Chapter 1

Introduction

1.1 Background

Owing to globalization, liberalization, improvements in technology, and competitive business environment, mergers and acquisitions are becoming more important throughout the world (Leepsa & Mishra, 2012: Usman, Mehboob, Ullah, & Farooq, 2010). Merger and acquisition is the fast way for corporate firms to achieve the highest, effective, and sustainable growth level however, it introduces several risks to merged/acquired firms. Merger and acquisition activities are found in all sectors including banking sector. The most dominant reason for M&A to take place is the synergy that can be created by the combination of business activities which will lead to better, faster and low cost performances. Essentially, a business will attempt to merge with another business that has complementary strengths and weaknesses (Renaud, 2016).

Finance theories suggest both positive as well as negative effects of mergers and acquisitions on corporate firms' performance. According to merger and acquisition theory, successful merger and acquisition deals increase the profitability of the merged/acquirer firms. This increase in profitability could be result of improved monopoly or an increase in efficiency (Beena, 2000). On the other hand, according to the managerial theory of a firm, mergers and acquisitions have a negative impact on merged/acquirer firm's financial performance and profitability specifically (Ghatak, 2012; Kumar & Bansal, 2008).

In context of Nepal, liberalization in opening of banking and financial institution led to mushrooming of banking & financial institutions. Then, the Nepalese Banking sector faced a huge problem and was in critical juncture. So, in order to cope with the problem, Nepal Rasta Bank (NRB) directed the Banking Institutions to go in the process of mergers and acquisitions with an aim to make few but strong institutions. The policy adopted by the NRB has started to pay back with the increase in the numbers of bank and financial institution for merger.

Although there are several advantages of mergers and acquisitions, and Nepalese banks have headed in this process, they have faced various problems. Merger and acquisition do not always lead to success or always failure. M&A depends upon how well the vision, mission and objective of two organizations are well integrated. Moreover, it depends on how effective the management is and how the stakeholders perceive the M&A decision. Knowing that Nepalese banking sector lacks sufficient corporate experience in mergers and acquisitions, the government should just not rely on mergers and acquisitions strategy for addressing the problem of banking sector. Rather, it should bring appropriate fiscal policies and monetary policies to settle the problem.

The success or failure in company's performance after merger can be measured with various financial tools and one of them is profitability. Profitability is the most influential variable in determining growth of firms through mergers and acquisitions in banking field. However, industry concentration, sales growth, stock market index and GDP growth also determines growth of firms through mergers and acquisitions but to a lesser extent.

Lucey (2000) indicated that the financial performance of the company can be expressed in terms of income generated from its operation, after offsetting expenses when the profitability of the firm is arrived at. Bidder variables are operationalized by assessing firm profitability which tends to positively influence mergers and acquisitions. Large and profitable firms often have or can better access financial resources that are needed to acquire other firms. More over large firms are expected to engage more in diversifying mergers and acquisitions as there may be few opportunities left for growth in their own industry ceteris paribus. These financial resources can also create value when used to acquire a financially constrained target firm thus a positive relation between profitability, firm size and M&A (Gaughan, 2002).

The study of financial performance in terms of profitability after the merger strategy adaptation by Nepalese commercial banks involves examining a company's financial statements and evaluating its operations. The study concludes that firms be encouraged to embrace M&A growth strategy in corporate finance especially when pursuing the profitability and wealth objectives. So the study is about the merger and acquisitions in banking industry and their ability to generate earnings in relative. The analysis is concerned only with variables directly related to the selected company.

1.2 Introduction to Nepalese Banking Sector

Nepal Rastra Bank is the central bank of Nepal which started its operation in 1956 under the Nepal Rastra Bank Act 1955. As per the information provided by Maskey and Subedi (2009), the history of banking sector in Nepal traces back to 1937 when the first ever bank was established in Nepal named as Nepal Bank Limited. In the study conducted by Maskey and Subedi (2009), they have stated that the history shows that Nepal Bank Limited was established was a semi government bank with NRs. 10 million as authorized capital and NRs. 892 thousand as paid up capital. The writers further indicate that in Nepal, metallic coins were in use until mid-forties because of which handling of money was very hard. Thus, then the Government of Nepal felt the need to establish separate body to handle the currencies as well as promote the financial organization in the country.

The writers further indicate that when Nepal Bank Limited was formed, the need of governing bank was felt slowly as Nepal Bank Limited had to act as a central bank without necessary laws and foundations and thus, Nepal Rastra Bank was established. Then, with a view to develop the industrial sector of Nepal, Industrial Development Bank was established in 1957, which later reformed to Nepal Industrial Development Corporation. Later, Rastriya Banijya Bank was established in 1965 as second commercial bank and Agricultural Development Bank was established in 1968 to develop the agricultural sector of Nepal. After that, there were no new banks in Nepal for almost two decades. The banking sector began to see new banks along with joint ventures after the liberalization and deregulation policy was adopted by Nepal Rastra Bank. Such financial sector policies, regulations and institutional developments were introduced from 1980. By introducing such policy, the government encouraged the private sector as well as foreign parties to increase their participation in the banking sector of Nepal. Currently, Nepalese banking sector consists of four categories of banks: category A as commercial banks, category B as development banks, category C as finance companies and category D as micro-finance development banks. Commercial banks of Nepal mostly specialize in accepting deposit and providing loans. Apart from that, they are allowed to provide service of currency exchange as per the direction provided by Nepal Rastra Bank. Development banks are more concerned with utilizing savings from the customers and redirecting them for various investment and development purpose. The function of finance company is also like that of any other depositary institution in Nepal performing depository and lending service. Microfinance development bank is more related with the rural areas and providing the deposit-loan function at the micro level to poor and disadvantaged groups. As per the Annual Report of Nepal Rastra Bank for the fiscal year 2013/14, the number of banks and financial institutions (including the cooperatives and non- government organizations with limited banking) licensed by the NRB decreased to 248 in mid-July 2014 from 254 a year ago. The decline in the total number banks and financial institutions (BFIs) was due to the merger of 64 BFIs into 25 after the promulgation of Merger By-Law, 2011. Accordingly, in mid-July 2014, the number of commercial banks remained 30, development banks 84, finance companies 53 and micro-finance development banks remained 33. Out of 37 “D” class microfinance institutions, there were 5 Grameen Bikas Banks (rural development banks), 28 replicators of Grameen Bank and 4 wholesale microfinance institutions in operation in mid-July 2014. On July 3, 2014, approval has been granted from NRB for the establishment of one national-level "Nepal Grameen Bikas Bank Ltd" with the merger of 4 rural development banks into Paschimanchal Grameen Bikas Bank. The number of deposit accounts and borrowers in these microfinance institutions reached 1.2 million and 1.1 million respectively. These microfinance institutions have provided services in 71 districts in mid-July 2014. The financial intermediary sector, in overall, grew by 1.8 per cent in 2014, as opposed to 0.8 per cent decrease in the previous year.

1.3 Merger and Acquisition in Banking Sector of Nepal

In recent years, mergers and acquisitions have been the burning issue in the banking sector. Complying with the global scenario, Nepalese banks and financial institutions are still going through the situation of merger and acquisition. The first banks to merge in Nepal were Himchuli Bikash Bank (category "B") and Birgunj Finance Limited ("C") on which the banks were renamed to H & B Development Bank Limited (National Level category "B") and the banking operation started from 15/06/2011 after merger. The Banks and Financial Institutions Acquisitions Bylaw came into practice only from 2014 (Nepal Rastra Bank Allows Acquisitions of Financial Institutions, 2014).

There are 28 commercial banks in Nepal along with 39 development banks and 27 finance companies till mid of October 2017, having paid up capital of not less than Rs 8 billion, Rs. 2.5 billion and Rs 800 million, respectively. And the number of micro finance financial institutions as on Mid October 2017 is 54.

The following table shows the list of commercial banks of Nepal till middle of October, 2017:

Table 1: List of Commercial Banks after merger

Class: "A" (Commercial Banks) (Rs. In Crore)

S. No.	Name	Operation Date (A.D.)	Head Office	Paid up Capital	Working Area
1	Nepal Bank Ltd.	1937/11/15	Dharmapath,Kathmandu	804.27	National Level
2	Rastriya Banijya Bank Ltd.	1966/01/23	Singhadurbarplaza,Kathmandu	858.90	National Level
3	Agriculture Development Bank Ltd.	1968/01/21	Ramshahpath, Kathmandu	1252.04	National Level
4	Nabil Bank Ltd.	1984/07/12	Beena Marg, Kathmandu	804.32	National Level
5	Nepal Investment Bank Ltd.	1986/03/09	Durbarmarg, Kathmandu	924.04	National Level
6	Standard Chartered Bank Nepal Ltd.	1987/02/28	Nayabaneshwor, Kathmandu	400.57	National Level
7	Himalayan Bank Ltd.	1993/01/18	Kamaladi, Kathmandu	649.16	National Level
8	Nepal SBI Bank Ltd.	1993/07/07	Kesharmahal, Kathmandu	697.18	National Level
9	Nepal Bangaladesh Bank Ltd.	1994/06/06	Kamaladi, Kathmandu	721.91	National Level
10	Everest Bank Ltd.	1994/10/18	Lazimpat , Kathmandu	611.52	National Level
11	Kumari Bank Ltd.	2001/04/03	Durbarmarg, Kathmandu	596.95	National Level
12	Laxmi Bank Ltd.	2002/04/03	Hattisar, Kathmandu	747.24	National Level
13	Citizens Bank International Ltd.	2007/04/20	Narayanhitipath, Kathmandu	802.92	National Level
14	Prime Commercial Bank Ltd.	2007/09/24	Kamalpokhari, Kathmandu	632.54	National Level
15	Sunrise Bank Ltd.	2007/10/12	Gairidhara, Kathmandu	709.22	National Level
16	Mega Bank Nepal Ltd.	2010/07/23	Kamaladi, Kathmandu	458.23	National Level
17	Century Commercial Bank Ltd.	2011/03/10	Putalisadak , Kathmandu	546.06	National Level
18	Sanima Bank Ltd.	2012/02/15	Nagpokhari, Kathmandu	800.13	National Level
19	Machhapuchhre Bank Ltd.	2012/7/9*	New Road, Pokhara, Kaski	737.45	National Level

20	NIC Asia Bank Ltd.	2013/6/30*	Thapathali, Kathmandu	803.11	National Level
21	Global IME Bank Ltd.	2014/4/9*	Panipokhari, Kathmandu	808.03	National Level
22	NMB Bank Ltd.	2015/10/18*	Babarmahal, Kathmandu	646.18	National Level
23	Prabhu Bank Ltd.	2016/2/12*	Babarmahal, Kathmandu	588.14	National Level
24	Siddhartha Bank Ltd.	2016/7/21*	Hattisar, Kathmandu	682.61	National Level
25	Bank of Kathmandu Ltd.	2016/7/14*	Kamalpokhari, Kathmandu	562.96	National Level
26	Civil Bank Ltd.	2016/10/17*	Kamaladi, Kathmandu	518.52	National Level
27	Nepal Credit and Commerce Bank Ltd.	2017/01/01*	Bagbazar, Kathmandu	467.91	National Level
28	Janata Bank Nepal Ltd.	2017/04/07*	Thapathali, Kathmandu	699.37	National Level

*Joint operation date after merger.

