Analysis of the effect of mergers and acquisition on the tinancial performance of banks in Ghana.

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Abstract

In Ghana, most commercial banks have gone into receivership because of their inability to meet the Bank of Ghana's new minimum capital requirement of 400 million Cedis. This has resulted in dwindling of returns on assets, profits, reduced investments and hence instability in the financial sector. To overcome these challenges and improve their financial performance, some commercial banks in Ghana have opted for mergers. The problem nonetheless is that, recent studies to establish the effect of mergers on financial performance of banks has revealed mixed results. While some researchers found a positive and significant effect of mergers on financial performance of banks, others have found no meaningful effect of mergers on financial performance. These inconsistent results make it difficult for players in the banking sector to say with conviction as to whether merging two banks is a viable venture or not.

The effect of mergers on financial performance was measured using liquidity, asset quality and capital base. Multiple regression, descriptive and correlation analysis were performed on the secondary data obtained.

The findings of the study led the researcher to conclude that the three predictor variables which are asset quality, liquidity level and capital base contributed significantly to financial performance at the selected Bank in Ghana.

In spite of the above achievement, the study still found a gap that the three predictor variables could not meet. This means that for the Banks to fully benefit from its merger in terms of financial performance, it must complement asset quality, capital base and liquidity level with other factors and measures.

Introduction and background of study

Mergers and acquisition have gained a growing societal significance in recent years as a strategy to increase the profit of companies or generally improve their operations (Kumar & Bansal, 2018).

A merger usually occurs when two or more companies combine their forces to operate as one company (Kovacich & Halibozek, 2018). It is a deliberate combination of two or several firms coming together to form one larger firm. It encompasses cash payments or stock swaps to the target firms. This makes it possible for shareholders of the target firms to share in the risks involved in the transaction (Hitt, 2017). The trend is extensively becoming the preferred choice for many firms including banks globally due to its numerous benefits (Fofack, 2018). According to Baldwin (2018), merged companies are able to gain a higher bargaining power because of their sizes and leverage on those powers to force suppliers to sell to them at a price that they are willing to pay, which is often cheaper. Quality goods and services acquired at a cheaper price and sold to customers at a high price implies that the merged firms are able to generate more profits on their investments. This often makes them more successful in their market (Franke, 2017).

This study seeks to examine the effect of mergers and acquisition on the financial performance of some of the Banks that has gone through mergers or acquisition. Financial performance is a measure of how well a company utilizes its assets to generate income or revenue (Pandey, 2018). It can also be regarded as a measure of the overall financial health position of a company over a stipulated period of time (Akguc, 2018). According to Kihanda (2017), financial performance is used to compare the performance of companies operating across the same sector or industry in aggregation. Examining the performance of a company is critical as it helps managers and investors to establish whether the business is viable or not.

A major performance measure applied in contemporary financial management is the financial ratio examination and it differs based on the explicit interest of the parties involved. According to McLaughlin (2018), trade creditors are concerned basically with the liquidity of the company. Their claims are short term, and the aptitude of the company to settle these claims is best shown by means of an orderly analysis of the company's liquidity. The claims of bond holders is long-term in nature. As a result, they are more concerned in the cash flow ability of the company in order to ensure that it can pay their debts in due course. Investors in a firm's common stock are interested largely in the current and anticipated future earnings and the steadiness of these earnings.

Financial performance can be measured using financial indicators and non-financial indicators. Common examples of financial indicators are Return on Equity, Return on Assets, Return on Capital employed, etc. Non-financial performance indicators include efficiency, customer satisfaction, and market share among others.

In this research, financial performance will be measured using financial indicators such as ROE and ROA. Mergers and acquisition will be examined using asset quality, liquidity and capital base respectively as used by Kovacich & Halibozek (2018). The study will predominantly use financial data drawn from audited financial statement of selected Banks in Ghana covering a period of five years, 2014 to 2019. This will enable the researcher to establish whether the merger of OMNI bank and Sahel Sahara Bank has led to a greater benefit in terms of profits or not.

