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Post-Merger Corporate Performance: A Case of NIB Bank Pakistan.

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Abstract

This study measures whether the mergers generate efficient, trustworthy and wide-ranging capital base for the bank that completely comprised mergers and to what range mergers of banks increase the confidence of the investors, the customers, the shareholders and capacity to finance the real time sector. For the purpose total 9 ratios under profitability ratios and other ratios applied on key financial figures to analyze the selected bank performance. Key figures were taken from the website of the NIB bank. Data was taken from 2004-07 before merger and 2008-12 after the merger.

Keywords

Merger, Banks, Pakistan, Post Merger Corporate Performance

Introduction

Over the years the Pakistani banking sector has experienced extraordinary change, in ownership composition, provisions of a number of organizations, along with the depth of operations. These alterations have been prejudiced commonly by challenges invented by deregulation in rules of the financial sector, globalization of processes, procedural inventions and acceptance of managerial and prudential requirements that kneel to global codes.

After the declaration by the state bank of Pakistan, that banks in Pakistan should strengthen their minimum capital adequacy ratio in relation to the bank risk weighted assets or set by SBP, the trend of merger and acquisitions that now swept through the banking sector has been started.

Mergers and Procurements are usual in an emerging countries of the world; but are just becoming protruding in Pakistan. Merger and acquisition is just one more method of saying existence of the rightest specifically a bigger, more effective, better-capitalized, more skilled industry.

Problem Statement

The current abrupt rise in bank mergers in Pakistan is appealing great responsiveness, partially as a consequence of strong notice in what stimulates corporations to combine and how mergers have emotional impact on effectiveness.

A quarrel of this is the decrease in the quantity of banks nationwide but the attention of power in local banking markets is not greater than before. The problems of under-capitalization, negligence and poor company governance have sustained to be bases of uncertainty and dishonesty in consecutive Pakistani banking crises until now. Henceforth, mergers are reflecting a valuable part in rearrangement the banking world without risk and nonexistence of opposition. This study will reflect this review by searching the consequence of the merger that had occurred in the banking sector of Pakistan on the performance of a selected bank.

Importance of the Study

The value of business is enhanced by a merger. Reasons behind the merger are to upsurge income by improving share in market, cost, economies of scale and economies of scope. With the increase in bank size, effectiveness also progresses. Along with benefits of economies of scale and diversification, horizontal integration and vertical integration are two other economic reasons of M&A (Gaughan, 2011). Merger delivers a dissimilar and fresh culture to work with employees. Employees can work in a progressive culture using several wanted changes. The success of mergers rest on an alteration in a state of mind of the people (Sathe and Davidson, 2000; Champy, 1995). Calomiris and Karceski (2000) draw attention to that competence achievement can flow to bank clients (Nikolaos & Ioanna, 2005).

Literature Review

According to Marcia Millon and Jamie John (2006) if banks are large their mergers generate higher performance gains and if banks are small, then the mergers which are activity focused generate larger performance gains as compare to activity diversifying mergers. Similarly, the mergers which are geographically focused produce better performance gains than geographically diversifying mergers. According to him corporate performance increases due to revenue enhancement and cost reduction activities. The merged banks also experience abnormal long-run stock returns along with these increases in accounting-based operating performance. Reason for bank mergers is the potential cost synergies that may exist.

From Philip Gilligan, and John banks (2002) point of view the reasons of mergers in Banks in Asia are because now many banks are not as profitable as they were once. So they consider mergers as a solution. Due to many issues many banks are compelled to concentrate on retail banking over wholesale business. G. Meeks and J. G. Meeks (1981) said if for instance, the bargaining power of a participant is on average increased by merger so it is a reasonable generalization that profitability could ascend even though efficiency remained unchanged or actually fell. Prager and Hannan (1998), analyzed that the concentration of local markets increased because of the price effects of bank mergers. They concluded that mergers which occur in more concentrated banking markets shows adverse changes in short term deposit interest rates. Merged banks earn a monopoly by offering low deposit interest rates. The banks which don't merge have a change in deposit rates in the same direction; they said that merged bank's deposit rates should decrease by a greater percentage instead of increasing.

According to Dario Focarelli, Fabio Panetta and Carmelo Salleo (2002) the strategic objective of merger is to expand revenues from financial services, while to improve the quality of the loan portfolio of the passive bank is central objective for acquisitions.