Note: http://bfr.nrb.org.np, 2017

1.3.1 Laws of Merger in Nepalese Banking Sector

Nepal Rastra Bank, the central bank of Nepal, has stated various conditions on which it can direct the banking and financial institutions for immediate merger. The conditions, obtained from the website of Nepal Rastra Bank under the policies titled “Merger By laws, 2011 (Including First Amendment)” on 2016 are:

a. If the various banking and financial institution are owned by the same family, relatives or groups
b. If there is shortfall of capital, then the banking and financial institutions must go for merger (for this, the commercial banks are supposed to have capital adequacy ratio of 10 per cent and development banks are supposed to have the capital adequacy ratio of 11 per cent)
c. If the banking and financial institutions have been treated with reformatory punishment for three or more times
d. If the banking and financial institutions are unable to fulfillment their responsibility of payments because of systematic risks
e. If the banking and financial scenario has better results if two or more banks get merged

f. If there are chances of negative results in the financial situation of the country when the banks and financial institutions are allowed to perform in as-is basis

The provisions of merger bylaws obtained from New Business Age (2013) under the policies titled “Merger By laws, 2011 (Including First Amendment)” on 2016 are:

a. A, B, C, class financial institutions can merge with each other but the D class financial institutions can merge only with another same class financial institution.
b. Banking and Financial Institutions (BFI) that want to merge should delegate separate merger committees from their annual general meetings and sign a memorandum of understanding (MoU).
c. The due process including a MoU should be endorsed with an action plan before applying to the Nepal Rastra Bank for a Letter of Intent (LOI). The NRB should hold a meeting within 15 days of receiving the LOI application.
d. The NRB has a right to grant whether to approve the LOI or not after meeting discussion and detailed study of the concerned financial institution.
e. After receiving a LOI from the central bank a due diligence audit should be completed within six months.
f. The detailed evaluation comprising assets, liabilities and transactions of the concerned institutions should be submitted to the NRB.
g. An agreement copy of the final decision regarding name, address and share ratio of concerned the BFIs should be submitted to the NRB.
h. An action plan of the concerned financial institution including date of operation after merger is completed should be submitted to the NRB.

1.3.2 Steps in merger process of Nepalese banks and financial Institutions

The steps in the merger process of Nepalese banks and financial institutions are:

a. Formation of merger committee: There will be formation of the committee including the directors from all the BFIs that are subjected to merge.
b. Special Annual General Meeting: Here, the AGM will be held with the discussion of objectives and reasons to the shareholders. The decision will be taken into consideration only if majority of shareholders agree on it.
c. Memorandum of Understanding: It explains the future plans after merger backed up by at least two third of consensus and also is used as a tool for legal commitment. This is submitted to Nepal Rastra Bank for merger.
d. Application to Nepal Rastra Bank for merger: Application is submitted to Nepal Rastra Bank stating current positions of the companies and their future objectives after merger.
e. Due diligence report: Prepared by the independent third party audit firm, it explains the information regarding net worth, capital adequacy, liquidity condition, types of loans and the like of the companies.
f. Final approval: The decision regarding merger is done by Nepal Rastra Bank based upon financial statements, memorandum of understanding, valuation of companies' asset and liabilities, location details and name of the companies about merge along with share valuation report, business plan after merger and the like.

1.3.3 Risk in merger and acquisition

Merger and acquisitions are not hundred percent risk free activities/achievements. With regards to various uncertain events there can be problems in or problems created by merger and acquisition. Clashes related to difference between organization cultures, inadequate information flows, lack of transparency etc. are the risks factors involved. Similarly, merger also means that there will be sharing of confidential information among the companies involved and by chance if the merger fails to occur, then it would result in the companies knowing things about each other that were supposed to be confidential.

A study was conducted by Nepal Rastra Bank (2015) among Nepalese banks with regards to the changes in risk management caused by merger and acquisition. Among the participants who were founders, 51.4 per cent stated that the result was positive, 41.1 per cent stated that the situation had not changed and 7.5 per cent state that the situation had worsened. Among the participants who were employees and managers, 41.1 per cent stated that the result was positive, 47.1 per cent stated that the situation had not changed while 11 per cent stated that the situation had worsened.

1.4 Statement of the Problem

In most merger arrangements, there is lack of a systematic and thorough attention paid to potential problems of the integration, particularly in aspects of financial performance Jemison & Sitkin (1986). Many mergers have occurred in Nepalese banking sector but there is no definite study to show the direct effects of merger in terms of profitability. There is no clear indicator of the benefits of a merger. There exists a high degree of calculated risk-taking to tap opportunities that come the way of business, but there is risk avoidance in business and where risk is low, development is also low and industrial advance merit becomes nearly static Rankine (1998). Merger and acquisition could also be a very expensive venture in terms of fund required to prosecute it successfully Harney (2011).

As merger and acquisition in banking sector has been a frequent activity in Nepalese banking industry which is an initiative followed by Nepal Rastra Bank with an aim of restructuring the banking industry in order to stabilize the banking system. Nepal Rastra Bank has stated in Nepalese language that after the deregulation in Nepalese banking sector, the number of banking and financial institutions increased but it did not lead to healthy competitive environment. Also, it was felt that there were many banking and financial institutions looking for institutional stability while others looking for safe and easy exit. This initiative resulted in various banks and financial institutions merged with choice of partners.

Among the merged commercial banks, Prabhu Bank, Global IME Bank, and NIC Asia Bank are in operation of more than 2 years after merger. So the studies regarding their profitability after merger are the areas of interest.

There are also various problems faced by the Nepal banking sector or various opportunities that the BFIs see when merging with or acquiring other banks. This study therefore sought to fill the knowledge gap that whether merger is fruitful to the company by analyzing the profitability of Commercial banks after merger and acquisition.

Therefore, this study deals with the following issues;

a. What is the profitability position of Global IME Bank, NIC Asia Bank, and Prabhu Bank after adopting mergers and acquisitions (M&As) strategy?
b. What are the impacts of M&A on the profitability position of Global IME Bank, NIC Asia Bank, and Prabhu Bank?

1.5 Objectives of the Study

- To measure the profitability position of Global IME Bank, NIC Asia Bank and Prabhu Bank after mergers and acquisitions (M&As); and
- To analyze the impact of mergers and acquisitions (M&As) on the profitability position of Global IME Bank, NIC Asia Bank and Prabhu Bank

1.6 Limitations of the Study

This study is simply a partial study for the fulfillment of M.B.S. degree, which has to be finished within limited period. Hence, this study is not far from several limitation of its own kind, which weakens the heart of the study. It has certain limitations.

- This study has employed mainly secondary data of six years (three years before and after the M&A, respectively) published in the annual reports of the selected banks.

- The study provides the information of the sample BFIs' performance in general.
- The accuracy of the research work dependents on data collected from organization's annual report.
- Use of limited analytical tools is another limitation of this study.

1.7 Organization of the Study

This study has been organized over altogether five chapters. Starting from Introduction, Literature review, Research methodology, Data Analysis and summary, to conclusion and recommendation as get of the entire study. A brief outline of this chapter has been outlined as under.

Chapter I "**Introduction**": It introduces the subject, present the research problem, reason for studying, objective of the study, along with limitation. In Chapter II "**Review of Literature**": It concerns with the conceptual framework of M&A reasons along with its factors and determinants has been reviewed and presented. In Chapter III "**Research Methodology**": It comprises research design, nature and source of data, data gathering method and analytical tools used. In Chapter IV "**Presentation and Analysis of Data**": This chapter deals with the presentation and analysis of data and scoring the empirical finding out the study through definite course of research methodology. In Chapter V "**Summary, Conclusion and Recommendation**": It is followed by the basic conclusion of the study based in the fourth chapter on the basic of these conclusions and recommendation has also been presented for consideration.

Chapter 2
Review of Literature

2.1 Introduction to Merger, Acquisition and Profitability

The issues of mergers, acquisitions and profitability are vital to a company that has undergone such organizational phases. The issues are discussed in the following paragraphs:

2.1.1 Merger

A merger is the complete absorption of one firm by another, wherein acquiring firm retains the identity and the acquired firm ceases to exist as a separate entity (Ross et al., 2003).

Types of Mergers:

a. Horizontal Mergers: Horizontal mergers happen when a company merges or takes over another company that offers the same or similar product lines and services to the final consumers, which means that it is in the same industry and at the same stage of production. Companies, in this case, are usually direct competitors (Different types of Mergers and Acquisitions (M&A), 2015). Example of horizontal merger is between Bank of Madura with ICICI Bank.
b. Vertical Mergers: A vertical merger is done with an aim to combine two companies that are in the same value chain of producing the same good and service, but the only difference is the stage of production at which they are operating (Different types of Mergers and Acquisitions (M&A), 2015). The example of vertical merger can be between Time Warner Incorporated and Turner Corporation.
c. Concentric Mergers: Concentric mergers take place between firms that serve the same customers in a particular industry, but they don't offer the same products and services. Their products may be complements, product which go

together, but technically not the same products (Different types of Mergers and Acquisitions (M&A), 2015). The example is, Coca Cola working with Six Flags Entertainment Company.

d. Conglomerate Merger: When two companies that operate in completely different industry go for merger regardless of the stage of production, then such merger is known as conglomerate merger. This is usually done to diversify into other industries, which helps reduce risks (Different types of Mergers and Acquisitions (M&A), 2015). The example of conglomerate merger can be between Walt Disney Company and American Broadcasting Company.

2.1.2 Acquisition

An acquisition is a transaction in which an individual or company, known as the offerer (or acquirer) gains control of the management and assets of another company, known as the offeree (or target), either by becoming the owner of these assets or indirectly by obtaining control of the management of the company, or by acquiring the shares (Firer et al., 2004, 759).

Types of Acquisition:

a. Stock Acquisition: The acquirer buys the target's stock of from the selling shareholders. In a stock purchase, all of the assets and liabilities of the seller are sold upon transfer of the seller's stock to the acquirer. As such, no tedious valuation of the seller's individual assets and liabilities is required and the transaction is mechanically simple. The acquirer does not receive a stepped-up tax basis in the acquired net assets but, rather, a carryover basis. Any goodwill created in a stock acquisition is not tax- deductible (Asset and Stock Deals, retrieved 2016).

b. Asset Acquisition: The acquirer buys some or all of the target's assets/liabilities directly from the seller. If all assets are acquired, the target is liquidated. The acquirer can choose which specific assets and liabilities it wants to purchase, avoiding unwanted assets and liabilities for which it does not want to assume responsibility. The asset purchase agreement between the buyer and seller will list or describe and assign values to each asset (or liability) to be acquired, including every asset from office supplies to goodwill (Asset and Stock Deals, retrieved 2016).

Takeovers can be friendly or hostile. As per Hanks (retrieved 2016), a friendly acquisition occurs when the acquiring company gives information to the target company's Board of Directors that it plans to purchase a controlling interest. The proposed buyout is then voted upon by the Board of Directors. The votes would decide whether the proposal should be accepted or not. If they voted in favor of proposal, then the acquiring company then takes control of the target company's operations. However, the acquiring company may or may not choose to keep the target company's board of directors in place. A hostile acquisition happens when the target company's board of directors does not vote in favor of the stock sale to the acquiring company. Agents of the acquiring company then will try to buy the target company's stock from other available sources, gain a controlling interest and force out the board members who voted against the acquisition. When this happens, the acquiring company will aggressively go after shares of the target firm, while the target's board of directors prepares to fight for survival (Hanks, retrieved 2016). Though merger and acquisition term is used interchangeably, there are some differences between them. S.S (2015) has indicated following as the types of differences between merger and acquisition:

1. A type of corporate strategy in which two companies amalgamate to form a new company is known as merger. A corporate strategy, in which one company purchases another company and gains control over it, is known as acquisition.

2. In the merger, the two companies dissolve to form a new enterprise whereas in acquisition, the two companies do not lose their existence.

3. Generally, two companies of the same nature and size go for merger unlike acquisition, in which the smaller company is overpowered by the larger company.

4. In a merger, the minimum numbers of companies involved are three, but in acquisition, the minimum number of companies involved is two.

5. The merger is done voluntarily by the companies while acquisition is done either voluntarily or involuntarily.

6. In a merger, there are more legal formalities as compared to acquisition.

Merger and acquisition in the banking sector is not a new phenomenon. Many international as well as national banks have been through merger and acquisition activities. Normally there is involvement of at least two parties in merger and acquisition process. Merger and acquisition normally occurs when both parties see a chance to increase the advantage of working together rather than performing alone. Both parties hope to benefit from the greater efficiency and competitive strength found in the combined company (Giddy, 2006). Therefore, the variables discussed are the factors that affect both parties prior to merger and acquisition for the decision to undertake M&A.