In Ghana, most commercial banks have gone into receivership because of their inability to meet the Bank of Ghana's new minimum capital requirement of 400 million Cedis. This has resulted in dwindling of returns on assets, profits, reduced investments and hence instability in the financial sector (Adjei, 2018).

To overcome these challenges and improve their financial performance, some commercial banks in Ghana have opted for mergers and acquisitions. The problem nonetheless is that, recent studies to establish the effect of mergers and acquisition on financial performance of banks has revealed mixed results. While researchers such as Kihanda (2017), Mwangi (2017), Kovacich & Halibozek (2018) found a positive and significant effect of merger on financial performance of banks, others like Saple (2017), Wachira (2018) and Chesang (2018) have found no meaningful effect of mergers on financial performance.

In order to clear this doubt and determine the effect of mergers on financial performance, the researcher seeks to examine mergers from the perspective of Ghanaian Banks. The researcher considers this as a knowledge gap that must be bridged, hence this research.

Empirical Review

Effect of Asset Quality on Financial Performance

In Nairobi, Kenya, Nzoka (2015) undertook a study for the motive of determining the effect of asset quality on the financial performance of commercial banks in Kenya between the years 2010 and 2014. The researcher applied a descriptive research design to the study and this was targeted at all 43commercial banks in Kenya at the time. Secondary data was taken from annual Central Bank of Kenya banks supervision reports. Statistical as well as narrative methods were employed in analyzing the data. The findings of the study revealed that, statistically, asset quality had a fairly significant impact on financial performance. This is because asset quality alone cannot be used to determine the financial performance of commercial banks.

A study was also undertaken by Adeolu (2014) on the effect of asset quality on bank performance for commercial banks in Nigeria. Again, secondary data was obtained from the annual reports and accounts of the six largest banks listed on the Nigeria Stock Exchange. After using the Pearson correlation and regression tool of the SPSS for data analysis, Adeolu concluded that asset quality and bank performance had a statistically strong and positive relationship and influence.

Another study undertaken by Eyup et al (2017) to ascertain whether non-performing loans affected banks' profitability in Turkey. The study analyzed secondary data obtained from financial statements prepared in line with IFRS of 55 banks in Turkey using a panel regression method for the period 1st quarter of 2005 to 3rd quarter of 2016. From the findings, Eyup et al (2017) concluded that there existed a significant negative relationship between a non-performing loan (NPLs) and a bank's profitability which is usually measured by return of assets (ROA) and return on equity (ROE). This simply means that the higher the NPLs (lower asset quality) the lower the ROA and ROE. and vice versa.

To sum this up, asset quality is definitely an important variable in assessing a bank's financial performance. However, it is not sufficient. This is because a bank may record lower asset quality ratios and yet be doing well in terms of liquidity, solvency, capital base and others and thus will be seen as performing quite well financially. High NPL ratios is a struggle that most commercial banks get to deal with from time to time and therefore stringent measures must be put in place to beat down these ratios since they could affect a firm's financial performance in the long run.

Relationship between Capital base and Financial Performance

In 2017, Nyawira et al (2017) undertook a study to evaluate the relationship that exists between capital requirement set by the Central Bank of Kenya and the financial performance for the Kenyan banking sector. A descriptive research design was employed and a total of forty-three commercial banks operating in Kenya as the target population. The study used secondary data which was collected from bank supervision and banking sector reports and the data was analyzed using descriptive statistics, correlation and regression analysis. The findings of this study revealed that there was a positive linear relationship with financial performance. It was also found that the results were significant for ROA and ROE but insignificant for NIM. In sum, the study concluded that when capital requirement increases financial performance also increases.

Aymen (2013) also undertook a study to ascertain the impact of capital on the financial performance of banks in Tunisia using 19 banks from 2000 to 2009. Using a static panel to analyze secondary data from their annual reports, the researcher represented capital with the ratio equity to total assets while financial performance was measured using ROA, ROE and Net Interest Margin (NIM). From the findings, the researcher established that the relationship between capital and financial performance was positive. However, it was only the relationship between capital and ROA that was statistically significant.