Hemabajaj (2009) analyzed that in the merger when two organizations merge, their employees have to face different culture or alien ways of doing things. Because of cultural changes interaction, between employees depends on a type of merger. If similar firms are going to merge then level of interaction will be high but if different firms are merging it may result in a cultural clash due to differences in symbols, attitudes, values and beliefs allied with their culture. If Cultural conflicts are high it may cause uncertainty and stress, and become a cause of productivity loss, low morale and high employee turnover.

Mehwish Aziz, Ferheen Kayani, and Attiya Javid (2011) concluded that due to merger the profitability and the net interest spread of two merged banks decreases. As there are many mergers are taking place in Pakistan, there is a need of a competition policy. Dario Focarelli and Fabio Panetta (2003) found that deposit rates increases only for those banks that are successful in reducing their costs. While the costs of restructuring in the short run the consolidated entity may cover the gains, which cannot fully emerge for years.

According to Rizwan, Majed, Muhammad, & NUML, (2011) some changes occur in working and response of employees when mergers take place. If there is a positive response then it leads towards efficiency of business and ultimately at the end customers feels change. The cultural change after merger and acquisition is also highly regarded as an important trait for success. The most crucial dimension in the post-acquisition integration phase is to form an effective post-acquisition transition strategy immediately after the deal is closed. Hussain, M., & Mubeen, M. (2018) in a recent comprehensive study on the merger of banks in Pakistan suggested a positive impact of merger on the corporate performance is quite visible.

M. Idrees Khawaja, Musleh-ud Din and Rizwana Siddiqui (2006) concluded that inelasticity of deposit supply has significant and positive impact on spread while concentration is not the basis of a statistically important pressure upon interest spread. They argued that the very high level of inelastic deposit supply leaves only a small incentive to the banker to accept competitive practices and consequently the concentration ratio, which results in the level of competition, fails to work out a pressure upon spread. They argued that the materialization of alternate financial intermediaries is necessary to decrease the spread. In the meantime, the regulator can play some important role in lowering the spread".

In a study by Alexander J. Yeats (1973) concludes that the merger has played a significant role in shaping the existing market structure and a strategy of "no mergers" would create a de-concentration of deposits. He further suggests that merger activity performed an important role in either keeping a high level of deposit concentration or in fact, increasing deposit concentration in the state. Richard A. Shick and Frank C. Jen (1974) say that it is shown by recent empirical investigations that shareholders receive benefits from mergers in spite of the fact that academicians traditionally have argued, they do not.

Morris (2004) suggests that a significant sociological suggestion is that alterations in social structure led to alterations in social behavior. Markets are increasingly analyzed by sociologists as social structures instead of as strictly economic structures. Furthermore, regulation is understood as a social structure, providing a mechanism of social control that keeps rules of the transaction in the economy. So, both the financial market and the regulatory structure in which banks are surrounded can be conceptualized as social structures, and, as the banks are considered as social actors, these social actors should show different behaviors in changing social structures. He says that mergers are frequently being used to change a corporate structure and, ultimately, to concentrate assets in the industry. To resolve the uncertainty in the organization, organizations can choose to evade uncertainty, change the organization, change the environment; one such reaction may be merger. The organization's interaction with its environment can be made more stable and predictable by increased size. Furthermore, merger makes the resulting organization more influential in its relationships with its competitors.

Theresa Morris (2004) concludes that capital adequacy has a constantly negative influence and management competence has the predicted negative impact on the odds of a banks being a non-survivor of a merger after deregulation. Though, asset quality has a statistically significant impact on the odds of merger.