2.1.3 Profitability

Profitability refers to the capacity to make a profit. Profit is what is left over from income earned after deduction of all costs and expenses related to earning the income. Therefore, profitability ratio involves a measurement of profitability which is a way to measure a company's performance.

It involves several ratios used to judge a company's performance and to compare its performance against other similarly situated companies. One of the ratios to measure a company's ability is profitability ratios.

Profitability ratios measure a company's ability to generate earnings relative to its expenses and other costs. For most company profitability ratios, larger values relative to its industry or to the same ratio from a previous period are better.

The well-known profitability ratios used in analyzing company's performance are return on assets (ROA), return on equity (ROE) and earnings per share (EPS). These gauge a company's ability to generate earnings from their investments.

a. Earnings per share: Earnings per share (EPS) measure the net income of the company to average outstanding shares. The EPS is an important fundamental used in valuing a company because it breaks down a firm's profits on a per share basis. An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment)-that company would be more efficient at using its capital to generate income and, all other things being equal would be a "better" company. Investors also need to be aware of earnings manipulation that will affect the quality of the earnings number. It is important not to rely on any one financial measure, but to use it in conjunction with statement analysis and other measures.

b. Return on Assets: Return on Assets (ROA) measures how effectively a company uses the firm's assets to generate operating profits. It also measures the total return to all providers of capital (debt and equity). If a company carries no debt, its ROE and ROA would be same.

   In general, a high return on assets ratio means that a company's assets are productive and well managed. This does not necessarily apply to firms in capital-intensive industries because they tend to have higher levels of fixed assets, which can translate to lower ROAs.

   Likewise, some companies may have assets levels that are "understated", such as those with high levels of intangible assets. Intangible assets are non-monetary assets that cannot be seen touched, or physically measured, such as trademarks, brand names, and patents. However, accounting rules don't recognize these assets on the balance sheet. For example, Microsoft will have far fewer assets on its balance sheet than Ford. Issues such as these make it important that, when comparing ROA and ROE across companies, we have to make sure that the companies are in similar lines of business.

ROE is generally calculated as net income divided by total assets. Sometimes average total asset is used to avoid anomalies in net asset values.

c. Return on Equity: Return on equity (ROE) measures how a company makes its income from shareholder's equity. It means how much net income was earned as a percentage of shareholder's equity. More simply, it can show how much profit a company generates with the money shareholders have invested.

   ROE is calculated as net income divided by common equity (it does not include preferred shares). Common equity is assets less liabilities. Some ROE calculations use average common equity over a specified period. You can also calculate ROE using common equity as of the beginning or end of a period.

   Return on equity helps gauge how efficient a company is at generating profits. Firms with consistently high returns on equity, especially relative to industry norms, typically have some type of competitive advantage.

   One drawback to return on equity, however, is that it doesn't tell you whether or not a company has an excessive amount of debt. Remember that shareholder's equity is assets less liabilities, which include a company's short- and long-term debt. Therefore, the more debt a company has the less equity it has, which will result in a higher return on equity. This highlights the need to analyze the trends in the underlying data fields of any financial ratio we be using.

2.2 Theories of Merger and Acquisition

There are various theories regarding merger and acquisition. Some of them are described below:

2.2.1 Efficiency Theories

The differential efficiency theory states that more firms that are efficient will acquire less efficient firms and realize gains by improving their efficiency. This means that target is not always inefficient but only relatively inefficient. Hence, mergers are driven by differential efficiency between the target and bidder management.

The inefficient management theory suggests that the existing management is simply inefficient, and hence, another management whether best or not, would replace the existing one and increase the efficiency of the business.

The operating synergy theory postulates that even when both the target as well as bidder is equally efficient, simply combining their resources would lead to synergistic benefits due to economies of scale and complementary benefits. Thus, mergers are driven by synergy.

The financial synergy theory emphasizes that debt capacity of two combined firm will be larger than summation of debt capacities of two individual firms. Financial synergy also arises from credit rating of both the firms, tax differential of both the firms, proportion of use of internal and external funds.

Diversification provides numerous benefits to managers, employees, owners of the firms and to the firm itself. Diversification through mergers is commonly preferred to diversification through internal growth, given that the firm may lack internal resources or capabilities requires.

Strategic Realignment to Changing Environment: It suggests that the firms use the strategy of Mergers &acquisition as ways to rapidly adjust to changes in their external environments. When a company has an opportunity of growth available only for a limited period of time slow internal growth may not be sufficient.

Hubris Hypothesis: Hubris hypothesis implies that manager's look for acquisition of firms for their own potential motives and that the economic gains are not the only motivation for the acquisitions. This theory is particularly evident in case of competitive tender offer to acquire a target.

2.2.2 Monopoly Theory

The theory is viewed as acquisitions were executed to achieve market power. The implications of this type of acquisition are; Conglomerates use cross-subsidized products, to limit competition in more than one market simultaneously, and to deter the potential entrance of competitors into its market.

2.2.3 Valuation Theory

This philosophy viewed acquisitions as being executed by managers who have superior information than the stock market about their exact target's unrealized potential value. The assumption here is that the acquirer possesses valuable and unique information to enhance the value of a combined firm through purchasing an undervalued target or deriving benefits from combining the target's business with its own. The leveraged buyout can be categorized into this theory. One of the most common criticisms about this valuation theory is that it is impossible to acquire accurate and tangible information about the acquisition results, and further stated that "the concept of private information as a basis for mergers warrants further consideration, since it shows away the problematic assumption of capital market efficiency can be avoided."

2.2.4 Empire-building Theory

The agency theory comes into sharp focus here whereby managers maximize their personal goals, rather than their shareholders' value maximization through acquisition. This theory stems from early study on the relationship between ownership and corporate governance structure.

2.2.5 Process Theory

This approach hinges on rationalization and it indicated that strategic decisions are described as outcomes of processes governed by bounded rational theory, the central role of organization routines, or political power in the decision process rather than completely rational choices. Duhaime & Schwenk (1985) identified the limitations of information processing capacities in acquisition decisions. He found that the managers' behavior was over-optimistic in the acquisition decision process. They proposed a systematic acquisition process perspective.

He found that political and structural matters affect the acquisition process and outcome, whereas argued that cultural distances between two companies have enormous impacts on acquisition and the post-acquisition integration process. The conclusion is that "the evidence on the process theory can best be described as ambiguous. The available evidence is largely supportive.

2.2.6 Raider Theory

(Holderness & Sheehan 1985) portrayed the term, "raider," as meaning a person who causes wealth transfers from the shareholders of a target firm. One of the wealth transfer media is abundant compensation after a success full acquisition transaction, called "golden parachute." The primary problem with this assertion is its illogical hypothesis of wealth transfer. In addition to this, there is ample evidence of unfavorable results.

2.2.7 Disturbance Theory

This approach holds that the motives of acquisitions occurred as a result of economic disturbances. According to Gort (1969), economic disturbances cause changes in individuals' expectation and increase the general degree of uncertainty. Thus, they alter the array of individual expectations.

2.3 Driving Factors of M&As

Mergers can also be termed as the investment decision of a firm. Their numbers should be delicately calculated like other investments. These decisions might lead to significant uncertainties if not seriously handled.

The benefits of mergers are often difficult to quantify. Generally, merger is taken as device to expand the business in larger geographical regions with larger capital value. It is believed that merger is more applicable than sharing bonus in order to raise capital. Major driving motives could be:

- Apply superior managerial skills,
- Obtain unique technical capabilities,
- Enter new market

Table 2: Mergers Motives

Synergy	Bargain Gaining	Managerial Motives	Third Party Motives
• $PV_{AB} = PV_A + PV_B +$ gains • Market power • Economies of scale • Internationalization of transactions • Entry of new markets • Tax advantages • Risk diversifica-tions	• Elimination of inefficient and misguide manage-ment • Undervalued shares: strong form or semi-strong form of stock market efficiency.	• Empire Building • Status • Power • Remuneration • Hubris • Survival: speedy growth strategy to reduce probability of being takeover target • Free cash flow: Management prefers to use free cash flow in acquisitions rather than return it to shareholders.	• Advisors • At the insistence of customers or suppliers.

Note. From Mergers Motives (Glenn Arnold 2002, p.873)

In today's world, most acquisitions fail to deliver their expected outcomes but yet they remain very popular and essential for the growth of companies (Moeller & Brady, 2007).

The table 2 shows that the present value (PV) of companies together is higher than when the companies are apart. After mergers, companies want to gain something extra in market power, economies of scale, new market and so on. This creation of extra value of merged entity is ‘Synergy’. In this case, it would be wise to say ‘Higher the synergy creation, higher the excitement in mergers.’ In 2nd column, bargain buying suggests the benefits which might be gained by acquiring company which has efficient management ability, either at running target’s operation or at identifying lowest possible price of target firm. In 3rd column, it shows various motives of the managerial teams, which might finally encourage going to mergers. Finally, 4th column suggests the motives of 3rd parties other than the entities involved into mergers. Expectations of certain benefits by 3rd parties like advisors might play lead role in creating mergers.

2.4 History of Merger and Acquisition

Both mergers and acquisitions are aspects of strategic management, corporate finance and management dealing with buying, selling, dividing and combining of different companies and similar entities that can help and enterprise grow rapidly in its sector or location of origin, or a new field or new location, without creating a subsidiary, or child entity or using a joint venture (CTI Reviews, 2014). The history of merger and acquisition started from 19th century. However, there were few exceptions like: East India Company merged with an erstwhile competitor to regain its monopoly over Indian Trade in 1708, Italian Monte dei Pachi & Monte Pio banks were united as the Monti Reuniti in 1784, Hudson’s Bay Company merged with North West Company in 1821. The merger in the 19th century is greatly related in the U.S. business arena which occurred in the period 1895-1905. At this period of time, small firms having little market share consolidated with firms of similar type in order to form larger as well as powerful companies in order to dominate the markets. Till date, the total mergers as waves can be divided into six different waves which are described below:

First wave: The first wave occurred from 1897 to 1904. This period is characterized by monopolistic market that had resulted from horizontal mergers. This period of wave is considered to be the period in which large monopolies were created. O'Brien (1988) has stated that the mergers at this time occurred were mostly influenced by the companies that wanted to have strong presence and power in the market rather than economies of scale. Although monopoly was supposed to be highly discouraged by the Sherman Antitrust Act which was implemented in 1890, the companies used merger as a tool to get around this law. Gaughan (2011) has stated the inefficiency of Justice Department being responsible for improper execution of Antitrust Act. Gaughan (2011) has further stated that corporations were better able to hold stock in other companies and increase their business operations thereby creating merger environment because of relaxation of corporate laws. During the period 1898 to 1904, the firms were disappearing for the sake of merger and acquisition in the rate of 301 per year with 1028 firms disappearing into merger in 1899 alone (Nelson, 1959). The period of 1905 to 1914 is described as a decade of lower merger activity. The momentum reappeared from 1915.

Second wave: The second occurred from 1916 to 1929. This period is supposed to be affected from oligopolies. After the equity market had declined in first wave, it began to develop in this phase. Investment capital was easily accessible and stock market began to boom because of economic growth. In this period, the government of United States had executed hard and strict rules in antitrust law. Clatyon Act was executed in 1914 which was like back force for Sherman Act. According to Sundarsanam (2010), with strict antitrust laws, vertical mergers began to flourish and thus industries not related to each other, began to go for merger. This led to demolition of monopolies and formation of oligopolies. This period is also characterized by small scale companies merging with each other in order to gain economies of scale. This period ended with the decrement in equity market. Because of Second World War, merger and acquisition activities remained low until around 1950s after second wave.

Third wave: The third wave occurred from 1965 to 1969. This period is characterized by conglomerate mergers resulting from booming economies in the 60s. With the intention of companies to execute diversified strategies along with diversified product lines, such conglomerate mergers came into practice. As per Shleifer & Vishny (1991), such conglomerate mergers were a because of antitrust laws that did not allow mergers between companies belonging to the same industry. In order to tackle the monopolies and oligopolies, Cells Kefuaver Act was implemented which did not allow the companies of same organization to merge. Such conglomerates were also a result of the companies wanting to reduce the fluctuation or volatility in their income (Sundarsanam, 2010). The third wave ended with oil crisis in 1973 as well as the economic recession of the 70s.

