MERGER AND ITS IMPACT ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN NEPAL

A Thesis proposal

By

Laxman Bahadur Dhami

Central Department of Management

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Introduction

1. Background of the study

Merger is the combination of two or more entities through a purchase acquisition or pooling of interests, it is different from consolidation as there is no new entity is created from merger. Those organizations who adopt strategy of merger or acquisition have motives like to gain advantage of economy of scale, economy of scope, increase market share and revenues, taxation, synergy, geographical and other diversification. Due to these reasons, banks merged with one another or targeted by acquiring bank. Recently, the financial sector of most of the countries and their entire economy has been the focus both in the business circles and in the media, in terms of exceptional challenges being faced. Regulatory measures are being followed at both micro level as well as the macroeconomic level in order to improve the future condition of the different sectors that are under financial pressure or under financial crises. Many mergers and acquisitions take place in order to overcome these financial crises. This increase of mergers and acquisitions will change the entire structure of financial industry with the objective of making this sector sound and decrease risks attached to financial industry.

Mergers, acquisitions and takeovers, consolidation have been a part of the business world for so many years ago. In today’s dynamic economic environment, the main objective of a company is to maximize the shareholder’s wealth. Through mergers and acquisitions, a company can develop a competitive advantage and ultimately increase shareholder value. A merger involves a blend of two companies, rather than mere legal enjoinment or absorption of one firm into another merger as a process in which one of the two companies loses its identity to make a one firm. In merger transaction involving two or more companies in the exchange of securities and only one company survives.

There are various strategic and financial objectives that influence mergers and acquisitions. According to Sudarsanam (2003) two organizations with often different corporate personalities, cultures and value systems are bought together. Merger or Amalgamation may take two forms: i) Merger through absorption: It is a combination of two or more companies combines together into an existing company. In absorption, all companies except one lose their identity. ii) Merger through consolidation: It is a combination of two or more companies into a new company. In case of consolidation through merger, all companies are legally dissolved and a new entity is created.

Bank mergers is claimed to be the sources of efficiency gains from the realization of economies of scale and economies of scope, the removal of overlapping services and the increasing awareness of innovative banking tools; however, one needs to read over the assertions with caution. It is due to the fact that much of the prior research has focused on the market driven merger or the voluntary merger. At the one hand, the voluntary bank merger refers to the process by which two or more banks merged and become one new entity. The merger takes place without any objection from the shareholders and the board of both banks.

Banking sector plays a leading role in financing country economic activities.Performance of banking sector is measured by Capital adequacy, assets quality, management efficiency, earning efficiency, liquidity. Performance of the banks is measured at two level, one is at the management and regulatory level of the banks and another is at external rating agencies. Purpose of regulatory and supervisory rating systems is to measure the bank performance at internal level and its compliance with regulatory requirements to keep the bank on right track. These ratings are highly confidential and are only available to the bank management. External credit rating agencies examine and evaluate the banks and issue ratings for the general public and investor in particulars. It is great importance that both these rating present the same results about the condition of the banks to provider clear information to investor and management.

2. Problem statement and research questions.

The study covers the analysis of the merger and its impact on financial performance of commercial banks in Nepal. Shareholders and managers of banks turn to mergers and acquisitions in the hope of improving financial performance in their banks but studies on this subject have produced mixed results. It is new concept in Nepalese BFIs and there is a lot of confusion about the merger and their impacts on the long term growth and profitability of the BFIs. Mergers have become the main means of attaining higher performance which is the ultimate goal of every firm, including banks. Some studies have suggested that merging banks perform better than the individual banks performed before the merger whereas other studies have not found any meaningful improvement in financial performance as a result of a merger.

This study is designed to fill the knowledge gap by answering the research question, what is the impact of Mergers and Acquisitions on the overall financial performance of commercial banks in Nepal? This study tries to answering the following questions.

i. What is the impact of merger on liquidity position of banks?
ii. What is the profitability position change after the merger?
iii. Is there any different in capital adequacy position before and after the merger?

