Current Status of Merger and Acquisition in Nepalese Banking Industry

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Abstract

Merger and acquisition (M&A) is one of the major aspects of corporate finance world. The reasons behind M&A's birth is with the integration of two separate companies together so as to create more value compared to being on an individual stand. Merger and Acquisition is getting a lot of attention in Nepalese Banking Industry because of strengthening money market. So, study aims to analyze the impact of merger and acquisition in Nepalese Banking Industry. The study also aims to investigate the impact that a merger and acquisition had on the employees of the company and focusing on the effects resulting from changes in management practices, personal circumstances and the organizational environment. Structured questionnaire was distributed to the employees of the sample banks. Mean, Standard Deviation, Correlation matrix and Independent sample t-test were used for data analysis. The study revealed that employees mainly face the problem of change in organizational culture after merger and acquisition. Furthermore, the relation has been shown on the way that company policies are put into practices and recent merger is the result of unfavorable economic condition of banks. The results also revealed that the financial performance of banks have been improved after the merger and acquisition.

***Keywords**: Shareholders, Mergers and Acquisitions (M&A), Return on Equity (ROE)*

Introduction

Two companies together are more valuable than two separate companies; this constitutes the motive behind mergers and acquisitions of companies while tracking the history of merger and acquisition. M&A's can add value to a company and can maximize its market share and profitability in three ways: through size (economies of scale), through market control (higher market share, lower dependency) (Appelbaum *et al.*, 2000) and through geographic and product diversification (KPMG, 2003). Moreover, the KPMG survey (2003) supports the view that 'a higher proportion of deals enhance value for the acquirer's shareholders.

Many researchers have found that negative employee reactions to a merger or acquisition may lead to negative outcomes such as lower levels of job security, lower levels of job satisfaction and less favorable attitudes toward management (Buono & Bowditch 1989, Nemanich & Keller 2007); lower commitment (Fulmer & Gilkey 1988); a high level of anxiety and stress, fear of a decline in status or career prospects and feelings of being "sold out" (Blake & Mouton 1985, Ivancevich, Schweiger & Power 1987); employee resistance preventing synergy realization (Larsson & Finkelstein 1999).

In case of Nepalese context, Bist (2019) remarked that financial market has been awash with merger talks since the incumbent governor took office. Some economists and policy-makers argue that there should be no more than 15 commercial banks in Nepal. However, such arguments are not backed by any substantial research. To better understand the advantages of mergers, the rampant banking problems should be understood first.

One major issue of the Nepali financial market is the large number of urban-based BFIs with lower paid-up capital. There were 151 BFIs in 2018. Given the size of the economy, this number is unnecessarily high. Unhealthy competition in deposit collection and loan disbursement, lack of capacity to finance large-scale projects, higher interest rate sensitivity and increment in flow of bad loans because of cross lending are some of the problems that an economy faces when it has a large number of small BFIs in the market.

Therefore, going for mergers will reduce the number of BFIs by strengthening the capital base and lending capacity, increase the ability to withstand interest rate sensitivity due to advantage of economies of scale, and restrain the unhealthy competitions in the market. Similarly, a small number of large banks are also considered immune to short-term financial upheavals. Therefore, the economy would sustain from external shocks.

Specifically, it is believed that scholars have failed to adequately study how employees and managers view the impact of merger and acquisition on a personal level. So, this study investigated the impact that a merger and acquisition had on the employees of the company and focusing on the effects resulting from changes in management practices, personal circumstances and the organizational environment.

Similarly, Mergers and acquisition has always been an issue for strategic managers and financial analysists, which due to the high competition arising from the fast-changing global market, it has significantly resulted in a condition where firms are finding it gradually difficult to remain competitive. So, another objective is to analyze the financial performance of banks before and after merger and acquisition.

Literature Review

A merger is defined as a strategy that combines two companies and occurs when two businesses join or merge to one single company with a new name. As Coffey et al. (2002) perceptively state, M&A represent a “marriage”. Machiraju (2007) has stated that merge takes place when two companies differ significantly in size. Acquisition refers to a situation where one company acquires another and the latter ceases to exist (Machiraju, 2007). To sum up, a merger “creates” a new company with a new name from two organizations who join forces. An acquisition happens when one business buys another company which is smaller and might be absorbed within the parent organization or run as a subsidiary (Taneja & Saxena, 2014).

Picardo (2019), A corporate merger or acquisition can have a profound effect on a company's growth prospects and long-term outlook. But while an acquisition can transform the acquiring company literally overnight, there is a significant degree of risk involved, as mergers and acquisitions (M&A) transactions overall are estimated to only have a 50% chance of success. Company, generally, go into merger because of the reasons such as to create synergies and economies of scale, to dominate the market and to get bigger.

Business Maps of India (n.d.) Mergers and acquisitions bring a number of changes within the organization. The size of the organizations change, its stocks, shares and assets also change, even the ownership may also change due to the mergers and acquisitions. The mergers and acquisitions play a major role on the activities of the organizations. However, the impact of mergers and acquisitions varies from entity to entity; it depends upon the group of people. The impact of mergers and acquisitions also depend on the structure of the deal.