Fourth wave: The fourth wave occurred from 1984 to 1989. This period is termed as a period of hostile merger by Gaughan (2011). With the aim to earn high returns in short period of time, hostile takeovers and mergers took place. As conglomerate mergers had some negative points too, there were significant mergers which were formulated to either specialized operations or downsize them. Also in fourth wave, large size companies were the prominent players of merger and acquisition while such were middle and small companies in previous merges. Mitchell & Mulherin (1996) have stated that oil price shocks, deregulation, financial innovation, competition were the prime factors resulting takeover activities in this period. Sundarsanam (2010) has stated that fall of Berlin Wall & Schengen Agreement in this period was the cause of rise in merger in Europe. Also, because of high inflation rates and thus high borrowing costs, big companies began to opt for merger and acquisition so that they could reduce operating and financing costs. With the collapse of stock market as well as highly leveraged companies, the fourth wave came to end.

Fifth wave: The fifth wave occurred from 1992 to 2000. The mergers here were characterized by friendly and long-term commitment type of deals. With the boom in the economy again, as well as rocketing of stock market, the companies opt for merger in order to fulfill the demand. In the fifth wave merger, the companies opted for equity financing rather than debt financing. Also, this wave is characterized by international mergers with companies going for cross merger deals. Deregulations also played the great role in such international mergers with Europe, America and other countries having many companies going for merger and acquisition. This merger waves were greatly supported by various multinational trade zones like European Union, North Atlantic Free Trade Agreement etc. This period ended with economic recession.

Sixth wave: The sixth wave occurred from 2003 to 2007. Martynova & Renneboog (2005) stated that the merger wave occurred after the market began to return to normal post terrorist attack on September 11, 2000. In this period, even though economy began to recover, the interest rate was kept low. In this period, the trend of cross-border merger and acquisition continued. Many private equity firms came into rise because of low interest rate thereby making it easier to obtain credit availability. The sixth wave came into end with subprime debt crisis in 2007 (Ferris & Pettit, 2013). Studies have shown that the takeovers did not occur evenly, rather there was a cluster of different waves.

The total mergers as waves are shown in table:

Table 3: Merger waves

Period	Name	Merger
1893–1904	First Wave	Horizontal mergers
1919–1929	Second Wave	Vertical mergers
1955–1970	Third Wave	Diversified conglomerate mergers
1974–1989	Fourth Wave	Co-generic mergers; Hostile takeovers; Corporate Raiding
1993–2000	Fifth Wave	Cross-border mergers, mega-mergers
2003–2008	Sixth Wave	Globalization, Shareholder Activism, Private Equity, LBO

2.5 Global M&A Position

The worldwide mergers and acquisitions trend has been presented in below figure.

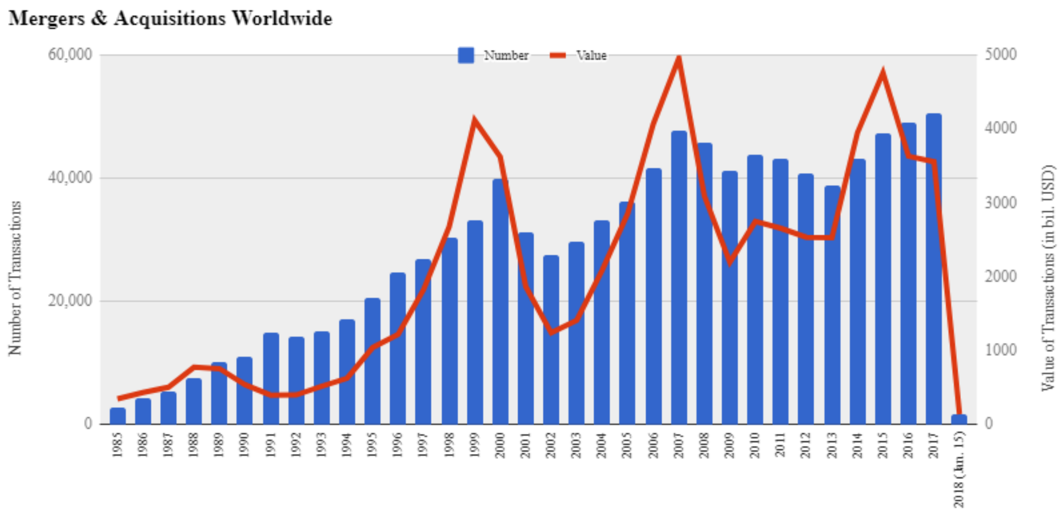

Figure 1: Global Mergers and Acquisitions. From Global Announced Mergers & Acquisitions 1985-2017, (Slater John 2017)

Arnold (2002) says that first major wave of merger took place in late 1970s and gradual increase in the data took place in late 1980s, 1990s and record high transactions in 2007 before recession (2008). The figure above helps to illustrate that the number of transactions and value of the transactions was peak high in 2007. Following recession in 2008, though the transactions shows gradual decrease in numbers, the value of mergers seems to fall so quickly and has regained its ascending since 2013. Then again, the number of transactions and value of the transactions peaked to second highest point on 2015, after that of 2007. The sharp recession was again felt in 2016 and remained almost same till 2017.

In 2017, companies announced over 50,600 transactions with a total value of more than 3.5 trillion USD (2.9 trillion EUR/ 2.5 trillion GBP). Compared to 2016, the numbers of deals grew only marginally by 2.9 per cent while the value declined by 2.00 per cent.

2.6 Review of Empirical Studies

Ravenscraft and Scherer (1989) examined target firm profitability over the period 1975 to 1977 using Line of Business data collected by the FTC. The FTC collected data for 471 firms from 1950 to 1976 by the business segments that the firms operated. This allows Ravenscraft and Scherer to track the post-merger performance of the target firm. They find that the target lines of business suffer a loss in profitability following the merger. They conclude that mergers destroy value on average, which directly contradicts the conclusion drawn from the announcement period stock market reaction.

Healy, Palepu et al Ruback (1992) examine post-merger operating performance for the 50 largest mergers between 1979 and 1984. In particular, they analyze the operating performance for the combined firm relative to the industry median. They find that merged firms experience improvements in asset productivity, leading to higher operating cash flows relative to their industry peers. Interestingly, their results show that the operating cash flows of merged firms actually drop from their premerger level on average, but that the non-merging firms in the same Industry drops considerably more. Thus, the post-merger operating performance improves relative to the industry benchmark.

Hall (1987) in a detailed study of all U.S. manufacturing firms in the years 1976-85, finds in approximately 600 acquisitions that firms that are acquired do not have higher R&D expenditures (measured by the ratio of R&D to sales) than firms in the same industry that are not acquired. Also, she finds that “firms involved in mergers showed no difference in their pre- and post-merger R&D performance over those not so involved.”

Jerold and Steven (2005) carried out a study on planning for a successful mergers and acquisitions in 2005 on Australia firms. The major objectives of the study were to find out the relationship between corporate strategy and M&A strategy, the criteria organizations use to screen M&A targets, whether M&A experience improves performance. Data from six major industries of about 200 firms was used in this study. They adopted a qualitative research approach. The interviews were undertaken with experienced senior managers of Australian listed companies and Australian based United States of America subsidiaries. The findings were that Mergers &Acquisitions was essential to growing market share in emerging markets. Acquisitions as a strategy to quickly position themselves for changes that occur in the information technology market and to reduce product time to market M&A s were used as a method to obtain strategic objectives and to meet the firms' financial criteria. They also found that additional to capability, scale, and geographical presence as the three major criteria to screen M & As.

Healy et al (1992) studied the post-acquisition performance of the 50 largest U.S. mergers between 1979 and 1984. They used accounting data primarily but tested their results by using market valuation measures as well. They analyzed both operating characteristics and investment characteristics, the first two measures of operating characteristics are the cash flow margin on sales and asset turnover. Their third variable measures the effect of the merger on employment. This tested the hypothesis that gains in mergers are achieved by downsizing and reducing the number of employees. Their fourth measure is pension expense per employee. Again, this is to test whether gains from mergers came at the expense of reducing pension protection for employees. They also consider a number of effects on investment; they tested whether gains came from under investing for the future, from selling off assets, or force reducing research and development activities. Their findings were that; industry employment decreased which implies that the merging firms did more restructuring and reorganization than other firms in the industry. But the cash flow margin on sales did not significantly change. However, asset turnover significantly improved. The return on the market value of assets also improved significantly. Pension expense per employee was reduced somewhat but not by statistically significant degree. None of the investment characteristics were significantly changed on the basis of industry adjusted performance. Their study only found a significant change on asset turnover and employment.

Kemal (2011) conducted a study to find the profitability of the Royal Bank of Scotland after merger deal with ABN AMRO Bank from 2006-2009 where he calculated 20 ratios and concluded that the merger failed to pull up profitability thus proved to be a failure.

Korir (2006) carried out a study on Effects of Mergers on Financial Performance of Companies listed at the Nairobi Securities Exchange. The objective of this study was to find out the effects of mergers, if any on performance of companies listed at the NSE. The timeframe observed was from 1994-2005. The population used in this study was 48 companies listed on the Nairobi Stock Exchange. Shares of some of these sampled companies were heavily traded at the NSE. A sample of 20 listed companies was contacted, it consisted of 10 companies that merged and 10 that never merged and were in operation for the period counterparts were merged. Measures of performance used were turnover, volume, market capitalization and profit. They were analyzed on the basis of descriptive statistics. Descriptive statistics describe data on variables with single numbers while analysis of variance (ANOVA) tests for any significance difference between mean values of variables. It was concluded that mergers improves performance of companies listed at the NSE. This is explained by low variation in paired t-test below 0.005 for turnover, volume, market capitalization, and profit.

Luypaert (2008) investigated the determinants of growth through M&A in Belgium using a sample of 378 Belgian bidders engaged in 816 M&A transactions during 1997–2005. Using logit and probit regression analysis he analyzed firm characteristics, industry and market variables. Found that intangible capital, profitability and firm size significantly positively affected M&A decision whereas ownership concentration and debt had a negative impact. He concluded that M&A

were more likely in industries where incumbents operate in a relatively low scale, less concentrated and recently deregulated.

Lipton (2006) investigated external factors affecting mergers and merger waves by analyzing global M&As from the year 1985 to 2006. Observed that during 1990s merger-waves, as stock prices and earnings ratios increased mergers volumes increased dramatically from $339 billion in 1991 to $3.3 trillion in 2000 globally. Hence there is positive relationship between stock price increase and M&A activity. Concluded that receptive equity and debt market were critical factors in M&As activity. These findings supported Nelson (1959) who investigated merger movement in American Industry by exploring impact of stock market performance on M&A activity. Found that stock prices increase was followed by merger activity increase. Concluded that M&As were highly concentrated in time clustering during periods of high stock market valuations.

Barasa (2008) conducted a study on the effect of mergers and acquisitions announcement on share prices quoted at the NSE. The study was done on 11 companies that had made merger announcements for the period 1997-2006.It was found out that merger announcement do not affect share prices of the NSE quoted companies.

Cain & Denis (2009) explicitly examine the valuation analyses underlying the fairness opinion reported in the merger proxy statement for 582 negotiated mergers announced between 1998 and 2005 for evidence on valuation biases that would favor deal advisors. Using data on high and low target valuations produced by the various valuation techniques underlying fairness opinions on both sides of the deal, they compare the average target valuation against the offer price and thus determine the extent of “bias” in the fairness opinions provided by investment bankers. Although the authors do not observe any bias associated with target fairness opinions, they find that fairness opinions sought by acquirers are optimistically biased in that the valuations underlying the opinion are significantly higher than the offer price (by 20 per cent on average). Additionally, Cain & Denis find the bias to be lower when top tier investment banks provide the fairness opinion and when the advisor has a prior relationship with the firm. They report two other findings. First, the bias does not vary based on whether investment bankers are paid contingent fees. Second, neither does the bias vary based on whether the valuations are performed by unaffiliated investment banks (without the alleged conflicts faced by advisors in the deal) or by affiliated advisors. Cain and Denis interpret their evidence to be consistent with advisors delivering valuations that favor the completion of deals.

