquisitions is also bringing new sources of competition to local banking markets. Hence, mergers and acquisitions are playing a useful role in reshaping the banking industry. This study seeks to analyse the financial efficiency of banks in the pre and post merger and acquisition era in Nigeria with special focus on the First Bank of Nigeria Plc, Wema Bank Nigeria plc, and Access Bank Plc.

2. LITERATURE REVIEW AND THEORITICAL FRAMEWORK

Mergers entails the coming together of two or more firms to become one big firm while acquisition is the takeover or purchase of a small firm by a bigger firm, which are both pursuing similar motives (Ganghan, 1999; Amedu, 2004; Bello, 2004; Kathy, 2005). Accordingly, Soludo (2004) opines that mergers and acquisitions are aimed at achieving cost efficiency through economics of scale, and to diversity and expand on the range of business activities for improved performance.

Numerous studies have empirically examined whether mergers and acquisitions are solutions to bank problems. The studies of Carlelti, Hahtmaan, and Spagnolo (2002) and Szapery (2001) provides the foundation for a research on the linkage between bank mergers and acquisitions and profitability. Evidence provided by De-Nicolo (2003) and Caprion (1996) suggests that mergers and acquisitions in the financial system could impact positively on the efficiency of most banks. Surprisingly, the available empirical evidence suggests that mergers and acquisitions operations in the United States banking industry have not had a positive influence on performance in terms of efficiency.

Also, evidence supporting mergers and acquisitions to achieve cost saving and efficiency gain is sparse (Kwan and Eisenbeis, 1999). Akvein, Berger and Humphrey (1997) analyse changes in profitability experienced in the same set of large mergers as examined by Berger and Humphrey (1997). They found that banking organisations significantly improved their profit efficiency ranking after mergers. DeYoung (1997) finds out that when both the acquirer and target were poor performers, mergers resulted in improving their performance. Healy, Palepu and Ruback (1992) examine all commercial banks and bank holding company mergers and acquisitions occurring between 1982 and 1986. They found that mergers and acquisitions did not reduce non-interest expenses that could have led to improved efficiency. According to Pilloff and Santomero (1997), there is little empirical evidence of mergers achieving growth or other important performance gains. Their finding undermines a major rationale for mergers and consequently raised doubt about other benefits mergers and acquisitions may provide to businesses.

However, Kay (1993) finds some evidence of superior post merger period because of the merged firms' enhanced ability to attract loans. They also show increased employee productivity and net asset growth. Also, this is evident in the Nigeria's banking industry (Okpanachi, 2007). Walter and Uche (2005) posit that mergers and acquisitions made Nigerian banks more efficient. They used table to present their data which was analysed using simple percentage. Akpan (2007) using chi-square to test his stated hypothesis found that the policy of consolidation and recapitalisation has ensured customer's confidence in the Nigerian banking industry in terms of high profit. But for Sobowale (2004) and Osho (2004), it is expected that the value of the companies that participated in mergers and acquisitions activities would be higher than before because future dividends and earning streams are expected to rise and subsequently improves efficiency.

Similarly, Uchendu (2005) and Kama (2007) opine that, the bank consolidation which took place in Malaysia facilitated banks expansion which led to growth in their banking sector. In a related study of the Chilean banking industry, Kwan (2007) finds that the experience in Chile was mainly from productivity's improvement from the large banks formed as a result of mergers and acquisitions.

Surprisingly, the majority of studies comparing pre and post mergers performance found that, this potential efficiency derived from mergers and acquisitions rarely materialize (Akvein et al., 1997). Towards this end, Beital, Schiereck and Wahrenbur (2003) finds no gain effect due to mergers and acquisitions, but for Kama (2007), mergers and acquisitions played an important role in improving banking performance after merger and financial performance which is a stimulus for efficiency.

According to Bwala (2003), efficiency is the ratio of a system's effective or useful output i.e. its total output. It can also be defined as the degree to which actual output(s) deviate from the optimum given a unit of measures of input. Akvein et al. (1997) say that economic literature distinguishes four types of efficiency: productive efficiency, transactional efficiency, allocative efficiency and dynamic efficiency.