Employees generally view organizational changes as a threat, so that mergers and acquisitions, which are particularly stressful forms of organizational reconfiguration, often generate significant trauma and uncertainty about the future for employees (Morán & Panasian 2005). Mergers and acquisitions introduce changes in their well-defined career paths that can affect future opportunities in the organizations for which they work. For them, M&A will often mean lay-offs, relocation, downsizing, restructuring or being assigned to new jobs. They, thus, find themselves faced with a completely different situation and with the prospect of changes in job profiles and work teams. As a consequence, they may feel very insecure, anxious or even betrayed. The research done by Naveed, Hanif & Ali (2011) showed that employees who were working in a pre-mergers & acquisitions environment felt a strong threat to their job security.

Effective support for career development is important for employees and forms part of a joint strategy with organizations to achieve the resilience required to handle change more effectively. There is evidence, however, that the organizational changes typically described in the literature, such as delayering in a quest for flexibility, have had a negative impact on career progress and resulted in resistance to change (Lips-Wiersma & Hall 2007).

Organizations focus on career development to build engagement during difficult times so that stressed employees have a positive focus on the future (Knight 2014).

This study showed M&A as a problematic child of business world. But it is robustly discussed in financial sector. Nepal Rastra Bank, a central bank of Nepal, promulgated the policy of merger and acquisition of Banks and Financial Institutions. Monetary policy of 2018/19 has emphasized on merger and acquisition of Banks and Financial Institutions of Nepal. Merger and acquisition had taken place since long back but the study on the impact of it is less.Based on the above studies and discussions following theretical framework has beendeveloped:

Dependent Variable

Impact on Mergers and Acquisition

Independent Variable

- Risk in M&A
- Economic Condition

Methodology

The research design adopted in this study consists of descriptive and correlational research design have been used. Descriptive design have been used to deal with the various issues raised in the study.

Correlational design has been used to assess the impact of merger and acquisition on its success. The population from which we drew our sample was the bank involved in M&As in Nepal . Out of 63 number of Merged and acquired banks in Nepal, we surveyed 12 banks based on convenient sampling. Questionnaires were distributed to 215 people out of which 93 useable responses were collected. It is an average response rate of 43%. Sample is determined based on Roscoe (1972)'s recommendations i.e. every variable is equal to 10 samples. Here is four variables thus, 40 sample is sufficient for further analysis but 93 responses were used for analysis. Data were collected using five point Likert scale questionnaire ranging from 1= strongly disagree to 5= strongly agree. The questionnaire were administered through delivery and collection method. Purposive sampling has been used to collect data. Cross tabulation has been used to manage data. Independent T-test has been used to determine the difference in the opinion of staffs of different level on the payment and compensation policy for the extra work. Similarly, Chi-square test has been used to determine the association between risk involved in Merger and Acquisition and the success rate of it. Also, correlational analysis has been applied to identify the positive or negative relationship between the way company's policies are put into practices and the unfavorable economic condition of bank.

Analysis

Opinion difference with regard to compensation policy for the extra work.

Table 1: Levene's Test for Equality of Variances

		F	Sig.	T	Df	Sig.	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
Reward and compensation for extra work.	Equal variances assumed	0.013	0.910	0.876	47	0.385	0.26703	0.30478	-0.34612	0.88017

	Equal variances not assumed		0.866	34.452	0.392	0.26703	0.30822	-0.35905	0.89310

The observed value of p is greater than 0.05. Hence, there is no special treatment given according to post (junior officer and senior officer) when it comes to compensation policy for extra work. All are given similar importance and no difference in compensation policy for extra work. In the same way according to the respondent view it can be interpreted that the employees of the banks who are junior and senior officers are given with same level of compensation for extra work

Opinion difference of Trainee and Manager on the Payment with regard to compensation policy for the extra work.

Table 2: Levene's Test for Equality of Variances

		Sig.	T	Df	Sig.	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Reward and compensation policies for extra work.	Equal variances assumed	0.137	0.408	34	0.686	0.20000	0.48990	-0.79559	1.19559
	Equal variances not assumed		0.509	9.384	0.622	0.20000	0.39265	-0.68273	1.08273

From the table 2, it can be seen that the p value that is 0.137 which is greater than given value of 0.05. Hence, there is no special treatment given according to post (trainee and manager) when it comes to compensation policy for extra work. All are given similar importance and no difference in compensation policy for extra work. In the same way considering to the respondent view it can be interpreted that the employees of the banks who are trainee and managers are given with same level of compensation for extra work

Table 3: Chi Square Analysis of Risk Involved in M&A and the success rate of M&A

	Value	Df	Asymptotic Significance	Exact Sig.	Exact Sig.
Pearson Chi-Square	1.531	1	.216		
Likelihood Ratio	1.412	1	.235		
Fisher's Exact Test				.297	.184
Linear-by-Linear Association	1.514	1	.219		

a. 1 cells (25.0%) have expected count less than 5. The minimum expected count is 3.22.

b. Computed only for a 2x2 table.