Palepu (1986), in the best study to date of the determinants of takeover, finds strong evidence consistent with the free cash flow theory of mergers. He studied a sample of 163 firms acquired in the period 1971-79 and a random sample of 256 firms that were not acquired. Both samples were in mining and manufacturing and were listed on either the New York or the American Stock Exchange. He finds that target firms were characterized by significantly lower growth and lower leverage than the non target firms, although there was no significant difference in their holdings of liquid assets. He also finds that poor prior performance (measured by the net of market returns in the four years before the acquisition) is significantly related to the probability of takeover and, interestingly, that accounting measures of past performance such as return on equity are unrelated to the probability of takeover. He also finds that firms with a mismatch between growth and resources are more likely to be taken over. These are firms with high growth (measured by average sales growth), low liquidity (measured by the ratio of liquid assets to total assets), and high leverage, and firms with low growth, high liquidity, and low leverage. Finally, Palepu’s evidence rejects the hypothesis that takeovers are due to the undervaluation of a firm’s assets as measured by the market-to-book ratio.

Loderer & Martin (1992) studied 304 mergers and 155 acquisitions that took place between 1965 and 1986 and observed a negative but insignificant abnormal return over the 5 subsequent years after the mergers and positive but insignificant abnormal return for the acquisitions.

Morck & Yeung (1991) examine 322 foreign acquisitions by U.S.-based firms between 1979 and 1988 and find one-day positive abnormal returns occur only if the firm has substantial intangible assets. They conclude that adopting a multinational structure allows these firms to apply these assets to a larger scale of operations than would be possible within the U.S., while at the same time keeping them out of the hands of potential competitors.

Doukas & Travlos (1988) find shareholders in 202 U.S. firms making foreign acquisitions realize positive abnormal returns at the announcement date if the bidder already has foreign operations, but is not operating in the target's home country.

Doukas & Travlos also find that shareholders of U.S. firms expanding internationally for the first time realize insignificant positive abnormal returns at the announcement date, and shareholders of U.S. firms already operating in the target's home country realize insignificant negative abnormal returns.

Andre, Kooli & L'Her (2004) studied the long term performance of 267 Canadian mergers and acquisitions that took place between 1980 and 2000 using different calendar-time approaches with and without overlapping cases. Their results suggested that Canadian acquirers significantly underperform over the three-year post-event period. Further analysis showed that their results are consistent with the extrapolation and the method-of-payment hypotheses, that is glamour acquirers and equity financed deals underperform. Andre, Kooli & L'Her also found that cross border deals perform poorly in the long run.

Ingham, Kiran & Lovestam (1992) studied relationship between mergers and firm profitability by surveying 146 of the UK's top 500 companies. The study revealed that is the expected reward of increased profitability which has driven the takeover market and that it is this traditional measure which is used in ex-post evaluation. According to the findings, managers firmly perceive that their takeover activity had been performance enhancing for their company. The evidence presented did suggest that the integration of small acquisitions into an existing organizational structure may be achieved without severe problems of loss of control and the subsequent decline in performance which beset large acquisitions.

Jensen & Ruback (1983) reviewed 13 merger announcements in Japanese oil companies. The study sought to whether there were abnormal stock returns around takeover announcements. They found that the average excess returns to target firms' stockholders are of 30 per cent and 20 per cent for the successful tender offers and mergers respectively while bidding firms' stockholders gained an average of 4 per cent around tender offers but no abnormal return around the merger. (Eckbo,1992) however, found no evidence to support significant abnormal returns of acquiring firms over a three-year period after the bid date. Agrawal, Jeffrey, Jaffe & Mandelker (1992) concluded that bidding firms lost from the acquisitions over several years.

2.6.1 Positive Impacts of M&A on Financial Performance

Several studies have found that merger events have a positive effect on the financial position of a firm specifically profitability, leverage, and liquidity. For example, Pandit & Srivastava (2016) explained that valuation of merger deal is essential aspect while comparing the performance of mergers. According to authors valuation method is important for effective negotiation. They took interview of ten executives of merged companies and also analyzed secondary data of financial ratios. They have concluded that only fair valuation prudent post merger management can create synergies and positive effects on corporate firms' performance.

Arikan & Stulz (2016) compared different theories and established that younger firms can create a more valuable and well-diversified merger as compare to old firms. Their findings are consistent with neoclassical theories that showed that acquirer firms performed better and also created wealth through acquisitions of nonpublic firms. Furthermore, their findings are consistent with agency theory because their findings depicted that older firms have negative stock price reactions for public firms.

Drees (2014) used meta-analysis on 204 studies to assess the corporate strategies for this purpose he took joint ventures, mergers and acquisitions, and alliances as data. He concluded that joint ventures and mergers and acquisitions enhance substantive performance. He also found that merger deals have more positive effects on accounting based and market based performance as compared to joint ventures and alliances.

Andreou, Louca, & Panayides (2012) investigated the valuation effects of merger deals in the transportation industry taking 59 merger deals as sample for the time period of 1980–2009. Their study found that mergers create synergy, specifically those tender offers which are consistent with the observation that transportation mergers take place for synergistic reasons rather than management's want for bonus consumption. They have discussed that though both kinds of shareholders (target and bidder firm's shareholders) are better off; the target firm's shareholders enjoy most of the synergistic gains. Further, they found that vertical mergers have greater valuation effects than horizontal mergers and the wealth effects of bidders are greater for open mergers.

Leepsa & Mishra (2012) examined the effects on post merger financial performance in companies dealing in manufacturing sector of India. They also observed the long-term changes in post merger performance of these companies. The study was carried out for 4-year period under consideration using accounting based approach and using three different financial parameters that are liquidity, profitability, and leverage. Average of before and after merger financial ratios were compared to examine if there is any noteworthy change in financial performance due to mergers, using paired two sample t tests. The liquidity position of the firms was found improving so does the profitability of firms which also improved in terms of return on capital and decreased in terms of return on net worth of firms. The improvement was noticed in solvency position terms of networking capital. Overall, an improvement was seen in the financial performance of the firms after merger in terms of liquidity that is current ratio, quick ratio and in terms of profitability that is return on capital. Similarly, the study showed improvement in terms of leverage that is interest coverage ratio. Nevertheless, most of their results were not statistically significant.

Ghatak (2012) studied the impact of mergers on the financial position of Indian pharmaceutical companies by taking 52 listed drugs and pharmaceutical companies (2005–2010) as a sample. He found that the size, selling effort, exports, and imports intensities of firm positively influence the profitability after merger. It was also found that merger deals showed insignificant positive effects on profitability of firms in the long run on the account of X-inefficiency and free entrance of new firms into the industry.

Indhumathi, Selvam, & Babu (2011) compared the sample of merged companies from the years 2002–2005. They analyzed the performance of the both target firm and buying firms using data for three year before and after occurrence of mergers by using ratio analysis and t-test. They found that the wealth of shareholders of the buying firms increased after the merger deal.

Kumar & Bansal (2008) argued that increase in profits and synergy gain is not only possible by only getting into the merger deals. By using ratio analysis for 74 merger deals for the time period 2000–2006, they found that in large number of the merger deals, the acquiring firms had generated synergy in the long run in form of higher cash flows, more business diversification, and decreasing costs.

Chatfield, Dalbor, Ramdeen, & Harrah (2011) examined financial position in form of supernormal profits for 26 target and 171 buying firms in restaurant merger deals. Their empirical results showed that target entities in restaurants had enjoyed significantly positive returns. These results indicated that these results are may be synergistic gains from mergers.

Figueira, Nellis, & Parker (2009) investigated mergers activity in the EU banking system for the years of 1998–2004 by using Data Envelopment Analysis (DEA) technique for the purpose of assessing performance of banks. They recognized that banks involved in merger events are more efficient after the merger deal when compared to the other large banks.

DeYoung, Evanoff, & Molyneux (2009) provided an evaluation of financial mergers and acquisitions of more than 150 research articles from literature. They found that North American bank mergers have positively affected the efficiency. The event-study literature showed a mixed picture concerning stockholder wealth creation. Efficiency gains were found in the literature of European bank mergers as well as stockholder value improvement in the study. They found mixed impact of geographic and product diversification through merger whereas, the findings of financial institution mergers showed unfavorable impacts on certain types of borrowers, depositors, and other external stakeholders.

Al-Sharkas, Hassan, & Lawrence (2008) investigated the effects of cost and profit efficiency of banking sector merger events on the US banking sector by using the Stochastic Frontier Approach (SFA) and Data Envelopment Analysis (DEA) to study the production structure of merged and non-merged banks. The results depicted improvement in cost efficiencies and profit efficiencies after a merger deal. In addition to this, their results showed that non-merged banks have higher costs than merged banks because merged banks were focusing on technical efficiency as well as allocated efficiency.

Frederikslust, der Wal, & Westdijk (2008) discussed the wealth creation and redistribution theories of mergers in their study by taking a sample of 101 merger events (1954–1997). They showed that more than 50 per cent of the buying companies had a positive response to share value at the announcement of merger, while 82 per cent of the merger deals showed that share price performance for target firms improved.

Vanitha & Selvam (2007) compared the financial position of 17 merged entities out of 58 manufacturing firms in India (2000–2002) by employing ratio analysis and t-tests. They found that it was possible for the merged firms to get success in financial performance because the merging firms were taken over by those firms that had good repute and also efficient management. Similarly, Pawaskar (2001) has evaluated the financial position of firms using data for 36 merger deals. He compared the state of operating performance before and after merger of the companies. Significant changes in the financial performance of the firms involved in merger activity were seen. According to his findings, the mergers seemed to lead to financial synergies and a one-time growth only.

Gugler, Mueller, Yurtoglu, & Zulehner (2003) contributed a large cross national assessment of the effects of mergers in the literature of effects of mergers on profitability. They used ordinary least square estimation technique for projection taking 14269 merger deals as sample from different countries for the time period of 1981–1998. They considered only those merger deals where more than 50 per cent of the equity of target firm was acquired. They found that 56.7 per cent of all mergers resulted in higher than projected profits but almost the same fraction of mergers resulted in lower than projected sales. Further, they found that market power and efficiency is the reason for different results for profit and sale for the same data set.

Ramaswamy & Waegelein (2003) examined the financial position using financial data of 162 merged firms and industry adjusted cash flow returns as performance criterion taking 5-year pre and post-merger period. They found that after merger, performance was negatively related with size of target firm and have positive relationship with long-term motivation recompense plans. Firms that were in different industries also showed improvement in financial performance. They used regression analysis to conclude whether there was any improvement in performance after merger as compare to the financial performance before merger. They found improvement in after merger operating and financial position calculated by industry-adjusted return on assets for selected sample.

2.6.2 Negative Impacts of M&A on Financial Performance

In contrast to the studies cited above, the several other studies have documented that merger deals have also affected negatively or insignificantly the financial position of the merged firms. For example, Al-Hroot (2016) attempted to analyze impact of merger deals on financial performance of merged Jordanian industrial companies. He took a sample of 7 merged companies from 2000 to 2014 and applied ratio analysis. By using paired sample t-test, he showed that overall financial performance has insignificantly improved in post merger time period. He used profitability, liquidity efficiency, and liquidity ratios. He further found that different industries showed different results for impact of merger deals.

Huh (2015) investigated the impact of corporate acquisitions on performance of steel industry. He focused on technical efficiency and PER of acquiring steel firms from 1992 to 2011. The study separates acquiring firms in steelmakers and financial institutions to discuss the impact of acquisitions. The findings showed that operating performance of acquired steelmakers by financial institutions has been deteriorated insignificantly, while PER has increased significantly.