Capital, indeed, is the bedrock of any business entity and banks must not downplay its significance in the success of the firm. We can therefore conclude, especially with the studies referenced above, that when capital increases, financial performance also increases to a large extent and experts say these and many others informed the Bank of Ghana's decision to increase the minimum capital requirements for all banks in 2017.

Effect of liquidity level on Financial Performance of Banks

Charmler et al (2018) conducted research to assess the impact of liquidity on performance of commercial banks in Ghana. The study was aimed at examining the level, the trend and impact of bank liquidity on profitability of commercial banks in Ghana. A sample of 21 banks were used for a 10-year period (2007 to 2016) and data was arranged in the form of a panel. Descriptive statistics, regression and correlation analysis were used in analyzing the data. The results showed a positive association between bank liquidity and profitability which means that bank liquidity is very important as it affects banks' profitability. The researchers, however, noted that though liquidity improves profitability, increase in liquidity in some situations could be counterproductive and could reduce profitability.

For the financial sector and particularly the banking industry, liquidity is such a big deal since liquidity crisis in one bank could lead to a run on other banks within the jurisdiction. Though liquidity may not be a sufficient variable to measure financial performance, it is an important variable that banks must never downplay.

General Studies on Effect of Mergers on Financial Performance

With respect to the area of mergers and acquisitions, there are quite a number of studies that have been conducted. One of them is the study by Moeller (2016) in Nairobi, Kenya which was undertaken for the motive of determining the impact of merger restructuring on the performances of four chosen banks. The researcher applied a casual research design to the study. A total of 75 respondents provided the data via questionnaires. Statistical as well as narrative methods were employed in analyzing the data. In the findings, it was observed that, merger restructuring did not bring about any improved financial performance regarding the four chosen banks that partook in the merger and acquisition. Solvency percentages in addition to capital adequacy were discovered to have made enormous contributions to the merged banks' financial performance.

In a similar investigation conducted in Dashen, Addis Ababa, Shanmugam (2018) evaluated the implications of mergers on banks. A quantitative research and descriptive study were adhered to during the study. The study's participants included 54 accounting and finance. During the examination, primary data was utilized. The data collected was taken through descriptive and inferential analysis. The study employed the SPSS in carrying out the analysis. The investigation's revelation was that, merging as an individual activity does not lead to the achievement of competitive, efficient and strong banking systems. Nevertheless, measures like enhancing the expertise and competence of the banking personnel and introducing effective corporate governance to additionally fortify competitiveness and resilience of banking firms can be used to complement it.

The effect of mergers and acquisition on Indonesian banks was also evaluated by Viverita (2017) in a study by making comparisons among financial performances 7 years before and after mergers. Qualitative and quantitative approaches as well as descriptive research were abided by. Data collected for the study was taken through inferential analyses. It was observed after the research that, mergers actually lead to an increase in the ability of banks to generate profit. The observation manifested in performance indicators like return on asset, ROE, net interest margin, capital adequacy ratio and non-performing loans. It was also contrarily observed that, merged banks were unable to enhance their capability of carrying out the task of serving as an intermediary institution, which was evident in the decline of loans to deposits made by their customers which may be as a result of a decline in activities within the real sectors.

After 13 firms were sampled from the firms listed on the Bombay Stock Exchange which undertook mergers or acquisitions, data was gathered from them covering a period between 2002 and 2005. Based on analysis of the data collected, Selvam (2019), the researcher, drew a conclusion that, the liquidity performance of the companies that underwent the procedure of merger and acquisition witnessed improvements in the periods after the mergers and acquisitions.

Conceptual Framework

According to (Wachira, 2018), a conceptual framework is used by a researcher seeking to conceptualize the relationship between research variables diagrammatically or graphically. It permits the quantitative conceptualization; operationalization, data collection and measurement of the variables identified (McLaughlin, 2010). The conceptual framework shown in Figure 3.1 was used as a guide during this study. The conceptual framework of the study consists of independent variables; asset quality, liquidity level and capital base strategies while the dependent variable was financial performance.

