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Increasing Trend of Mergers and its Impact on the Bottom Line

Evidence from Pakistan's Banking Sector

Muzzammil Hussain
University of Gujrat
muzzammil.hussain@uog.edu.pk

Muhammad Mubeen
University of Gujrat
muhammadmubeen320@gmail.com

Abstract

Aim of the study is to provide the information to the bankers, government authorities, employees and the investor of the financial institutions about the impact of the merger on the performance of the banks. For this purpose, financial ratios such as the liquidity ratio, loan to deposit ratios are measured to see the short term paying capacity of the banks. Investment ratio such as earning asset to total asset ratio; solvency ratio such as "deposit time capital"; equity capital to total asset, profitability ratios include the interest margin to earning asset are used to analyze the impact of merger and on bank performance. By using ratio analysis, the study concludes if the merger and have a positive relationship with merger.

Keyword

Merger, financial institutions performance, financial ratios

Introduction

Banks in Pakistan are facing security, financial and political influences that affect the banks performance. There are four types of financial institutions such as the commercial banks, development financial institutions, micro finance banks and non-financial institutions (Shakoor, Nawaz, Asab, & Khan, 2014)
Merger and acquisition is a very broad practice. Organizations often use mergers as an expansion strategy to enhance the business operations or to enter different industry. The

study is very important for the investors and shareholders of banks and financial institutions and bankers that help them to know the impact on the performance of the banks. There are two types of variables - the dependent and independent variables – are use in the study. Dependent variable is the performance of the banks. Performance means that liquidity performance, investment performance, profitability performance and solvency performance. The dependent variable - liquidity performance - has three independent variables such as deposit to total asset ratio, advances to deposits ratios and cash to total asset ratio. The dependent variable leverage performance have the independent variables such as the return on asset ratio, return on equity ratios, net profit margin ratios, gross profit margin ratio. The dependent variable investment performance has the two independent variables such as return on investment and earning per share. The dependent variable solvency performance has the independent variables such as debt to equity ratio, interest coverage ratios and debt ratios. (Awan & Mahmood, 2015)

Research question

1. Does the merger increase or decrease the financial performance of banks or financial institutions?
2. How does the merger increase or decrease the profitability position of the banks?

Literature review

Merger is the practice by which the organization use to expand its business and want to enter in any other market. Most of the organizations use the merger to enhance or increase the efficiency and effectiveness. (Shakoor, Nawaz, Asab, & Khan, 2014), (Awan & Mahmmod, 2015) If the loan to deposit ratios is high the liquidity performance of the banks is high. If the financial position of the company is very good liquidity position of the bank is good. So, if advances to deposit ratio is has a positive impact on the financial performance of the bank. According to the (Sufian & Fadzlan, 2004) mergers and acquisitions has positive increased in the performance of banks. Sufian and Fadzlan further states that the performance of the target banks performance is increased significantly than the acquiring bank performance. According to the (Afza & Yousaf, 2012) merger can impact on the cost and profit efficiency of the banks. They used the four year data for the study and find the cost and profit efficiency and compared pre and post period. The cost efficiency of the banks was increased after the merger but for the same period banks profitability does not witnessed any significant improved.

Net profit margin ratios states that there is the inverse connection between the bank performance and the merger and acquisition activities. Another study of (Awan & Mahmmod, 2015) stated that the bank performance and merger and acquisition have the positive relationship. Haider, Shoaib & Kanwal (2015) state that the liquidity is the ability of the company to pay the short term obligation of the company through the current assets. They argued that the liquidity performance of the banks increases after the merger and acquisition and it increase the ability to pay the short term obligation through the current assets. The liquidity position has a positive relationship with the merger and acquisition. According to the (Shakoor, Nawaz, Asab, & Khan, 2014) the performance of the banks and the merger and acquisition have negative relationship with each other.

Afza & Yousaf, (2012) states that the leverage position is increases due to unused debt and the debt capacity. They used two types of variables such as dependent and independent in this study. The dependent variable is the return on equity and the independent variable is the performance of the banks. According to the (Haider, Shoaib, & Kanwal, 2015) the merger and acquisition has the negative relationship between the performance of the banks and states that the performance of bidder bank has improved after merger and acquisition.