Ahmed & Ahmed (2014) took sample of merged manufacturing companies of Pakistan and analyzed financial performance after merger deals. Like other studies, their findings also showed insignificant improvement in profitability, liquidity and capital position. Similarly, the results for efficiency showed insignificant deteriorated performance.

Kandžija et al. (2014) studied the Croatian merged companies and found that failure or success of merger depends on industry structure. They found that the performance of the target company significant depends on the concentration ratio of the target company's industry. Specifically, they found that the target firm's performance would be higher if the concentration ratio is lower.

Leepsa & Mishra (2014) tried to develop a scientific approach that can help to analyze the multiple financial ratios in pre and post merger time periods. They tried to explore those factors that affect post merger performance of manufacturing firms of India. They developed a composite index score by using Principal Components Analysis for before and after merger period. They utilized different financial ratios from 2000 to 2008 and found that return on capital, method of payment, size of acquirer, quick ratios, industry relatedness, debt ratio and interest coverage ratios are determinates of success or failure of a merger deal.

Braguinsky, Mityakov, & Liscovich (2014) explored the effects of change in ownership and executive control due to mergers on productivity and profitability. Authors used financial, operational and ownership data of Japanese cotton spinning industry to conduct their research. Their findings showed that after merger firms were less profitable.

Bhabra & Huang (2013) examined 136 sample merged Chinese companies (1997–2007). They found that the acquiring firms experience positively significant stock returns in 3-year after mergers. Yet, their findings also showed that operating performance has not changed in post merger time period.

Sharma (2016) analyzed the post merger performance of metal industry. She took nine metal companies from India for the period 2009–2010. She applied paired sample t-test for the comparison of pre and post merger performance. Her findings showed minor but insignificant improvement in liquidity and leverage position of metal industry after merger. Profitability in this study declined significantly in terms of RONW and ROA. She suggested that synergy through mergers is possible to generate in the long run with efficient use of resources. She further concluded that success of a merger depends on integration process, keeping eye on this process and timings of decision etc.

Poornima & Subhashini (2013) using paired sample t-test examined the performance of 33 merged companies for the time period 2009–2010 for India. They examined the profitability ratio, the leverage ratio, the liquidity ratio, and the managerial efficiency ratio to carry out their empirical analysis to compare the pre and post merger performance. They found that there is no significant improvement in the profitability of the firms after being acquired. They also reported that other financial ratios also do not show any significant change after the merger deal.

Chang & Tsai (2012) studied the long-run performances of 4288 merged firms during the period 1990–2007 in the USA. Their results depicted a declining performance of acquirer firms. They further examined superior stock performance of acquiring firms before occurrence of merger. They found that investors might anticipate earlier good performance and that the long-run returns correct the overestimation as result of announcements of merger decision.

Likewise, Kemal (2011) analyzed the four year (2006–2009) post merger financial statements of Royal Bank of Scotland (RBS) in Pakistan by taking 20 fundamental ratios. The result of his case study showed that merger deal did not improve the financial position of RBS in terms of profitability, liquidity, cash flows, and asset management.

Doytch & Cakan (2011) in their paper analyzed the impact of merger deals on economic growth. The analysis was carried out on primary, manufacturing, and services sectors. Mergers sales were divided according to sectors, domestically and also in cross-border merger. The sample of the OECD countries was studied. By using a Generalized Method of Moments (GMM) estimator, they did not find any significant evidence for that mergers activity added to economic growth, apart from growth of the services sector. Both, financial and non-financial domestic mergers in services sectors had a positive impact on growth of service sector, while mergers of primary and manufacturing sectors affected sectors growth rates negatively. The negative impact of mergers on growth was also found at the aggregate economic level.

Singh & Mogla (2010) compared the pre-merger and post-merger operating performance of merged companies of India by taking sample of 153 companies merged during the years of 1994 and 2002. They used accounting based approach for empirical analysis. Their results exposed that the profitability has significantly decreased after the mergers and the profitability of matching firms also showed a significant decrease over the same time period. They concluded that the decreases in profitability couldn't be credited to mergers alone. They also used regression equation for same data and found that the current ratio, the debt equity ratio, and firm size were negatively associated to profitability, and the positive impact of interest coverage ratio and the age of firms on profitability. Firms working in groups were better performed than non-group firms.

Usman et al. (2010) examined the financial condition of merged companies of manufacturing sector of Pakistan. They used the accounting based approach and took average financial ratios pre and post merger relative to their industrial peers. For their analysis, they took 14 firms as sample and used paired sample t-test to examine any noteworthy change between the controls adjusted three year pre and control adjusted three year post merger periods. Their results showed insignificant performance of the merged firms after merger as compare to their control adjusted firms for the control adjusted net profit margin, return on total asset, and gearing ratio measures. The control adjusted return on equity, return on capital employed, earning per share, and total asset turn over showed insignificant declining trend after the three-year post merger period.

Usman et al. (2008) analyzed the textile mergers in Pakistan to check any noticeable influence on the operating and financial position of merged companies taking five merger events during the period of 2001–2005. By employing t-test, they found a decrease (although insignificant in statistical sense) in the operating performance of merged firms due to merger deal. Moreover, they projected performance using ordinary least square method and found an insignificant rise after merger event.

Mantravadi & Reddy (2008) studied the effects of merger deals on the operating performance of target firms in different industries by using accounting based approach of ratio analysis. They took 68 mergers from different industries for the period from 1991 to 2003. The results showed differential effect of mergers for different industries. They concluded that the industry type does not create a difference to operating performance of merged firms.

Lipson & Mortal (2007) explored those factors which can affect liquidity position of firm by investigating the relationship between liquidity changes and changes in characteristics of firms during mergers. By taking sample of 1464 firms during the period from 1993 to 2003 and by applying regression analysis, they found that profits of firms decline as the number of analysts, shareholders, market makers, firm size, and volume rise or as volatility reduces. Further, they concluded that increased volume, firm size, and decreased instability are associated with increased depth.

Ooghe, Laere, & Langhe (2006) took 143 merged Belgian companies between 1992 and 1994 for examining the financial position of the merged firms after the occurrence of merger, using statistical analysis of industry-adjusted variables. They found a decline in profitability and the liquidity position of most of the merged companies. They also found that the productivity of labor increases due to mergers, but this was just because of improvement in gross added value per employee.

Bhuyan (2002) argued that vertical merger had become an important business strategy to react to the needs of a consumer led marketing system. He took a sample of 43 US food-manufacturing firms and examined the impact of vertical mergers on profitability. He showed that vertical mergers negatively impacted profits due to the fact that vertical mergers failed to create differential advantages, such as cost savings, for the integrated firm.

Meschi (2000) in his survey reviewed the hypothetical and empirical literature on the causes and consequences of mergers and acquisitions. The empirical evidence on the performance of mergers exhibited that mergers are not always positively profitable. The author concluded that in most of merger cases, the shareholders of the acquiring company got lose as the value of their stock holdings decline in post merger. Moreover, the acquired company is most likely to experience a fall in profitability, market share, or productivity. The author also showed that only the shareholders of the acquired company achieved considerable returns from mergers. Taking into account the effect of mergers on market structure, it is found that mergers have no effect on concentration levels and market shares in the USA, while they seem to have a positive effect in the UK.

Berger et al. (1997) analyzed the effects of mergers in banking sector on small business lending by taking data of around 6000 US Bank merger deals. They estimated the energetic reactions of other local banks first time in the USA. They found that the stationary effects of mergers decreased small scale business financing.

Pilloff (1996) examined 36 merger deals (1980–1992) taken place in banking industry and found considerable consolidation on the account of mergers among large financial institutions. The study showed little change according to performance measures after merger. He found correlation among low target profitability, acquirer total expenses, and high target absolute and relative size with successive performance improvements. Abnormal returns of merged firms were related to expense-related variables. Correlations of abnormal returns with performance procedures were constantly insignificant, provided direct proof that market expectations are not related to subsequent gains of mergers.

After reviewing literature of mergers and acquisitions carefully we observe that deals of merger and acquisitions have different effects on financial performance of merged/acquirer firms. In a few cases, we found that mergers and acquisitions improve significantly all underlying indicators like profitability, liquidity, and solvency. On the other hand, we observed that mergers and acquisitions have also affected the overall financial performance negatively. There are several studies in which we found that post merger performance has mixed results, for instance, profitability improved but liquidity position did not improve. When we review the literature of mergers and acquisitions in Pakistan, we see a big gap that need to be filled. In Pakistan, the relevant literature is not comprehensive. The previous existing studies did not analyzed mergers and acquisitions of non-financial companies in comprehensive way. Further, most of the exiting studies have just used t-test to carry out their empirical analysis and none of the study has conducted the regression analysis to find out the impact of mergers and acquisitions on financial performance of merged/acquirer companies. Departing from the existing studies, we have extended our data, time period, and carry out regression analysis to see the impacts of merger deals on the financial performance of manufacturing companies listed at Pakistan Stock Exchange (PSX). We further enrich our study by using a very sophisticated technique, namely empirical Bayesian technique, that has not been used so for by even a single study in mergers and acquisitions literature. Thus, our study significantly contributes into the existing literature.

2.7 Concluding Remarks

The studies the researchers have reviewed have either dealt with a before-after M&A case of a single bank or just compared the M&A of two banks, and have not compared three banks in regard to profitability after M&A, more particularly, Global IME Bank, NIC Asia Bank, and Prabhu Bank. So to fulfill this research gap this study has been carried out.

Chapter 3

Research Methodology

Research methodology is the process of arriving at the solution of the problem through planned and systematic dealing with the collection, analysis and interpretation of facts and figures. Research is a systematic method of finding right solution for the problem whereas research methodology refers to the various sequential steps to adopt by a researcher in studying a problem with certain objectives in view. In other words research methodology refers to the various methods of practices applied by the researcher in the entire aspect of the study. It is the plan, structure and strategy of investigations conceived to answer the research question or test the research hypothesis. Research design includes different dependent and independent variables, types of research design, research questions and hypothesis sample, data collection activities, technique of analysis etc.

3.1 Research Design

The present study is mainly based on descriptive and analytical research designs. It has used the descriptive research design to describe the general position, business growth and profitability of the Nepalese commercial banks that have gone through before and after the mergers and acquisitions.

Similarly, the analytical research design makes analysis of the gathered facts and information and makes a critical evaluation of it; it was used in this study, as it analyses the profitability position of the sample banks before and after the mergers and acquisitions.

Finally research design is the plan, structure and strategy of investigations conceived so as to obtain answers to research questions and to control variances. To achieve this study descriptive and analytical research designs have been used.

3.2 Population and Sample

Under the study of profitability of Nepalese commercial banks, the total number of commercial banks including domestic and joint venture banks operating in the Nepal is the population. At present there are twenty eight licensed commercial banks running in Nepal; and out of it, there are a number of banks that have undergone mergers and acquisitions in the recent years and such banks have been considered as the population of this study.

Sampling Criteria: Out of them, the study has chosen three commercial banks as a sample; as they have made more than two incidents of M&As in the recent years; it is the main criteria of sampling for this study. Based on the above criteria, the study has selected the following sample banks for the analysis:

- Global IME Bank
- NIC Asia Bank
- Prabhu Bank

In the sample, banks are taken according to their comparative and gradually growth rate by profitability can be analyzed.

3.3 Sources of Data

This study is mainly based on secondary data. Concerned banks, Nepal Rastra Bank, SEBO, and different library are the providers of the data. The review of literature of the proposed study was based on the text books, official publications, journals, unpublished thesis, web site etc. The necessary data and information at macro level have been collected from relevant institutions and authorities such as NRB, Ministry of Finance, NEPSE, SEBO and their respective publications. Similarly, the required micro level data are derived from annual reports of selected banks, SEBO and NEPSE. In addition to above, supplementary data and information were collected from different library such as central library of T.U., SEBO etc.