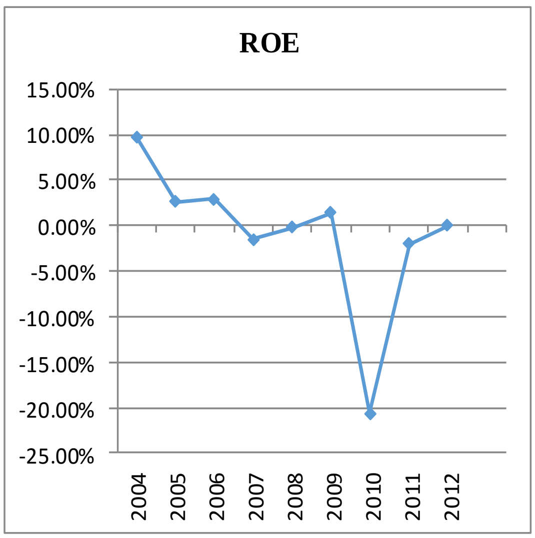
Marvin e. Rozen (1962) wrote that there are many considerations which motivate bank mergers. Most important is, they create possible important economies of scale- partly as an outcome of the chances for specialization in a larger organization and partially because the use of costly equipment is viable only if business volume is great. Higher lending limit and more varied and improved services are permitted by merger. Marvin e. Rozen explains that individual bank problems including weak financial situations, management succession difficulties and inefficient management can also be reasons of mergers. Limitations on entry can encourage mergers. Mergers can result in greater efficiency, lesser costs and improved service etc. Similarly, mergers can motivate as well as regulate competition.

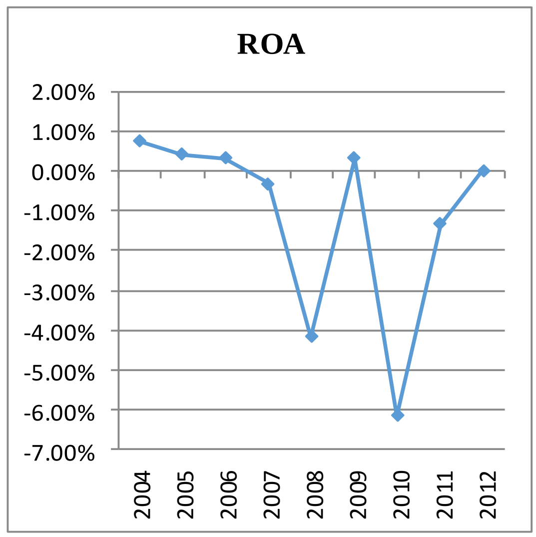
Kummer and Steger (2008) suggest that the rate of mergers of being successful is very less. Purchasing out a company is easy, but it is the post-acquisition stage where the unwanted happens. There are lots of questions which arise as a result of M&A. It is just the survival of the fittest.

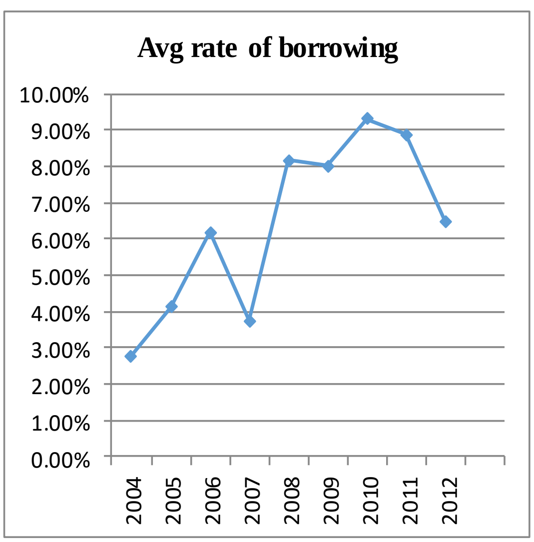
Yakov and Geoffery (1997) describes merging banks can increase revenues without much change to cost and equity by fluctuating their output mixes from security towards loans. Mergers are very helpful in reforming banks. Joshua (2011) describes that it is witnessed that commonly merging actions were done by banks and banks commonly accepted the merger when they need change means diversification, or they want to improve profitability or to decrease competition etc. Mergers and acquisitions in the financial system might impact certainly on the competence of most banks.