- *Productive efficiency:* Is the ability of firms to get the highest output from the least input given current technological constraints. According to Merjaarel (2005) mergers can influence productive efficiency through economics of scale, economics of scope and synergies.

- *Transactional efficiency:* This recognizes that firms expend resources to protect the economic returns to their efforts and properly right.
- *Allocative efficiency:* Concerns the clearance of markets and the achievement of maximal consumer benefits given a particular production function.
- *Dynamic efficiency:* Concerns the clearance of markets in a dynamic perspective through the improvement of existing products and processes and the development of new products.

The directive by Central Bank that banks should raise their capital base to the tune of ₦25 billion has several implications for both the banking industry and Nigerian economy at large. These implications are as follows: with respect to the banking industry, the implications can be categorized into two parts namely; brand and structural implications.

With regards to brand implications, the new entities that will come from the just of merger and acquisitions will need to deal with brand related issues such as:

- There will be a change of name if two or more banks come together and decide not to adopt any of the participating bank name.
- The logos which were formally used by each of the banks will be dropped and another one adopted.
- There will also be the evolution of a new brand culture for the emerging banks
- The place of information communication technology in the bank will be changes, that is, banks software as the new banks will go for the best to meet up customers demand.

The recapitalisation of banks will leave in its wake, a number of structural issues which will have direct impact on staff, customers and the entire banking sector, these include:

- The reduction in the number of banks in the country
- Increased competition due to better incentives and rendering of bank services
- Acquisition digestion issues which will include loss of jobs, consolidation of branch locations and tackling of inefficiencies and bureaucracies, reconstitution of management and board of banks.

2.1 Motives behind Mergers and Acquisitions

These motives are considered to add to shareholders value:

a. *Economies of scale:* This refers to the fact that the combined company can often reduce duplicate departments or operations, lowering the costs of the company relatives to the same revenue stream, thus increasing profit.

b. *Increased revenue /market shares:* This motive assumes that the company will be absorbing a major competitor and thus increase its power to set prices.

c. *Synergy:* When 2 + 2 = 5 and not 4, synergy is said to have taken place. This occurs when the combination two or more processes or activities gives a higher result than what should ordinarily be gotten when results independently gotten are combined.

d. *Taxes:* A profitable company can buy a loss maker to use the target's loss as their advantage by reducing their liability.

e. *Geographical or other diversification:* This is designed to smooth the earning results of a company, which over the long term smoothen the stock price of a company giving conservative investors more confidence in investing in the company.

2.2 Empirical Literature on Mergers and Acquisition of Banks

Many researchers have attempted to examine the effect of mergers and acquisitions on the efficiency of the banking industry. For instance, Tripe (2000) analysed a small sample of seven to fourteen banks, employed accounting ratios and two Data Envelopment Analysis (DEA) models to explore the efficiency of six banks mergers in New Zealand between 1989 and 1998. They found that the acquiring banks to be generally larger than their existing ones, although they were not consistently more efficient. They found that five or six merged banks had efficiency gains based on the financial ratios while another only achieved a slight improvement in operating expenses to average total income. Based on DEA analysis, they found that only some merged banks were more efficient than the target banks pre-merger. The results suggest that four banks had obvious efficiency gains post merger. Gourlay (2006) examined the efficiency gains from mergers among Indian Banks over the period 1991-1992 to 2004-2005 and observed that the mergers led to improvement of efficiency for the merging banks.

2.3 Mergers and Acquisitions in Nigeria Banking Industry

The former governor Soludo released a consolidation reform time table for the banking industry in line with the policy thrust of the national economic empowerment development strategy (NEEDS) document requiring banks in Nigeria to raise their minimum capital base ₦2 of ₦25 billion with Dec. 31, 2005 as dead line. At the end of 31st December 2005, 25 groups emerged from 75 banks out of the 89 licensed banks in the country.

The consolidation of the banking industry in Nigeria during 2004 and 2005 resulted in the reduction of the numbers of banks from 89-25 as at December 31,200 and further reduced to 21 as at November 2012 with merging and acquisition of Access Bank Plc and

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Intercontinental Bank Plc, Eco Bank and Oceanic Bank Plc, Stanbic Nigeria Bank Ltd and IBTC Chartered Bank Plc.