Table 3 is derived from the Chi square test. It can be seen that the results of association between “Risk Involved in M&A” and “The success rate of M&A”. The observed value of p is greater than 0.05 i.e. 0.216 which means there is no significant association between risk involved in merger and acquisition and success rate of merger and acquisition. The level of risk in the company doesn’t lead a company to watch the success. There may be several other factor along with risk to determine success rate of merger and acquisition.

In the same way, linear-by-linear association with risk involved in M&A and the success rate of M&A is greater than 0.05 i.e. 0.219 which means increase in risk involved in M&A leads to increase in the success rate of M&A. As in general, higher the risk, higher the return. This is also backed up by Likelihood ratio which is shown in given table 4.

Table 4: Association between company policies unfavorable economic condition of bank.

	Unfavorable economic conditions of banks	Company policies
Unfavorable economic conditions in bank	1	
Company policies	-0.121 (0.249)	1

**Correlation is significant at the 0.05 level (2 tailed).

The correlation result indicates that there is negative relationship between the way company’s policies are put into practices and the unfavorable economic condition of bank which is significant at 5% level of significance. There is unfavorable economic condition of the bank when the policies of the banks are not put into practices properly. As the significance 0.2149 indicates that this relation is not significant and may not have much consequences in real scenarios.

Discussion and Conclusion

The study shows the current position of merger and acquisition in Nepalese banking industries. Weaker the economic condition of the bank, higher the chance of merger and acquisition in the banking sector. Merger and Acquisition in the banking sector may be beneficial as well as it may create certain problems in the banking sectors. This study has contributed to identifying what successful financial institution with M&A experience are doing in the management of the people. With the evidence of respondent opinion, we have found that there is no difference in reward and compensation for extra work before and after the merger and acquisition policies in banks. Incentive schemes have been related to firm performance. It seems that this is an undervalued area in organizations. It is expected that organizations would use rewards as a strategic mechanism to attract new employees and to retain and motivate existing employees. However, there is no any difference in payment of reward and compensation for different position of the staffs at the time of M&A.

Communication is also an area which has been emphasized in the M&A literature. Hubbard and Purcell (2001) stress the importance of communication and more specifically the way in which actions are conducted and explained to employees when these appear to be highly important in managing employee expectations during acquisitions. Managing employee expectations in full-integration acquisitions is critical for the success of the M&A and is a long-term process, as procedural and cultural issues emerge later in the acquisition and are the hardest to manage. In this study, communication with employees, both downward and upward, does not differentiate company performance. This does not mean that companies have realized and have handled communication issues effectively. On the contrary, communication is quite poor which confirms previous research findings that reported that it is the least effectively managed aspect of M&As (Tetenbaum, 1999 & Nikandrou et al., 2000) maintain that communication strategy is the area that differentiates employee perceptions of management's trustworthiness depending on the origin of the acquiring company. In domestic acquisitions, acquired employees need to know more about the changes, while in foreign acquisitions, employees need to have more frequent communication even before the close of the deal. In this study, companies are not different in the way they handle communication issues.

According with many publications, the main reason for merger was the need to grab competitive advantages and for market dominance through economies of scale. But testing of hypotheses has demonstrated that the main cause on the recent merger, which is based on employees and manager's opinion, is the result of unfavorable economic condition. This might be the effect of policies implemented by central bank regarding minimum equity in the Nepalese banking industry whereas in other countries like South America where research is conducted might not have such strong policies regarding minimum equity capital in the bank and also because of the strong competition.

Also, the results of this study note that employees consider that merger is necessary, but in moderate degree. This conclusion implies with the overall perception about the benefits of the merger, which was considered by employees' perceptions in a moderate level. Finally, an important finding is the fact that there is no significant resistance to change both for employees in M&A banks which have increased shareholder value after merger. This result will allow a smoother integration into the new corporate culture, a fact which is also confirmed by the quality gap which isn't statistically significant.

Implication

From this research, we can suggest that financial institutions planning for merger and acquisition a long-term business planning should be applied or through a process of integrating company cultures before

M&A. After a merger, employees don't know what to expect. Also, it is crucial for the new company to recruit professionals who have extensive knowledge, experience and take care of factors such as employee morale. Furthermore, employees' participation is very important and through corporate communication the two cultures of these companies will understand how they should work together. Future work should concentrate to examine the effect of the new culture to the financial assets of the company. This analysis will extract conclusions both from the aspect of employees and the new company. Summarizing the conclusions above, the final company will have to form a new culture, which all employees will learn, follow and respect and will incorporate data both from the two organizations.

Further research work can be carried out considering employee turnover after merger and acquisition in Nepalese banking industry, success rate of before and after merger and acquisition of banking industry, impact of western culture of merger and acquisition in South Asian countries, etc

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