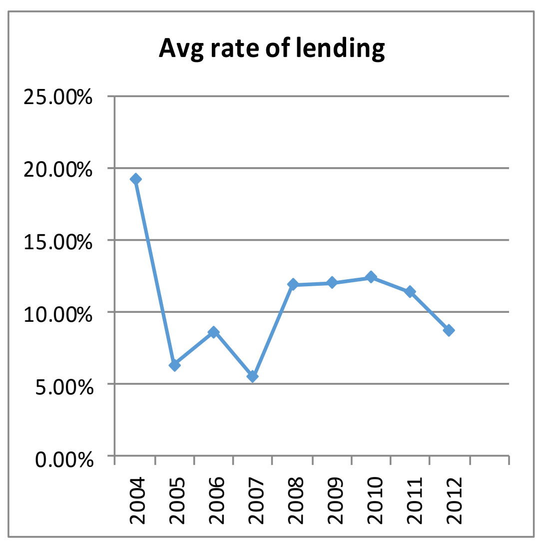
Methodology

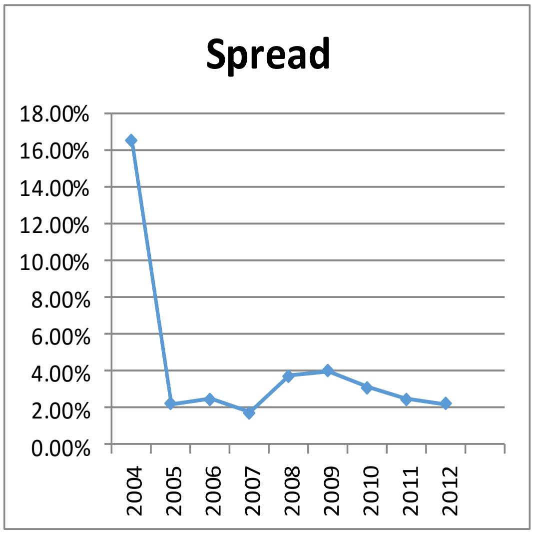
The financial statements of NIB bank are used to calculate financial ratios. The financial ratios used in this thesis are those which are used by audit members to aware of performance of banks. Data for research on the performance of NIB BANK is collected from its website. Its financial statements of 9 years from 2004-2012 are downloaded and used in a calculation of financial ratios. To analyze the performance of NIB bank before and after the merger, ratio analysis is conducted. For computation of ratios MS Excel 2010 is used. The data which is obtained after doing financial analysis is represented in tabulated and graphical form so that interpretation can easily be done. The profitability ratios are used to evaluate the management's ability to handle expenses and to earn profits from its activities.







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16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
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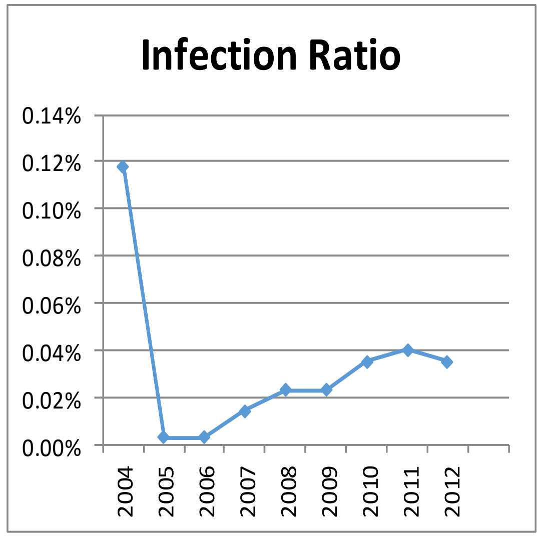
Infection Ratio
0.14%
0.12%
0.10%
0.08%
0.06%
0.04%
0.02%
0.00%
2004
2005
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2008
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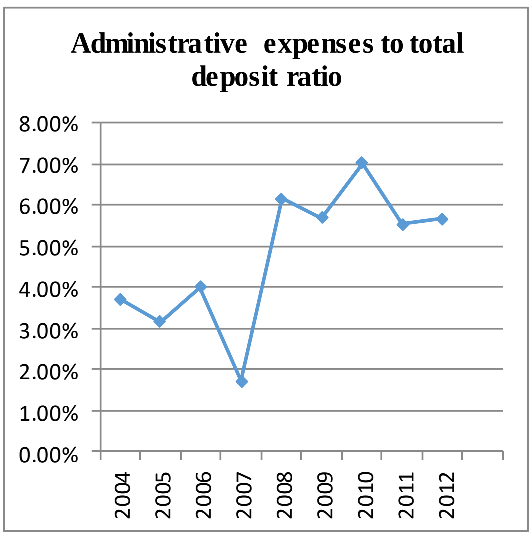
Administrative expenses to total deposit ratio
8.00%
7.00%
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
2004
2005
2006
2007
2008
2009
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2011
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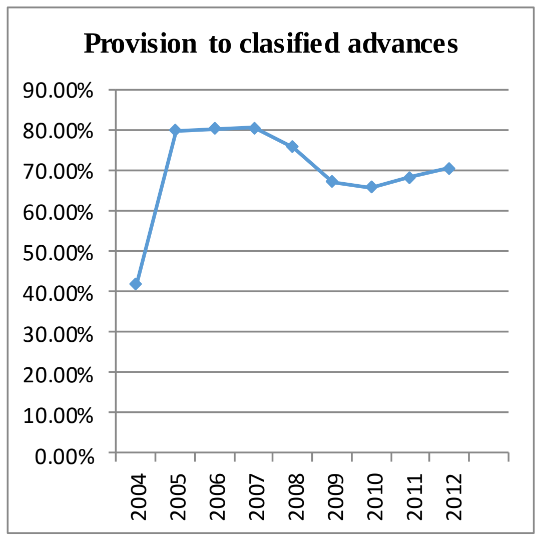
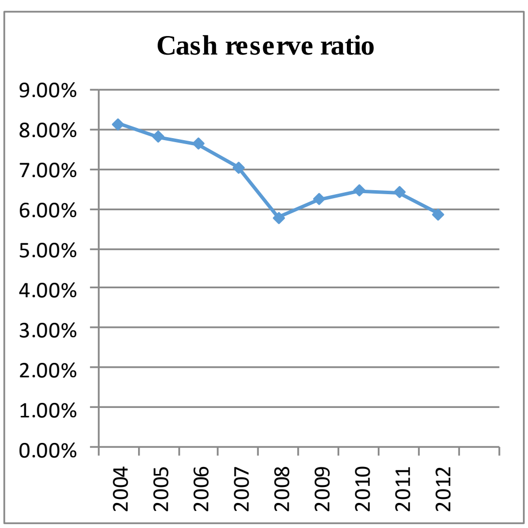