The major sources of data and information are as follows;

- Quarterly Economic Bulletin, NRB, (November 2017)
- Main Economic Indicators of Nepal, NRB (Monthly Report 2017)
- NRB Economic Report, NRB
- Non-Banking Financial Statistics, NRB
- Banking and Financial Statistics, NRB
- Economic Survey, Ministry of Finance
- Annual Reports of Concern Commercial Banks
- Previous Research Studies, Dissertation and Articles on the Subject
- Various Text Books
- Different Library
- Different Website Related to study

3.4 Data Collection and Processing Techniques

Although, the study mainly used secondary data, high level of efforts and more time was paid to get data. Official publications like Economic Survey, Annual Reports, Banking and Non-Banking Financial Statistics, Economic Bulletin etc. were obtained from respective offices. To some extent, informal interview was scheduled and conducted to obtain more information and reality about the various published data, after-merger status of the banks, and merger concept in the field of BFIs etc.

Due to poor data base, the data obtained from the various sources cannot be directly used in their original form. Further they need to be verified and simplified for the purpose of analysis. Hence, in this study the available data, information, figures and facts were checked, rechecked, edited and tabulated for computation. Similarly, according to the need and objectives, the secondary data were compiled, processed tabulated and graphed if necessary for the better presentation.

3.5 Data Analysis Tools

Data analysis is the process of bringing order, structure and meaning to the mass of information collected. Data analysis methods to be employed involve quantitative and qualitative procedures. The study used accounting ratios to analyze the financial performance of the mergers under study. The ratios of the acquirers before the merger will be examined so as to get an indication of the relative performance of the acquirer after merger. The focus of the analysis is on the combined institution. Pre-merger average data was compared with the post-merger average data in determining the changes that occurred in profitability following the merger or acquisition. The three profitability performance indicators: EPS, ROA & ROE were used.

- ROA=Return on asset as measured by comparing net income to average total assets.
- ROE=Return on equity measured by comparing net income to shareholder's equity.
- EPS=Earnings per share measured by comparing net income to average outstanding shares.

Chapter 4

Presentation and Analysis of Data

4.1 Introduction

This chapter presents data findings on EPS, ROA and ROE aimed at determining the profitability analysis after Mergers & Acquisitions. Data analysis methods employed involved quantitative and qualitative procedures. The study used accounting ratios to analyze the financial performance of the 3 banks mergers under study. First, the ratios of the acquirers before merger were examined so as to get an indication of the relative performance of the acquirer after merger. In this way, the focus of the analysis was on the combined institution. Pre-merger average data was compared with the post-merger average data in determining the changes occurred in performance following the merger or acquisition. The three profitability performance indicators: EPS, ROA and ROE are used.

4.2 Data Presentation

Prabhu Bank has spent various phases of its growth trajectory over a short period of its existence. Growth of Prabhu Bank was phenomenal after merger approval (in September 2014) and operation having Grand Bank Nepal Limited, Kist Bank Ltd, Prabhu Bikash Bank Ltd, Gaurishankar Development Bank Ltd and Zenith Finance Ltd together, attaining the status of “A” class financial institution licensed and regulated by the central bank of Nepal. Again, Prabhu Bank acquired Nepal Development Bank Ltd, which was in liquidation stage, in March 2015.

Table 4: EPS, ROA and ROE of Prabhu Bank (2012-2018)

Ratio\ Year	Before merger		After merger			
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Earnings per share (EPS in Rs. per share)	**-40.23**	**-15.24 (0.62)**	**31.73 (3.08)**	**35.79 (0.13)**	**29.78 (-0.17)**	**15.42 (-0.48)**
Return on Assets (ROA in per cent)	**-3.43**	**-1.44 (0.58)**	**2.19 (2.52)**	**1.58 (-0.28)**	**1.88 (0.19)**	**1.26 (-0.33)**
Return on Equity (ROE in per cent)	**-56.92**	**-0.27 (0.99)**	**0.28 (2.04)**	**18.37 (64.61)**	**22.22 (0.21)**	**13.17 (-0.41)**

Note: Data from Annual reports of Prabhu Bank

The above table shows six years of achievements (pre and post merger) of Prabhu Bank in terms of earning per share, return on assets and return on equity. The figures in parenthesis indicate the annual percentage change in the reported data on the basis of previous year.

In 2012/13, EPS, ROA, and ROE were in huge negative ranks having Rs (40.23) per share, (3.43) per cent, and (56.92) per cent respectively. These are the outcomes when there were not any merger or acquisition activities involved in bank. The next year, deficit figures reduced in compare to previous year however the ratios were not satisfactory. We can see in the table, EPS is Rs (15.24) per share, ROA is (1.44) per cent and ROE is (0.27) per cent in 2013/14. There was great improvement in ROE in relative to other two ratios in that year. 2014/15 was the turning period, forming Prabhu Bank with merger among Grand Bank Nepal Ltd, Kist Bank Ltd, Prabhu Bikash Bank Ltd, Gaurishankar Development Bank Ltd, and Zenith Finance Ltd. The year of merger had EPS of Rs 31.73 per share, ROA of 2.19 per cent, and ROE of 0.28 per cent. Prabhu Bank also acquired Nepal Development Bank in 2015. All the ratios upgraded to positive ranks which described the growth of the company with the first year of merger. Again, the EPS and ROE increased to Rs 35.79 per share and 18.37 per cent respectively in 2015/16 while ROA declined to 1.58 per cent. In 2016/17, EPS reduced by around

6 units to Rs 29.78 per share than that of previous earning but ROA upgraded to 1.88 per cent and ROE also to 22.22 per cent. Finally, Prabhu Bank has earnings per share of Rs 15.42, return on assets of 1.26 per cent, and return on equity of 13.17 per cent within latest financial year of 2017/18.

The main turning point of Prabhu Bank regarding the three profitability ratios was the year 2014/15 after which the company grew its profitability as it can be seen in the above table.

NIC Asia Bank has its antecedents in NIC Bank which was established in 21 July 1998. The Bank was rechristened as NIC ASIA Bank after the merger of NIC Bank with Bank of Asia Nepal in 30 June 2013. This was a historic merger in the annals of Nepalese financial landscape as the first of its kind merger between two successful commercial banks in the country. Today, NIC Asia Bank is one of the most successful commercial banks in Nepal.

In order to find the profitability performance of bank, the profitability before merger has to be analyzed.

Table 5: EPS, ROA and ROE of Bank of Asia before merger (2009-2012)

Ratio\ Year	2009/10	2010/11	2011/12
Earnings per share (EPS in Rs per share)	13.86	10.49 (-0.24)	8.63 (-0.18)
Return on Assets (ROA in per cent)	1.53	1.26 (-0.18)	0.97 (-0.23)

Note: Data from Annual reports of Bank of Asia

The three years profitability performance of Bank of Asia before merger with NIC Bank Ltd can be analyzed with above table where its earnings per share were gradually declining from 2009/10 to 2011/12. Similarly, return on assets was also decreasing slowly. EPS and ROA on 2009/10 was Rs 13.86 per share and 1.53 per cent respectively, in 2010/11 was Rs 10.49 per share and 1.26 per cent, and lastly in 2011/12 was Rs 8.63 per share and 0.97 per cent.

The profitability ratios below show the data of NIC before and after merger with Bank of Asia.

Table 6: EPS, ROA and ROE of NIC Asia Bank (2009-2015)

Ratio\ Year	Before Merger			After Merger		
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Earnings per share (EPS in Rs per share)	34.30	37.8 (0.10)	29.87 (-0.21)	47.41 (0.59)	35.98 (-0.24)	25.59 (-0.29)
Return on Assets (ROA in per cent)	2.3	2.34 (0.02)	1.64 (-0.30)	1.78 (0.09)	1.71 (-0.04)	1.21 (-0.29)
Return on Equity (ROE in per cent)	27.09	28.09 (0.04)	19 (-0.32)	14.63 (-0.23)	15.93 (0.09)	13.05 (-0.18)

Note: Data from Annual reports of NIC Asia Bank

NIC Bank Ltd was operating singly in 2009/10 till 2011/12. In 2009/10, NIC Bank had all the profitability ratios highly satisfactory in compare to coming financial years. The EPS was Rs 34.30 per share, ROA of 2.3 per cent and ROE of 27.09 per cent. These ratios increased in 2010/11 and reached Rs 37.8 per share, 2.34 per cent and 28.09 per cent as shown in the given table. However, there was a decline in EPS, ROA, and ROE, the next year, to Rs 29.87 per share, 1.64 per cent, and 19 per cent respectively.

The two commercial banks NIC Bank and Bank of Asia merged in 2012/13 when earning per share sharply rose to Rs 47.41. This EPS is the highest rate among the 6 years period from 2009 to 2015. ROA also increased to 1.78 per cent but ROE slightly decline to 14.63 per cent in that year. However, the three ratios gradually decreased in next two years. EPS of Rs 25.59 per share, ROA of 1.21 per cent and ROE of 13.05 per cent in 2014/15 are the lowest value acquired after merger.

Global IME Bank Ltd. (GIBL) emerged after successful merger of Global Bank Ltd (an “A” class commercial bank), IME Financial Institution (a “C” class finance company) and Lord Buddha Finance Ltd. (a “C” class finance company) in year 2012. Two more development banks (Social Development Bank and Gulmi Bikas Bank) merged with Global IME Bank Ltd in year 2013. Later, in the year 2014, Global IME Bank made another merger with Commerz and Trust Bank Nepal Ltd. (an “A” class commercial bank). During 2015-16, Global IME Bank Limited acquired Pacific Development Bank Limited (a "B" Class Development Bank) and Reliable Development Bank Limited (a "B" Class Development Bank).

Table 7: EPS, ROA and ROE of Global IME Bank (2011-2017)

Ratio\Year	2011/12	2012/13*	2013/14*	2014/15*	2015/16*	2016/17
Earnings per share (EPS in Rs per share)	11.79	16.15 (0.37)	19.57 (0.21)	15.58 (-0.20)	19.33 (0.24)	22.57 (0.17)
Return on Assets (ROA in per cent)	0.87	1.15 (0.32)	1.62 (0.41)	1.39 (-0.14)	1.58 (0.14)	1.72 (0.09)
Return on Equity (ROE in per cent)	11.37	12.35 (0.09)	12.69 (0.03)	12.38 (-0.02)	11.14 (-0.10)	11.66 (0.05)

*Merged Years

Note: Data from Annual reports of Global IME Bank

Global IME Bank has being going through merger and acquisition process from last several years. After merger of 2011/12, the EPS, ROA, and ROE of the bank were Rs 11.79 per share, 0.87per cent and 11.37per cent respectively. These ratios increased the following two years as seen in the data of 2012/13 and 2013/14. But again EPS fell down from Rs 19.57 to Rs 15.58, ROA from 1.62 per cent to 1.39 per cent and ROE from 12.69 per cent to 12.38 per cent. In the next two years, EPS, ROA and ROE gradually lifted up. Therefore, the latest year shows earnings per share of Rs 22.57, return on assets of 1.72 per cent, and return on equity of 11.66 per cent.

4.3 Discussion of Findings

The profitability ratios obtained from the annual reports of selected banks are tabulated and analyzed accordingly. Now the tabulated data are expressed in graphical view so that the trends are easier to understand.