(Adekunle & Rahman, 2013) Stated that the post-merger banks performance of the Nigerian banks is improved and determining the impact of the merger. To check the impact of the merger they selected the sample by using the judgment sampling technique and get the data from annual reports of listed commercial banks in Nigeria. The data was analyzed by using the ratio and the regression analysis. By using the analysis technique and concluded that the performance of the bank has a strong relationship between the merger and acquisition and has a strong relationship between the credit risk and liquidity risk. The bank performance is improved after merger and acquisition. (Asauten Samuila & Christopher O. Phd, 2015) States that financial sector improvement play a significant role in the development of economy of any country. This study evaluates the impact of the merger and acquisition on the performance of the Nigeria banks by using the CAMEL analysis which mean that the capital, asset, management, earnings and liquidity. They concluded that the performance of the banks has the positive relationship with merger and acquisition and put significant impact on the financial performance of commercial banks in Nigeria. According to the (Shakoor, Nawaz, Asab, & Khan, 2014) the performance of the business is improved due to interest coverage ratios after merger and acquisition. These ratios suggest that there is the negative relationship between the firm performance and merger and acquisitions activities. According to the (Awan & Mahmmod, 2015) the performance is improved after merger and acquisitions in aspect to the Debt ratio. (Awan & Mahmmod, 2015) argued on the merger and acquisitions and firm performance. Merger and acquisition lead to the better performance of the banks. He concluded that the performance of the banks is increases after merger and acquisition than the before merger and acquisitions

Methodology

For the purpose of this study following banks are selected out of total banks operating in Pakistan.

Allied bank limited
Askari Bank Limited
Faysal Bank Limited
NIB Bank Limited
Summit Bank Limited

The information of the banks about the merger is provided in table 1.

Table 1- Merger and Acquisition of Banks in the Study.

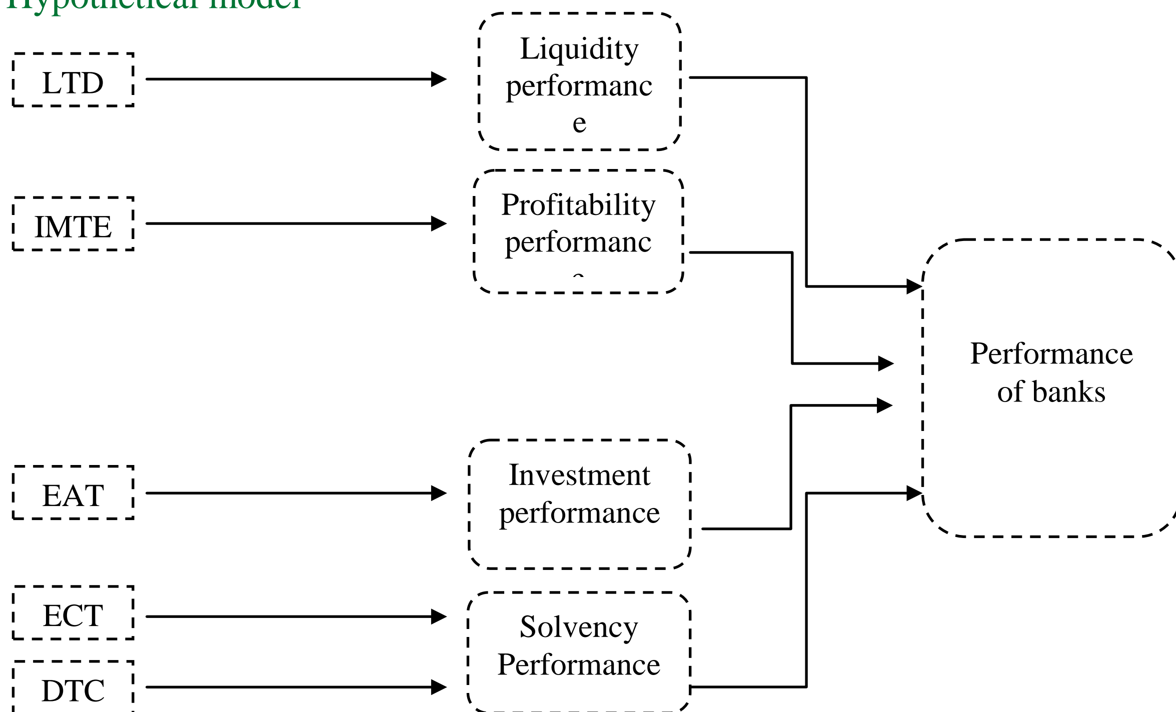
Company name	New name of company / merged with	Date
Royal bank of Scotland Ltd.	Faysal bank Ltd.	3/1/2011
Atlas bank Ltd.	Summit bank Ltd.	11/1/2011
First Allied Bank Modaraba	Allied Bank Ltd.	25/8/2006
PICIC Commercial bank Ltd.	Nib Bank Ltd.	1/1/2008
Askari leasing Ltd.	Askari Bank Ltd.	10/3/2010