3. RESEARCH METHODOLOGY

This study made use of secondary data obtained and computed from the banks published annual reports and accounts covering the period from years 2002 to 2009.

In this study, the collected data were analysed using t-test statistic at 5% level of significance with the aids of statistical package for social science (SPSS) which is an improvement on the ordinary student t- test. The t-test statistic formula is given as:

$$|\tau_0| = \frac{\overline{X}_1 - \overline{X}_2}{\sqrt{Sp^2\left(\frac{1}{n_1} + \frac{1}{n_2}\right) \infty\, t \frac{\alpha - V}{2}}}$$

where: $V = n_1 + n_2 - 2$

$$Sp^2 = \frac{(n_1 - 1)S_1^2 + (n^2 - 2)S_2^2}{n_1 + n_2 - 2}$$

where:

$\overline{X}_1 = mean\ of\ the\ pre-merger\ and\ acquisition$

$\overline{X}_2 = mean\ of\ the\ post-merger\ and\ acquisition$

$n_1 = number\ of\ years\ for\ pre-merger$

$n_2 = number\ of\ years\ for\ post-merger$

$S_1^2 = \text{var}iance\ of\ pre-merger$

$S_2^2 = \text{var}iance\ of\ post-merger$

$Sp^2 = pooled\ \text{var}iance$

$V = \text{deg}ree\ of\ freedom$

$\infty = 5\%\ level\ of\ significance$

$|\tau_0| = absolute\ value\ t-test$

The data collected and presented in the tables below were analysed using t-test statistic at 5% level of significance with the aid of statistical package for social sciences (SPSS). The tables showed the financial efficiency parameters in terms of gross earnings, profit after tax and net asset extracted from the annual reports and accounts of the three selected banks.

This study aimed at analysing the financial efficiency of banks in the pre and post merger and acquisition of banks. Here, the study extracted the gross earnings, profit after tax and net assets from the published annual reports and accounts of three sampled banks in order to test the formulated hypothesis and make analysis for interpretation of the results.

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Decision Rule:

Reject H_0 if $\rho - value$ is less than $x - value$. Otherwise, there is no sufficient reason to reject the null hypothesis H_0.

Table 1: Access Bank Plc extracted Financial Parameters (2002—2009)

Table 1a: Period of pre-mergers/acquisitions

Years	***2002 (₦m)***	***2003 (₦m)***	***2004 (₦m)***	***2005 (₦m)***
Gross earnings	2,604,378	4,367,887	5,515,086	7,494,855
Profit after tax	55,245	556,573	637,473	501,515
Net assets	1,943,784	2,365,357	2,702,830	14,071,924

Table 1b: Period of post mergers/acquisitions

Years	***2006 (₦m)***	***2007 (₦m)***	***2008 (₦m)***	***2009 (₦m)***
Gross earnings	13,360,358	27,881,451	57,627,098	84,643,020
Profit after tax	737,149	6,083,439	16,056,464	22,885,794
Net assets	28,893,886	28,384,891	171,002,026	173,151,023

Source: Researchers Computation from the published Annual Reports and Accounts.

Table 2: First Bank of Nigeria Plc extracted Financial Efficiency Parameters (2002—2009)

Table 2a: Period of pre-mergers/acquisitions

Years	***2002 (₦m)***	***2003 (₦m)***	***2004 (₦m)***	***2005 (₦m)***
Gross earnings	46,267	50,597	51,318	49,475
Profit after tax	4,776	11,010	11,483	12,184
Net assets	19,406	27,006	41,605	48,726

Table 2b: Period of post mergers/acquisitions

Years	***2006 (₦m)***	***2007 (₦m)***	***2008 (₦m)***	***2009 (₦m)***
Gross earnings	61,243	79,299	130,600	185,189
Profit after tax	16,053	18,355	30,437	35,074
Net assets	64,277	83,267	339,847	351,054

Source: Researchers Computation from the published Annual Reports and Accounts

Table 1a and 1b show the gross earning profit after tax and the net assets prior to and after mergers and acquisitions of the above name bank. Table 2a and 2b show the gross earning, profit after tax and the net assets prior to and after merger and acquisition of the above name bank.