The graphical presentation of EPS is below:

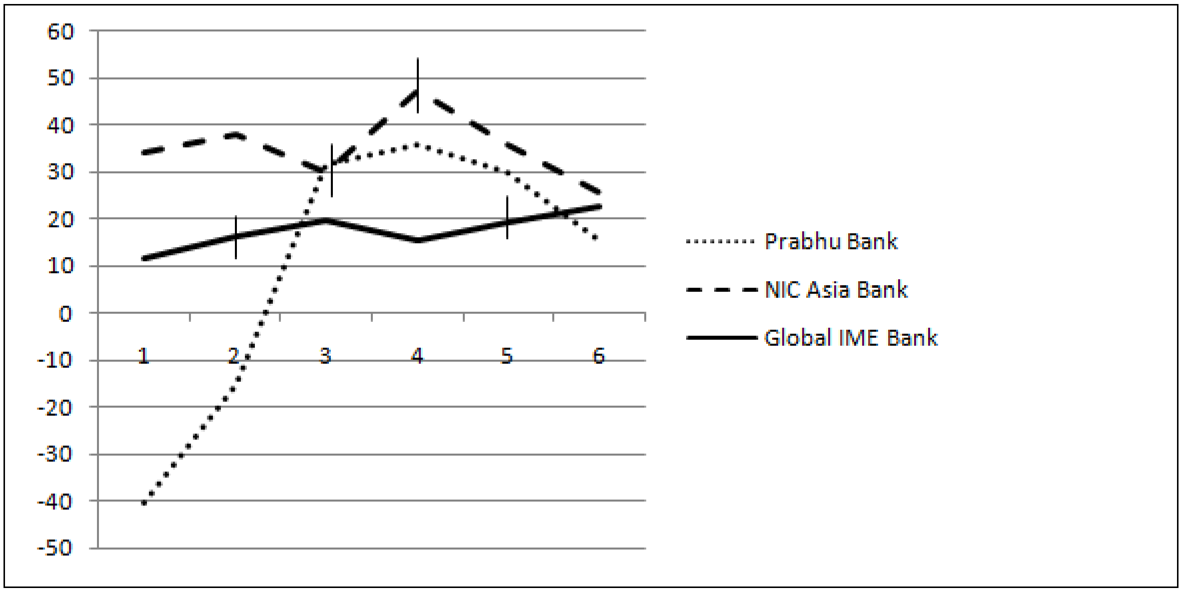

Figure 2: EPS of Prabhu Bank, NIC Asia Bank and Global IME Bank

The graph shows earnings per share of the three sample banks indicating the ratio before and after M&A. In the figure, the straight line crossing in the EPSs is the year when institutions had merger/acquisition.

The graph shows that Prabhu Bank has profited through M&A strategy as we can see the improvement, with a sharp increase in the merger year, in EPS. Before the merger, Prabhu Bank was facing negative EPS even with higher rate but that was recovered along with merger strategy. The next year after merger, EPS increased slowly and then declined the following years. NIC Asia Bank was facing ups and downs in its EPS before it merged with Bank of Asia and in the merger year, it gained highest EPS than that of all other sample banks. Then in fifth and sixth year, EPS of NIC Asia Bank declined, however, the ratio is highest in compare to Prabhu Bank and Global IME Bank. Global IME Bank was going through M&A

for several years and even though it has very stable EPS during its merger and acquisition years. It is because with the increase in net income, the shares number also might have increased through dividend share and so on.

The picture also indicates that Prabhu Bank has greatly improved in its profitability performance with the M&A strategy. And, Global IME Bank is gradually taking growth with slight fluctuations in EPS. NIC Asia Bank has no big variations before and after merger but still it has highest EPS comparing with other two banks.

The graphical presentation of ROA is as follows:

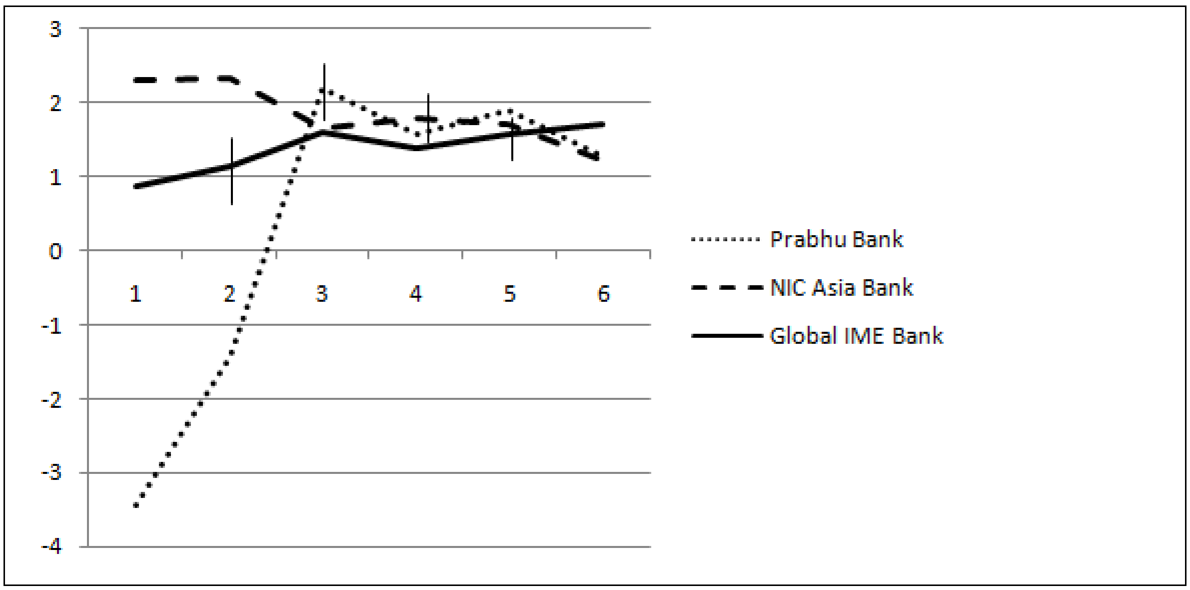

Figure 3: ROA of Prabhu Bank, NIC Asia Bank and Global IME Bank

Analyzing ROA among three banks, top most improvement is of Prabhu Bank since it has overcome from its negative return on assets within the beginning two years and along with the merger activities, its ROA is fluctuating with positive rates. Again, NIC Asia Bank has gradual declining condition in profitability ratio even after adaptation of merger strategy. Global IME Bank has liner trend in ROA.

The graphical presentation of ROE is as follows:

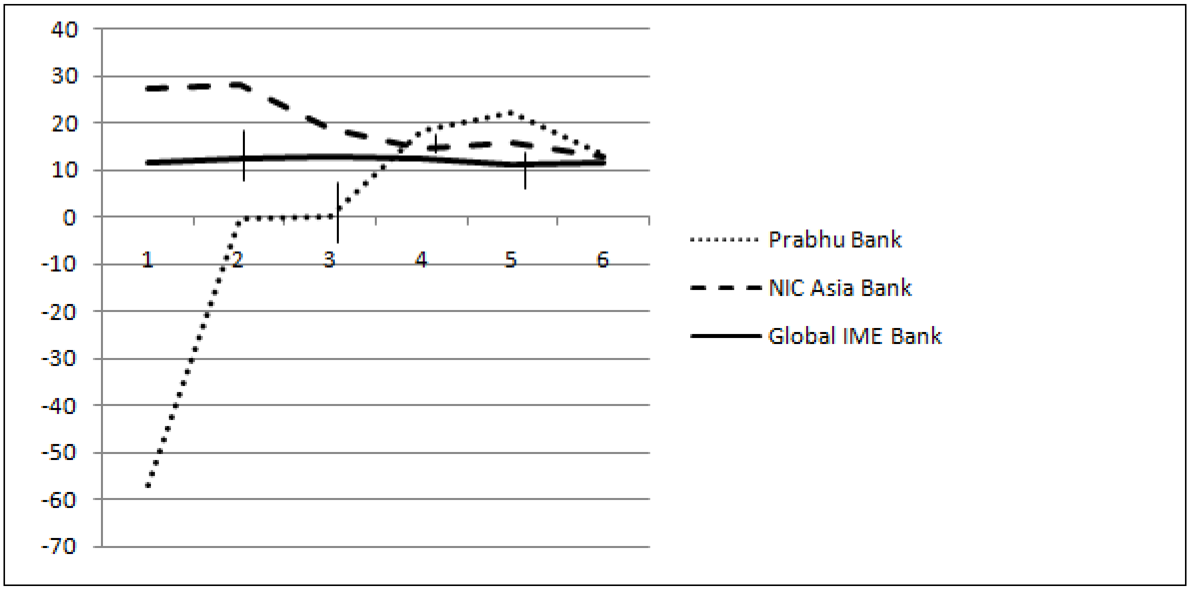

Figure 4: ROE of Prabhu Bank, NIC Asia Bank and Global IME Bank

Prabhu Bank's ROE has sharply grown in the second year and remained almost same till one year. Then, it grew up next two years and again declined. ROE of NIC Asia Bank degraded from its beginning rate till the end while Global IME Bank had similar and stable ROE for whole six years period.

In comparing the profitability ratios among the Prabhu Bank, NIC Asia Bank and Global IME Bank, Prabhu Bank is more successful to gain benefit from merger strategy. It has a progressive trend from deficit position to growth. The institution picked up to become more profitable as time passed. The next side, NIC Asia Bank has declining position in EPS, ROA and also in ROE; however, the declining rate is just gradual. And Global IME Bank has great ability to maintain stability in its profitability position even before and after mergers and acquisitions strategy.

Chapter 5

Summary, Conclusions and Recommendations

5.1 Introduction

This chapter presents summary, conclusion, limitations, recommendations and suggestions for further research. The objective of the study was to examine the profitability of Nepalese Commercial banks after mergers and acquisitions.

5.2 Summary

This study started with the research topic selection concerning the global trend of mergers and acquisitions (M&As) introducing that the main reason of M&As for business companies, is to gain a synergy with combination of business activities.

Firstly, even though there are large numbers of international as well as national institutions which have gone through merger and acquisition phases, so the performance of the merged/acquired companies need to be analyzed in order to understand the worth of combining big and complex companies with each other. Therefore, an objective of the study was set that included measuring and analyzing the financial performances of commercial banks of Nepal considering the limitations of the study. It is an interesting report for all the stakeholders to understand the combined performance of the banks. Secondly, literature review had done related to study topics included books definitions, theories and empirical studies from journal articles, international theses, and newspapers which are the sources to gain knowledge on effect of M&A in performance of institution. Thirdly, the methodology of research was set with descriptive research design including population and sample banks. Data were collected from secondary source such as annual reports of banks, articles and websites and data analysis tool was selected to analyze the performance of sample banks. Profitability ratio is one of the tools used to measure the financial performance of banks. Fourthly, the six years period profitability ratio such as earnings per share, return on assets and return on equity, were measured and analyzed taking sample banks. It also included calculation of the percentage change in the next year ratios with that of previous year. Lastly the study had interpretations and conclusions in findings along with recommendations.

5.3 Conclusions

The profitability of the new institution formed on the merger/ acquisition registered a higher profitability as depicted by an increase in the EPS, ROA and ROE on the merger/acquisition. Merging/acquiring improved the profitability of the new institution compared to the separate institutions facing liquidation. In aggregate, the improvement was realized immediately in the merged/acquired year. The increase in profitability was pronounced lower in the second and the third year than it was in the exact year of the merger.

Since many authors have examined different companies' and financial institutions' performance using various tools and concluded the positive and negative effects of M&A. In same way this study also included profitability ratio analysis of bank which showed uplifts and declines in EPS, ROA and ROE with pre and post merger period intervals. An analysis of EPS indicated that the profitability of the banks increased tremendously with merger/acquisition announcement and operation of institutions. The effects of the merger/acquisition in the financial institutions profitability were evident when looking at the EPS, ROA and ROE of the institutions before the merger/acquisition. Even the ratios declined after certain years of merger, the rate before and after merger had uplifts. In majority of the mergers/acquisitions, the merger improved the profitability of the new institution as the EPS, ROA and ROE kept on increasing immediately after the merger/acquisition. However, the profitability increased at lower rate in the second year after the merger/acquisition as compared to immediately after the merger/acquisition. EPS indicates the mergers and acquisitions improve the profitability of the financial institutions.

5.4 Recommendations

Following the findings from the analysis of the selected ratios of the financial institutions that have undergone mergers/acquisition in Nepalese commercial banks, the study recommends that

- Institutions having weak capital base can consolidate to create synergies so as to enjoy economies of scale as this will improve their profitability instead of going for liquidation and closure of institution because that might be a huge loss in terms of reputation and capital.
- Those firms facing constraints on the market should consolidate their energies by resorting to merger/acquisition so as to expand their profitability.
- The merger/ acquisition is not just for the best interest of the managers but also shareholders as it leads to an increase in shareholders' wealth as opposed to each financial institution operating separately on its own.

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