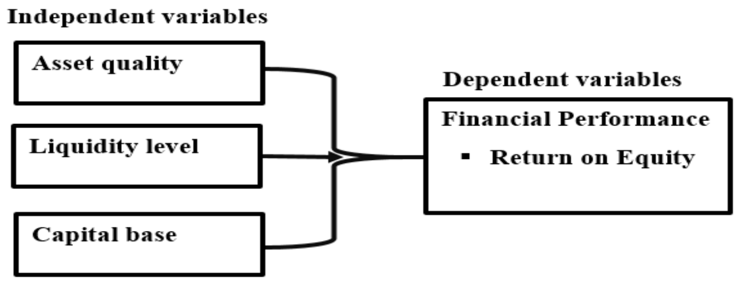

Figure 3.1: Conceptual Framework
Source: Adopted from Kovacich & Halibozek (2017).

Material And Tools

The approach of this research was mainly quantitative.

Since the researcher seeks to establish the cause-and-effect association between mergers and acquisition and financial performance, we adopted the explanatory research design in this study.

In connection to this research, the study has concentrated on few of the selected Banks that has gone through mergers and acquisition as a case study.

Secondary data published in the annual report and audited income statements of these selected Banks in Ghana, spanning a five-year period (2014-2019) was retrieved and used for the data analysis. Such data has included a comprehensive income statement of cash flows for five years after the merger, current assets and capital, current liabilities, revenue and long-term liabilities before and after the merger.

To determine the effect of mergers on financial performance, profitability ratio namely Return on Equity (ROE) is used. The focus of such analysis was on the merged banks.

A regression analysis was conducted to determine the association between the dependent and independent indicators. The dependent indicator was financial performance and was represented in the model by ROE. The independent variables were the mergers and acquisition indicators namely capital base, asset quality and liquidity.

The regression model that was used is as shown below:

$FP=\alpha+\beta_1 AQ+\beta_2 LL+\beta_3 CB+\varepsilon$

Where;

FP represent financial performance, α is the coefficient of intercept (constant term), AQ is asset quality, CB stands for capital base while L represents liquidity. β_1, β_2, and β_3 respectively are the regression coefficients for the three mergers and acquisition indicators. ε epitomizes the error term.

Results And Discussions

Descriptive Analysis

Descriptive statistics was employed to present the findings on the post-merger and acquisition ratios. These comprises capital base which was measured using equity to total assets ratio and equity to net loans ratio. Asset quality was measured using loan loss to net interest revenue, loan loss reserve to non-performing loans and non-performing loans to equity respectively. Also, Liquidity level was calculated using net loans to total assets, net loans to deposits and liquid assets to deposit in that order. The results are given in Table 4.1 below.

Table 5.1 Descriptive statistics of the Financial Ratios Variables pre- and post-merger and acquisition.

	Mean		Std. Dev		Independent t-test	
	Pre	Post	Pre	Post	t-value	Sig
Capital Base						
Equity to total assets ratio	7.12	9.31	6.20	8.32	3.075	0.000
Equity to net loans ratio	37.31	43.01	16.10	20.32	2.013	0.000
Asset Quality						
Loan loss to net interest revenue	9.21	14.17	12.36	16.83	1.347	0.142

Loan loss reserve to non-performing loans	81.24	88.58	31.67	47.75	1.231	0.126
Non-performing loans to equity	53.05	39.16	17.43	21.25	-2.74	0.002
Liquidity Level						
Net loans to total assets	21.74	29.32	10.00	13.23	1.120	0.151
Net loans to deposits	41.10	46.15	2.31	1.67	1.131	0.172
Liquid assets to deposit	77.31	72.21	19.26	20.18	-2.133	0.012

*p=0.5

The findings in table 5.1 show that most of the individual measures of the financial ratios increased after the merger. In relation to capital base, the average mean of equity to total assets ratio significantly (p= 0.00) increased from 7.12 to 9.31 whereas equity to net loans ratio average mean also significantly (p= 0.00) increased from 37.31 to 43.01.