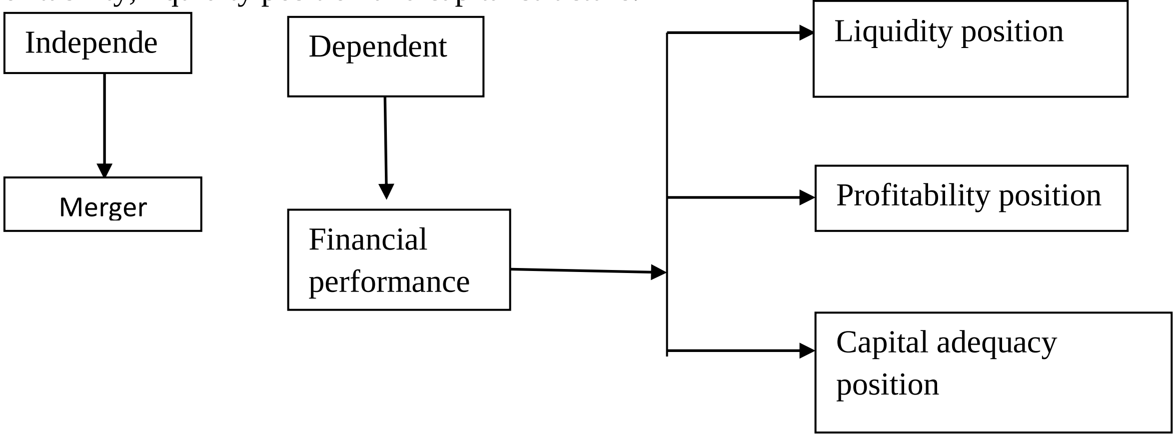
3. Objective of the study

The main objective of the study is to analysis the effect merger on the financial performance of banks.

i. To analyze the impact of merger on liquidity position of banks.
ii. To examine the impact of merger on profitability position of banks
iii. To assess the impact of merger on capital adequacy position of banks.

4. Conceptual framework

The following conceptual framework is developed for the purpose of this study. It shows the relationship between the merger as independent variable and the financial performance as dependent variable. The dependent variable (financial performance) is measured by using financial ratios, grouped into three categories including profitability, liquidity position and capital structure.



5. Rationale of the study

The study would have significance to a number of stakeholders. The study would be of value to investors and firms in NEPSA in having knowledge on the understanding of the importance of mergers and acquisitions in analyzing company performance. It would also benefit other firms in competitive industry and others not listed at NEPSA. The study would further provide more insight into the relationship between mergers and acquisitions and performance of commercial banks which would be of value to academicians and researchers in the same field. The environment is very dynamic making it a requirement for practitioners of management to update themselves and their respective industries on the best practices required. The study would also contribute to the bulk of knowledge and research at the University as it would be used as a basis of reference by students for any future study in the field of mergers and acquisitions.

6. Limitations of the study

This study tries to examine the effect of merger on financial performance of commercial banks in Nepal, still it has its own restrictions which are as below.

i. There are many variables that can be used to measure the performance of bank but this study cover only ROA, ROE, EPS, profit margin, assets quality, debt to equity ratio, CAR, liquidity ratios.
ii. There will be insufficiency of data availability due to some unfavorable conditions.
iii. Primary data will not be used in this research so that the qualitative aspects can- not be explore from this study.
iv. There will be small size of sample so that the research might not generalized whole population of 27commercial bank.

7. Literature review

Bipan Prakash, (2018) Explain that Banks play a critical role in the economic development of any country. For developing countries it works as blood circular in the economy. Since the financial market of Nepal(as a developing country) is characterized by numerous glitches, the Nepal Rastra Bank issued the merger guidelines (“Merger-by-Laws-2011”) in order to bring stability in the financial sector and to regulate the banking sector. This study finds the impact of mergers on financial performance of banks in Nepal. The findings depict a positive impact towards mergers and provide bank stakeholders with insights upon which they can base their decisions concerning.

Mergers Dwa and Sha (2017) this study aims to find the impact of mergers on operating performance of sample merged banks. To attain the research objective, this study has taken 8 independent variables; operating profit margin, net profit margin, return on assets, return on equity, debt equity ratio, return on loan loss provision, return on staff expenses and return on operating expenses. Three cases have been taken for the study as a sample to examine whether merger has led to a profitable situation or not. Research mainly focuses on quarterly secondary data which is analyzed using paired sample t-test, correlation analysis, and regression analysis. From the analysis it is deduced that merger has no significant role in case of Bank of Kathmandu and Lumbine bikash bank in terms of various financial ratios, since many financial ratios have been found weaker in post-merger period than pre-merger period. But merger plays a significant role in case of NMB Bank where almost all financial ratios have improved in post-merger. While analyzing the situation of overall commercial banking sectors, with the help of sampled data, it is observed that largely the merger isn't able to produce positive results for the merged entities. The study shows the reason for negative result of merger as the poor financial position of the target banks. Further the merger will somewhat act as a solution for the current problems of Nepalese BFIs. Merger will be a wise option to bring BFIs in strong and growing position and to meet the requirement of current paid up capital as per the latest NRB directive. But it also must be considered that merger in itself is not the ultimate solution to strengthen the financial position of BFIs. A lot of factors must be taken into account before finding the right partner to merge with and executing the merger.