Table 3: Wema Bank Plc extracted financial efficiency parameters (2002-2009)

Table 3a: Period of pre-mergers/acquisitions

Years	*2002 (₦m)*	*2003 (₦m)*	*2004 (₦m)*	*2005 (₦m)*
Gross earnings	7,919,749	9,716,374	12,856,096	15,287,866
Profit after tax	1,481,667	1,477,775	967,148	844,285
Net assets	3,768,119	7,215,393	8,040,348	24,258,860

Table 3b: Period of post mergers/acquisitions

Years	*2006 (₦m)*	*2007 (₦m)*	*2008 (₦m)*	*2009 (₦m)*
Gross earnings	14,836,623	26,430,982	51,279,366	18,994,974
Profit after tax	(6,601,961)	2,554,098	4,217,641	(6,763,434)
Net assets	20,540,001	25,182,705	31,061,406	45,837,971

Source: Researchers Computation from the published Annual Reports and Accounts

Table 3a and 3b show the gross earning, profit after tax and the net assets prior to and after merger and acquisition of the above name bank.

4. DISCUSSION OF FINDINGS

From the tables, all the selected banks witnessed improved financial performance as a result of merger and acquisition activities leading to more financial efficiency. To test the stated hypothesis, the study applied the t-test statistic with the aid of SPSS which produced result shown in tables 5, 6and 7.

Tables 5, 6 and 7 show the computed t-test from the SPSS output of the sampled banks financial efficiency parameters prior to and after mergers and acquisition activities. It depicted the combined means, standard deviation and the calculated p-value of the three banks after merger and acquisition bids, their combined means for gross earnings increased and that of profit after tax declined as a result of high tax charges while the net asset recorded tremendous increase due to investment in more fixed assets.

Looking at the result of the t-test, one is made to conclude that bank merger and acquisition has no significance impact on financial efficiency of selected banks with regards to the net assets and profit after tax. This arose from the fact that the calculated p-value $> \infty - value$ i.e. 0.361>0.05 for profit after tax and the calculated P-value is $> \infty - value$ i.e. 0.090 > 0.05 net assets and there is no sufficient reason to reject the null hypothesis, hence there is no significance difference between the pre and post merger and acquisition periods in terms of profit after tax and net assets. On the other hand, base on the data collected, the calculated p-value i.e. $0.027<0.05$ for gross earnings therefore the null hypothesis is rejected; hence there is a significant difference between the pre and post merger and acquisition periods in terms of gross earnings. But for Adereti and Sanni (2007), there was a significant increase in profitability of the four banks used in his study after the consolidation exercise in the Nigerian banking sector while the profitability of other thirteen banks significantly decreased.

5. CONCLUSION AND RECOMMENDATIONS

Consequently, the paper recommends that the banks should put in place strategies that would improve their performance, stability and growth. Also banks should be more aggressive in financial efficiency for an improved financial position in terms of profit after tax, net assets and also on gross earnings in order to reap more the benefits of post mergers and acquisitions bid in the Nigerian banking sector.

The paper attempted to make a comparative analysis of the financial efficiency of banks in the pre and post mergers in Nigeria. The results showed an enhanced financial performance leading to improved financial efficiency.

There are mixed evidences from researchers on the relationship between mergers and acquisitions, financial efficiency, profitability and performance. Caprion (1999) and De-Nicolo (2003) opines that mergers and acquisition in the financial system impact positively on both the financial and operation efficiency of most banks, but De Long & De Young (2007) suggests that mergers and acquisitions in the united states banking sector did not have a positive influence on performance is terms of improved financial efficiency.

However, it is still impossible to clearly state whether mergers and acquisitions in the Nigeria banking sector led to improved financial efficiency. This is because mergers and acquisitions in the Nigeria banking sector is a continuous scheme. Also, most of the conclusion reported by researchers on performance pattern of Nigerian banks as a result of mergers and acquisitions concentrate on using similar variables with fewer banks as population samples for their studies.