The data for the study was collected from Karachi stock exchange (KSE), competitive commission of Pakistan (CCP) and security and exchange commission of Pakistan. The data for the analysis purpose is extracted from the annual reports of the respective banks.

Hypothesis

H1: profitability performance is improved after merger.
H1: Investment performance improved after merger.
H1: leverage performance is improved after merger.
H1: Solvency performance is improved after merger.

Hypothetical model



IMTEA = Interest margin to earning assets
EATTA = Earning Asset to total assets
ECTTA = Equity capital to total assets
LTD = Loan to deposit
DTC = Deposit time capital

Table 2- Liquidity Performance

	Bank Name	Liquidity Performance
	Allied Bank Ltd.	
Pre	2003	69.91%
	2004	47.06%
	2005	68.52%
Post	2007	63.91%
	2008	71.60%
	2009	72.18%
	Askari Bank	
Pre	2007	70.45%
	2008	76.82%
	2009	65.56%
Post	2011	71.70%
	2012	78.82%
	2013	81.78%
	Summit Bank	
Pre	2008	70.84%
	2009	59.10%
	2010	63.00%
Post	2012	71.27%
	2013	76.02%
	2014	81.15%
	Faysal Bank	
Pre	2008	60.40%
	2009	64.98%
	2010	68.45%
Post	2012	71.58%
	2013	75.93%
	2014	76.95%
	NIB Bank	
Pre	2005	92.89%
	2006	101.58%
	2007	70.31%
Post	2009	90.50%
	2010	75.25%
	2011	71.20%

The sample for this research is the five commercial banks which are merged and acquired by any other banks or financial institutions. With the help of this ratio we can conclude that the performance of the banks is increases or decreases after merger. According to this table there is the negative relationship between the merger and banks performance. The ratio loan to deposit ratio of Askari bank, summit bank, Nib bank and Faysal bank decreases after merger and only one bank named as the allied bank increases the

performance of the bank but overall there is negative relationship between the merger and bank performance.

In table no 3 the profitability ratios of the pre and post merger period is measured. With the help of the ratios we can conclude that there is the negative relationship between the banks performance and the merger activities.

Table 3- Profitability Performance

	Bank Name	Profitability Performance
	Allied Bank	IMTEA
Pre	2003	8.04%
	2004	3.31%
	2005	4.75%
Post	2007	4.12%
	2008	4.48%
	2009	5.18%
	Askari Bank	
Pre	2007	4.08%
	2008	4.47%
	2009	4.20%
Post	2011	3.44%
	2012	3.09%
	2013	2.73%
	Summit Bank	
Pre	2008	4.19%
	2009	1.92%
	2010	1.63%
Post	2012	0.12%
	2013	0.87%
	2014	2.09%
	Faysal Bank	
Pre	2008	4.03%
	2009	3.07%
	2010	2.56%
Post	2012	3.42%
	2013	8.68%
	2014	4.10%
	NIB Bank	
Pre	2005	2.06%
	2006	2.52%
	2007	1.59%
Post	2009	3.59%
	2010	1.83%
	2011	1.67%

Post-performance of Askari bank limited, summit bank limited Nib bank limited and allied bank is decreases and the Faysal post performance is increases by comparing with the pre performance of the banks. So the profitability has a negative relationship with the firm's performance.

Table 4- Investment Performance

	Bank Name	Investment Performance
	Allied Bank	EATTA
Pre	2003	74%
	2004	87%
	2005	85.78%
Post	2007	84.77%
	2008	85.48%
	2009	86.40%
	Askari Bank	
Pre	2007	86.81%
	2008	83%
	2009	84.55%
Post	2011	84.98%
	2012	86.19%
	2013	79.52%
	Summit Bank	
Pre	2008	85.14%
	2009	86.74%
	2010	82.23%
Post	2012	80.39%
	2013	77.76%
	2014	78.69%
	Faysal Bank	
Pre	2008	89.25%
	2009	90.34%
	2010	84.42%
Post	2012	83.52%
	2013	84.03%
	2014	87.05%
	NIB Bank	
Pre	2005	90.53%
	2006	89.40%
	2007	71.94%
Post	2009	73.89%
	2010	81.53%
	2011	80.60%

The investment ratio shows that the performance of the banks is increases if the answer of the ratios is higher than the pre period. So there is the positive relationship between the performance of the banks and merger and acquisition.