Also, under asset quality, loan loss to net interest revenue and loan loss reserve to non-performing loans had no significant decline after the merger however non-performing loans to equity ratio significant decline (p=0.002) in their average mean. Consequently, net loans to total assets and net loans to deposit did not have any significant difference in their mean average however liquid assets to deposit average mean significantly (p= 0.012) increased from 77.31 to 72.21.

Correlation Analysis

A correlation analysis was performed to determine the relationship between capital base, liquidity level, asset quality and financial performance.

Table 5.2 Inter- correlation among the independent variables and dependent variable

	1	2	3	4
1. Capital Base				
2. Liquidity Level	.317**			
3. Asset Quality	.310**	.350**		
4. Financial Performance	.281*	.267*	.400**	

**. Correlation is significant at 0.01 level. *. Correlation is significant at 0.05 level

The table above shows that financial performance had a significant positive relationship with asset quality (r = .400, p<.01). Among the financial ratio variables tested asset quality reported a higher correlation coefficient with financial performance. The high significant correlation coefficient indicates there is a strong relationship between asset quality and financial performance. This shows that asset quality influences financial performance significantly therefore an increase in asset quality leads to an increase in the chances that the financial performance of will significantly increase.

Liquidity level accounted for a significant low positive correlation with financial performance (r= .267, p<.05) among the variables. This indicates that liquidity level influences financial performance significantly therefore an increase in liquidity level will lead to an increase in the financial performance of the bank.

Capital Base (r=. 0.281, $p<.05$) also significantly had a positive correlation with financial performance. This shows that an increase in financial performance increases with Capital Base.

Regression of Financial Ratios

In order to establish whether the independent financial ratios variables (asset quality, capital base and liquidity level) have any significant effect or relationship with financial performance of selected Banks after the merger a multiple regression statistical analysis was performed. The regression model that was used is as shown below.

$FP=\alpha+\beta_1AQ+\beta_2LL+\beta_3CB+\varepsilon$

Where;

FP represent financial performance, α is the coefficient of intercept (constant term), AQ is asset quality, CB stands for capital base while L represents liquidity. β_1, β_2, and β_3 respectively are the regression coefficients for the three mergers and acquisition indicators. ε epitomizes the error term.

The tables below show the findings of the analysis.

Table 5.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.738	.783	.614	.61359

a. Predictors: (Constant), capital base, asset quality, liquidity level
b. Dependent Variable: financial performance

Table 5.3 show the regression model summary. The model reveals that the three financial ratios variables, asset quality, capital base, liquidity level predicts 78.3% of the financial performance the banks after the merger. This indicates that 78.3% of the variance in financial performance are accounted for by these variables. The findings further indicates that other factors were responsible for the financial performance (21.7%) of the bank.

Table 5.4: Summary table of ANOVA Results

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	87.187	3	20.94	37.53	.002*
1	Residual	24.549	34	569.85		
	Total	111.736	37			

The regression ANOVA statistical test in Table 4.3 was used to determine the fitness of the regression model used. From the analysis regression sum of squares recorded a score of 87.187 and a residual mark of 24.549. The Table also produced a regression and residual mean squares of 20.94 and 569.85 respectively. An F-ratio and its associated p-value of .002 was also observed from the ANOVA statistical test. The findings indicates that the model is fit for the study judging from the .002 p-value recorded which is statistically significant.

Table 5.5: Summary table of the multiple regression analysis.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.771	1.525		3.405	.000

Asset quality	.261	.012	.612	9.375	.000
Liquidity level	.183	.066	.214	4.128	.001
Capital base	.458	.065	.439	7.643	.000

a. Dependent variable: financial performance

The coefficient results from the above Table, demonstrate that by adding the coefficients the model used which was $FP=\alpha+\beta_1AQ+\beta_2LL+\beta_3CB+\varepsilon$, now produce values of $FP=5.771+.261*AQ+.183*LL+.458*CB$.