This study concludes that though there is no significant difference between the pre and post mergers and acquisition periods in terms of profit after tax, net assets as the calculated p-values is greater than the x-value at 5% level of significance and on the other hand, base on the data collected, there is a significant difference in terms of gross earnings as the p-value calculated is less than the $x-value$ at 5% level of significance. These results could be

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attributed to the fact that most of banks spend huge sums of money after the mergers and acquisition to expand branches, invested on it, etc.

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APPENDIX

Table 4: **t-Test**

Group Statistics

	GROUPS	N	Mean	Std. Deviation	Std. Error Mean
GROSS EARNINGS	PRE-MERGER	4	1.6490E7	5.30869E6	2.65434E6
	POST MERGER	4	7.3878E7	3.91304E7	1.95652E7

Independent Samples Test

			GROSS EARNINGS	
			Equal variances assumed	Equal variances not assumed
Levene's Test for Equality of Variances		F	26.109	
		Sig.	.002	
t-test for Equality of Means		T	-2.907	-2.907
		Df	6	3.110
		Sig. (2-tailed)	.027	.060
		Mean Difference	-5.73881E7	-5.73881E7
		Std. Error Difference	1.97444E7	1.97444E7
	95% Confidence Interval of the Difference	Lower	-1.05701E8	-1.18981E8
		Upper	-9.07515E6	4.20456E6

Source: SPSS OUTPUT

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Table 5: ***t*-Test**

Group Statistics

	GROUPS	N	Mean	Std. Deviation	Std. Error Mean
GROSS EARNINGS	PRE-MERGER	4	1.6490E7	5.30869E6	2.65434E6
	POST MERGER	4	7.3878E7	3.91304E7	1.95652E7

Independent Samples Test

			GROSS EARNINGS	
			Equal variances assumed	Equal variances not assumed
Levene's Test for Equality of Variances		F	26.109	
		Sig.	.002	
t-test for Equality of Means		T	-2.907	-2.907
		Df	6	3.110
		Sig. (2-tailed)	.027	.060
		Mean Difference	-5.73881E7	-5.73881E7
		Std. Error Difference	1.97444E7	1.97444E7
	95% Confidence Interval of the Difference	Lower	-1.05701E8	-1.18981E8
		Upper	-9.07515E6	4.20456E6

Source: SPSS OUTPUT

Table 6: **t-Test**

Group Statistics

	GROUPS	N	Mean	Std. Deviation	Std. Error Mean
PROFIT AFTER TAX	PRE-MERGER	4	6.2265E6	9.47984E6	4.73992E6
	POST MERGER	4	1.3159E7	1.03366E7	5.16829E6

Independent Samples Test

C			PROFIT AFTER TAX	
			Equal variances assumed	Equal variances not assumed
Levene's Test for Equality of Variances		F	.213	
		Sig.	.661	
t-test for Equality of Means		T	-.989	-.989
		Df	6	5.956
		Sig. (2-tailed)	.361	.361
		Mean Difference	-6.93216E6	-6.93216E6
		Std. Error Difference	7.01271E6	7.01271E6
	95% Confidence Interval of the Difference	Lower	-2.40916E7	-2.41227E7
		Upper	1.02273E7	1.02584E7

Source: SPSS OUTPUT

Table 7: **t-Test**

Group Statistics

	GROUPS	N	Mean	Std. Deviation	Std. Error Mean
NET ASSET	PRE-MERGER	4	1.6126E7	1.49920E7	7.49602E6
	POST MERGER	4	1.0948E8	9.13819E7	4.56909E7

Independent Samples Test

			NET ASSET	
			Equal variances assumed	Equal variances not assumed
Levene's Test for Equality of Variances		F	91.222	
		Sig.	.000	
t-test for Equality of Means		T	-2.016	-2.016
		Df	6	3.161
		Sig. (2-tailed)	.090	.132
		Mean Difference	-9.33502E7	-9.33502E7
		Std. Error Difference	4.63018E7	4.63018E7
	95% Confidence Interval of the Difference	Lower	-2.06647E8	-2.36538E8
		Upper	1.99461E7	4.98374E7

Source: SPSS OUTPUT