Table 5- Solvency Performance

	Bank Name		Solvency Performance
	Allied Bank	ECTTA	DTC
Pre	2003	10.40%	3.93times
	2004	6.10%	13.37
	2005	5.93%	14.2
Post	2007	5.76%	14.31
	2008	5.65%	14.34
	2009	4.68%	12.71
	Askari Bank		
Pre	2007	6.69%	11.66times
	2008	5.83%	13.93
	2009	5.87%	13.77
Post	2011	4.82%	17.57
	2012	4.97%	24.43
	2013	4.21%	20.15
	Summit Bank		
Pre	2008	24.72%	2.70times
	2009	10.55%	7.69
	2010	4.84%	17.61
Post	2012	2.12%	34.08
	2013	2.55%	33.14
	2014	7.40%	9.57
	Faysal Bank		
Pre	2008	7.35%	10.09times
	2009	6.20%	10.88
	2010	6.23%	11.7
Post	2012	6.00%	12.81
	2013	5.79%	13.16
	2014	5.62%	12.97
	NIB Bank		
Pre	2005	13.28%	4.96times
	2006	9.43%	6.97
	2007	13.23%	4.95
Post	2009	20.21%	2.21
	2010	4.79%	10.02
	2011	9.13%	6.04

We can conclude that the performance of the allied bank, Askari bank, and Faysal bank increases after the merger the performance of the summit and Nib bank is not significantly improved and concluded that the investment performance of banks is

improved after merger. If the investment ratio is higher then the performance of the banks is high; if the investment ratio is low then the performance of the bank is low. The higher investment ratios are very important for performance improvement.
According to the table there is the negative relationship between the firm performance and the merger activity. So the equity capital to total asset ratio of Nib bank, summit bank, allied bank, Askari bank and Faysal bank equity capital to total asset ratio is less than the pre period it means that the post period performance of bank is lower than the pre period performance of the banks and hence there have a negative correlation between the financial performance of the bank and merger activity. The deposit times a capital ratio of all the banks which is selected is improved after the merger. So the deposit time's capital ratio is higher in the post period according to the comparison of pre and post results.

Table 6- Comprehensive Ratio Analysis

Ratios	Total number of ratios	Favorable ratios	Unfavorable ratios	Overall status
Liquidity ratio	5	4	1	Positive
Profitability ratios	5	1	4	Negative
Investment ratios	5	3	2	Positive
Solvency ratios	10	6	4	Positive

Above study help to analyze the impact of merger on the bank performance by calculating and evaluating the financial ratios analysis, According to this table the total liquidity ratios are five and the favorable ratios are four and the unfavorable ratios are one so we can concluded that the liquidity performance of the bank have a positive strong relationship with merger. So the post-performance of the bank is improved. This study shows that the profitability have the negative effect on the bank performance after merger. The profitability ratios are 5 and the favorable ratios is one and the unfavorable ratios are four. The investment ratio is 5 and favorable ratios are 3 and unfavorable ratios are two. By analysis of favorable and unfavorable ratios we concluded that the investment performance is improved after merger and same like the solvency ratios.

Conclusion

Mergers occur to improve the effectiveness and efficiency in the company's operations. The businesses do the merger to expand the business operations and increase the resources. Sometimes the management is overconfident about merger and they bear the loss. The study findings suggest that the performance of any organization is improved after merger. The positive impact is analyzed by using the ratios analysis and we use the annual reports to extract the financial performance data which in return helped to calculate the ratios to analyze the impact of merger on the banks performance. This study uses the ratios three year after and three year before ratios merger of the banks. These ratios suggest an overall impact on the performance is positive. So, this shows that the merger has the positive impact on the financial performance of the banks. This study is conducted for a short period of time. Some organization wants to expand their operations and remove the competition in the market from one another they use the merger and

acquisition activities. This study concluded that the performance of the banks is improved after merger.

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