The results from the coefficient Table proved that the research found a positive relationship between asset quality, liquidity level, capital base and financial performance. The predictor or independent variables also had a significant effect on financial performance as shown by the individual p-values they recorded.

From the findings, asset quality registered a coefficient score of .261, a t-statistics of 9.375 and a probability value of .000. This is a suggestion that financial performance of those selected Banks increased at the time of this research by 26.1% when asset quality gone up by 1%. The effect of asset quality on financial performance is statistically significant at 5%. This corroborates the findings of Yin (2018), who found a positive and significant association between asset quality of three selected banks and financial performance in Nairobi.

Liquidity level also registered a coefficient of .183, a t-statistics of 4.128 and a p-value of .000, implying liquidity level has resulted in an 18.3% growth in the financial performance of selected Banks after the merger. This coincide with the findings of Greuning and Bratanovic (2017) who established that sustaining a comparative degree of liquidity in the entire banking system is of utmost significance, as the recording of a liquidity disaster at a bank can lead to a severe consequence over the entire banking system.

Capital base had a coefficient score of .458, a t-statistics of 7.643 and a probability value of .000. This result indicates that financial performance has increased by 45.8% when capital base improved by 1%. The effect of capital base on financial performance was also observed to be significant statistically as per the .000 significance score registered.

Looking at the findings above, the study concludes that the three predictor variables measured in this research which are asset quality, liquidity level and capital base are major determinants of financial performance.

Summary And Conclusions

Summary of major findings

The main aim of this research was to examine the effect of mergers on the financial performance of selected Banks in Ghana. Three main financial ratios variables were identified in literature and used for the study. They were asset quality, capital base and liquidity level. In order to establish whether the independent financial ratios variables (asset quality, capital base and liquidity level) have any significant effect/relationship with financial performance a multiple regression statistical analysis was performed. The study also conducted a descriptive statistic and a correlation analysis on the obtained data.

The findings from the descriptive analysis show that most of the individual measures of the financial ratios increased after the merger. In relation to capital base, the average mean of equity to total assets ratio significantly increased from 7.12 to 9.31 whereas equity to net loans ratio average mean also significantly increased from 37.31 to 43.01.

Also, under asset quality, loan loss to net interest revenue and loan loss reserve to non-performing loans had no significant decline after the merger however non-performing loans to equity ratio significant decline in their average mean. Consequently, net loans to total assets and net loans to deposit did not have any significant difference in their mean average however liquid assets to deposit average mean significantly increased from 77.31 to 72.21.

The findings obtained from the model summary revealed that the financial ratio variables which are asset quality, capital base and liquidity level predicted 78.3% of the financial performance of the Banks after the merger.

The results from the coefficient test showed that a positive relationship exists between asset quality, liquidity level, capital base and financial performance. These variables also had a significant effect on financial performance as shown by the individual p-values they recorded. Considering the findings of the study, the researcher concludes that the three predictor variables measured in this research which are asset quality, liquidity level and capital base contributed significantly to financial performance. Capital base was found to be the highest contributor to financial performance with 45.8%, followed by asset quality with 26.1% and liquidity level with 18.3%.

Conclusion

From the study findings it shows that the bank is performing better after the merger. This is supported by the fact that asset quality, capital base and liquidity variables had a significant impact on financial performance. The study concludes that the merger has well positioned these Banks to be more liquid, financial stable and well placed to lend and increase profitability.

In spite of the above achievement, the study found a gap of 21.7% that asset quality, capital base and liquidity level could not meet. This means that for the Banks to fully benefit from its merger in terms of financial performance, it must complement asset quality, capital base and liquidity level with other factors and measures such as enhancing the proficiency and skill of its personnel and bringing along more effective corporate governance to further improve the elasticity and competitiveness of the bank.

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