Joash (2015) Mergers and Acquisitions perform a vital role in corporate finance in enabling firms achieve varied objectives and financial strategies. In Kenya, banks have been merging with the goal of improving their financial performance. Studies done on mergers and acquisitions have not conclusively established whether or not banks benefit from mergers. Most studies have observed that mergers did not lead to an improvement in financial performance as indicated by their profitability and earnings ratios. This study examined the banks that have merged or acquired in Kenya for the period between 2000 and 2014. The aim of the study was to analyze whether the merger had any effect on the banks' performance. The study was guided by the following specific objectives; to determine the effect of the mergers and acquisitions on the shareholders' value and to sexamine the implication of mergers and acquisitions on profitability. The study was a census of which all the 14 banks that have merged or acquired others in the period from 2000 to date were investigated. Data was collected by use of questionnaires with both open and closed ended questions. The collected data was analyzed using SPSS where the co-efficient of correlation obtained was used to determine the nature of the relationship between the independent and dependent variables. The study found out that the mergers and acquisitions raised the shareholders' value of the merged/acquiring banks in Kenya. The study further revealed that the main reason why most banks merged or acquired was to raise their profitability. The research questions were significant to the study and useful in arriving data conclusion. The researcher recommended that thorough feasibility studies should be carried out before the merger/acquisition process can be done. On areas of further research, it was recommended that effect of mergers/acquisitions in other sectors of the economy should be established with a view of drawing a parallel with the effects of the same processes in the banking sector.

8. Research gap

After review the past article end thesis impact on merger on financial performance of commercial banks. This research study is mainly differing than the previous research study due to the following reason.

i. This research focus on both measuring comparative financial performance and effect of merger on Performance of bank
ii. The ratios used ROA, ROE, EPS, Profit Margin, Assets Quality, loan and advance to total deposit, debt to equity ratio, Capital adequacy position to measure the financial performance of merged commercial banks which are different than the past researcher
iii. Past researcher cover the data up to 2016 AD only and his study cover the data form fiscal year 2014/15 to 2019/20
iv. Situational gap, sect oral gap, Area gap etc

8.1 Research design

Research design is the plan structure and strategy of investigation conceived to obtain answer to research question and to control variance. The first purpose is to answer the research question or test the relationship the second purpose of a research design is to control variance. The purposed study will be carried out successfully by collecting information regarding the behavior/ attitude of the bank personnel, borrowers, and the policies of the banks through personal interviews and written sources as well. Moreover, the study will be conducted in the light of central bank's rules and regulations that abide the commercial banks.

This research used descriptive and analytical research design in order to examine impact of merger on the financial performance of commercial banks. The methods of research utilize in descriptive research are survey method of all kinds, including comparative and co-relation methods. In analytical research, on the other hand, the researcher has to use facts or information already available, and analyses these to make critical evaluation of the material.

8.2 Population and sample

Population: The populations for this research are all the commercial banks which are marched after the merger and acquisition bylaw 2011 AD implemented. According to the monetary policy 2019/20 AD, in line with the Merger & Acquisition Policy of this Bank, a total of 171 BFIs have undergone through the merger/acquisition process as of mid-July 2019. Out of these, license of 128 institutions has been revoked thereby forming 43 institutions. Among them 12 are the commercial banks. These 12 merged commercial banks are taken as the population for the study.

Sample

Out of 12 merged commercial banks, three commercial banks, NMB bank, bank of Kathmandu Lumbini Limited (BOK), Siddhartha Bank Limited (SBL) which all are merged in 2015 AD are selected as sample by using systematic random sampling. The sample size of this study is three and sampling interval of this study is 4th, which is calculate dividing size of population by size of sample. Every 4th element in the population is chosen starting form a random point in the population frame.

8.3 Source of data

The thesis will be based on the secondary data collected regarding the merger and its impact on financial performance in banks, NRB publication, Journals, Websites, Laws, guidelines and directives regarding the subject matter listed in reference below.

8.4 Data collection and processing procedure

After the identification of sample bank, the sources of data required for the study are also identified and collected through following procedures

- First of all nature of data have been identified.
- For the collection of secondary data yearly annual report of the sampled bank has been taken for the period of years.

8.5 Data analysis tools and techniques

The data collection from various sources are recorded systematically and presented in appropriate from of tables and charts and appropriate mathematical, inferential, financial, graphical tools are applied to analyze the data. And data of four consecutive of the selected bank are used to meet the objective of the study.

Financial tools

- Return on assets
- Return on equity
- Profit margin ratio
- Debt to equity ratio
- Earning per share
- Capital adequacy ratio

Statistical tool

- Arithmetic mean
- Standard deviation
- Correlations of coefficient and regression analysis.

9. Chapter plan

The research will be organized into five chapters which will be presented in such a way that the research objective will be easily meet and research questions will be answered properly. The results and findings of the study will depict systematic manner. Each chapter's content is further described as follows:-

Chapter 1: Introduction

This chapter includes background of the study, statement of the problems, objectives of the study, conceptual framework, and significance of the study, limitation of the study and organization of the study.

Chapter 2: Review of literature

This chapter includes the relevant previous writing and studies to find the existing gap; review of textbook, dissertation is included in this chapter.

Chapter 3: Research methodology

This chapter explains about research methodology will be used for the study. it will cover research design, population and sample, sources of data, data analysis and software used.

.**Chapter 4: Result and discussion**

This chapter consists of systematic presentation and analysis of financial statement employing financial and statistical tools. It also includes major findings and discussion.

Chapter 5: Summary and Conclusion

This chapter finally summarizes the study in few paragraphs and tries to conclude the whole study; that is result of the research. And finally depending upon the summary and conclusion has been given.

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