Provision to clasified advances
90.00%
80.00%
70.00%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
2004
2005
2006
2007
2008
2009
2010
2011
2012


Cash reserve ratio
9.00%
8.00%
7.00%
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
2004
2005
2006
2007
2008
2009
2010
2011
2012

Discussion

ROE

ROE was continuously decreasing and NIB bank witnessed a negative return in the year 2007. First year after the merger (2008) shows that loss is reduced and the 2nd year (2009) of post-merger shows positive ROE. In 2010, it is seen that the value of ROE is highest negative and its main reason is a reduction in remunerative assets like advances and investments. Appropriation of goodwill is another cause of negative ROE. At the end of 2011 loss is considerably reduced and contributing character is lending to the financial institution. Financial 2012 shows nominal profit and it seems that positive effect of merger will improve in time to come. Negative ROE after the merger shows the inefficiency of bank management.

ROA

In NIB Bank, the ROA decreased during the period from 2004 to 2006 but that difference is very slight. In 2007, ROA ratio was negative. This is yet another indicator that management is not performing well. The major reason for a decline is there was a loss in 2007 and assets increased as compare to 2006. It is pre-merger performance. After the merger in 2008 there was loss due to which the ratio is negative. In 2009, there is a positive figure because assets increased in 2009 as compare to 2008 and there is profit while in 2008 there was loss. In 2010, there was a loss and assets decreased as compare to 2009 so the ratio is negative. In 2011 there was loss and assets were higher as compare to 2010 but due to loss this ratio is showing negative results. In 2012, there is a profit and assets are high as compare to 2010 so this ratio positive but low. It is very clear by taking averages that the return on assets is low after the merger.

Bank Average Rate of Lending

This ratio showed there are fluctuations in the lending rate before merger, the rate was low, but after merger the rate increased because the interest earned increased as compare to lending and advances. But in 2012, there was again a decline in the lending rate. So it's concluded that the bank performance is good after merger. By taking an averages it shows that after the merger, average lending rate of the bank is increased which is a positive sign.

Bank Average Rate of Borrowing

Before the merger, average borrowing rate was low except in 2006 when expenses were high as compare to previous years. After merger, there was a huge increase in expenses so the borrowing rate showed an upward trend. It shows the inefficiency of management because after the merger depositor's withdrawal their money so deposits decreased but the expenses were same or sometimes increased. In 2012, deposits increased and management controlled their expenses so the ratio is low, which is good for the bank.

When we took averages it resulted that the average rate of borrowing of the bank becomes double. It's not a good sign for bank because its expenses increased after merger and deposits decreased. When the merger took place investors were afraid to lose their money so, the investors started withdrawing their money. This led to a substantial decrease in the deposits.

Spread

In 2004, spread was 16% because average rate of lending was much higher than average borrowing rate of the bank. In 2005, there was a decrease of 14% because the average rate of lending decreased by a great percentage which shows the interest earned of the bank is not enough as compare to advances and loans. In 2011, it again decreased to 2% which again shows the inefficiency of management in this year lending rate was good, but borrowing rate was high that's why this ratio showed decline. In 2012, the lending rate was not up to expectations and borrowing rate was high so in this year again decrease in this ratio. Post-merger spread was decreased. The main reason of this was increase in banks average rate of borrowing. Banks rate of lending increased but borrowing rate also increased so the spread is low which shows after merger the profit of bank showed decline.

Infection Ratio

The infection ratio of the bank was decreasing in the years which are before the merger of the bank, but it can be seen that after the merger there is a positive trend in the infection ratio. It keep on increasing as the time passes. It is a good indication of the performance of the bank. This increase is due to the increase in the advances of the bank. By taking averages it is seen that before merger the infection ratio was good, but there is nominal difference in the infection ratio before and after merger.

CRR

In 2004, CRR was 8% which was near to mandatory requirement. But during the period of 2005-07, it reduced to 7% which shows that their balance with other treasury banks has decreased. And it is not good for banks progress because CRR has been decreased. In 2008, after the merger the ratio showed further decline which is the result of decline in balance with treasury banks and increase in deposits. Same is the situation is in 2009 2010 and in 2011. In 2012, CRR decreased as a result of decrease in balance with other banks. When we took averages, we come to know that after the merger CRR decreased this is because decrease in deposits with the bank as CRR is 10% of banks time and demand liabilities.

Admin Expenses to Total Deposits Ratio

This ratio shows variation in all the years in case of a NIB bank. Both in pre and post-merger years sometimes it is increasing and sometimes decreasing. The reason of this up and down is the increase or decrease both in administrative expenses and deposits of the bank in the passing year. In 2012 it again increases due to increase in the administrative expense but at the same time there is an increase in deposits also but the rise in the ratio of this year is not a negative sign. It shows the better performance of the bank which shows positive results in the future. By taking average it's clear that admin to total deposit ratio increased after the merger which reflects the inefficiency of management to handle its admin expenses against deposits.

Provision to Classified Advances

In case of the NIB bank the provision to classified advances ratio in the years before merger this ratio is good but in the year just after the merger it shows a decline. In the year 2009-10, it keep on decreasing due to increase in the classified advances. At the same time, there is an increase in the provisions as well so, it is not a negative sign. In the year 2011 and 2012 it shows a positive trend which is still a good sign. The reason of this increase is the decrease in the provisions and advances. This ratio shows that the bank will perform well in the coming years. Average shows that after merger the provisions to classified advances decreased but with a small proportion this was due to increase in classified advances and the provision for that advances was low.

Conclusion

After doing the financial analysis it is concluded that averages of all the ratios showed the downward trend except infection ratio which is just opposite the recent study done by Hussain, M., & Mubeen, M. (2018). Averages of ROE and ROA showed negative values after merger. By taking averages it's clear that banks average rate of lending increased which is a good sign for the bank but banks average rate of borrowing also increased which shows bad effects due to increase in both ratio the spread is low after merger.
The infection ratio showed an upward trend after merger. Provisions to classified advances showed a downward trend which shows a decline in provision made against non-performing loans. Admin to deposit ratio increased after the merger because management was unable to control its admin expenses against its deposits. CRR declined after merger which is red signal for bank and forces bank to meet SBP regulations and make CRR Up to 10% of its time and demand liabilities. So, it is concluded that merger is not the solution for all the problems as different cultures of the organization can affect negatively.

Future Research

In this study merger alone was considered as a variable to measure corporate performance which has its limitations. There are other factors like different culture, strategic plan and team cohesiveness, level of stress and job insecurity, employee motivation can have detrimental effect on the corporate performance. In the future studies these variables can be considered along with the merger to measure the corporate performance.

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