Examining the Influence of Mergers and Acquisitions on Financial Performance of the Commercial Banks in Nepal

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Abstract

Mergers and acquisitions (M&A) are strategic actions companies taken to grow their operations, expand their market access, and enhance overall profitability. The purpose of this study is to investigate an impact of mergers and acquisitions on financial performance of the Nepali commercial banks. This research employed a descriptive and casual comparative research design. Three commercial banks—Kumari Bank Limited, Rastriya Banijya Bank Limited, and Nepal Investment Mega Bank Limited—were randomly selected using a lottery method as the sample. The study employed a quantitative approach using annual reports of sampled commercial banks. The published data were taken from the Nepal Rastra Bank supervision report and the sampled commercial bank's annual report for four years before and after mergers and acquisitions. The data analysis was conducted using mean, standard deviation, correlation, and the paired t-test. Financially, the data shows a decline in return on assets (ROA) and return on equity (ROE) after the merger and acquisitions, The data indicates that ROA and ROE declined after the merger and acquisitions, implications for this study reduced efficiency in asset utilization and overall profitability of sampled commercial banks. However, the performance after the merger become consistent and organized. Consequently, their influence on the financial performance of the sampled commercial banks in Nepal. Future research directions could be examined the influence of mergers and acquisitions(M&A) on financial performance of insurance companies in Nepal.

Keywords: Commercial bank, financial performance, merger and acquisition, paired t-test

Introduction

Mergers and acquisitions (M & A) are strategic decisions undertaken by companies to achieve growth and expansion objectives, increase market share, and improve profitability. Merger and acquisition are recurring global phenomena and are considered as the useful strategies for the growth of the business in the corporate world (Rahman et al., 2017). Although the terms 'merger' and 'acquisition' are often used interchangeably, they have different meanings. A merger occurs when two organizations join to form a single or combined entity to achieve shared benefits, whereas an acquisition involves one organization taking control of the assets, equipment, or a business unit of another organization. It is crucial for organizations to recognize the advantages of engaging in mergers and acquisitions and to carefully identify the target business for such endeavors. Commercial banks in Nepal are increasingly engaging in mergers and acquisitions (M&A) as a strategy to strengthen their financial and operational activities. However, despite the growing number of M&A activities, there is limited empirical evidence on how these actions influence the financial performance of commercial banks. Whether mergers and acquisitions enhance profitability, asset utilization, and shareholder value and management reduce their effectiveness. This gap highlights the need to investigate the influence of mergers and acquisitions (M&A) on the financial performance of Nepali commercial banks. The mergers and acquisitions (M&A) can guide Nepal Rastra Bank and other regulatory authorities in designing policies that promote effective mergers and ensure financial stability. Furthermore, the post-merger performance helps bank managers make informed decisions regarding integration strategies, resource allocation, and risk management. The regulatory body of all the banks in Nepal, Nepal Rastra Bank, has introduced merger by-laws in May 2011 to reduce the number of institutions and strengthen the banks' position and performance. According to the report of the Nepal Rastra Bank (2024), the total number of the BFIs stood at 111 including 20 A class commercial banks, 17 B class development banks, 17C class finance companies, and 57 D class micro finance institutions. The NRB's promotion of mergers has led to a significant surge in merger activities, primarily driven by the pursuit of cost efficiency, as well as the desire to achieve economies of scale and scope in operations (Pathak, 2016). Smaller and medium-sized banks can enhance their cost efficiency through bank mergers, benefiting from economies of scale and scope, even without a reduction in the number of employees (Peng & Wang, 2004). However, Cornett et al. (2006) suggest that larger bank mergers yield greater performance gains compared to smaller ones, and mergers focused on specific activities yield higher performance gains compared to those aimed at diversifying activities. The merger and acquisition activities in the Nepali banking sector can be motivated by various factors such as achieving economies of scale, improving market share, and enhancing competitiveness. The major influence of the merger and acquisitions on the performance of the banking industry in Nepal are achievement of financial growth, better policies, increase in the size and strength of the BFIs, become financially sound, capital enhancement and increase in the profitability (Bajgain & Pradhan, 2021).

The increasing incidence of mergers and acquisitions (M&A) in the banking sector and its influence several elements such as financial performance. Nepalese banking sector is going through suffering and really tough phase NRB has brought a new merger bylaw have confidence in that it will solution of the entire problem. Nepal Rastra Bank, the central bank of Nepal work as a supervisory and monitoring body of all the BFIs, introduced a influential merger by-law in May 2011. Most of the experts and analyst believe that the Nepalese financial sector is overcrowded with so many players for the small size market if not acted on time these problems will worse. In this context, it is crucial to know how M &

A impact on ROA and ROE. The main purpose of the study is to investigate the post-merger financial performance of Nepali commercial banks. The study's focus on commercial banks in Nepal is crucial because the banking and financial sector holds great significance for the country's economy. Nepal Rastra Bank, as the regulatory authority, has implemented merger by-laws to consolidate banks and decrease the total number of institutions. Consequently, analyzing post-merger financial perfssormance is crucial for policymakers, regulators, and bank management. The study focuses only on a limited number of pre- and post-merger years, which may not capture long-term financial influences of mergers and acquisitions (M & A) of commercial banks in Nepal. Only a few commercial banks in the Pokhara Valley are considered, limiting the generalizability of the findings to all banks in Nepal.

Review of Literature

Mergers and acquisitions are increasingly common in today's business landscape, yet their success frequently depends on how well human resource issues are managed, as these play a critical role in ensuring a merger or acquisition succeeds. The business engages in a wide range of activities in seeking to exploit potential opportunities. Mergers, tender offers, and joint ventures play an important role in the growth or expansion of firms. While the term 'merger' and 'takeover' are often used interchangeably in reality there is a very slightly different between two. A merger is a friendly consolidation of assets into a single entity. On the other hand, a merger is a business-to-business arrangements in which assets are transferred to a new organization in a friendly manner. Merger involves similar size, which reduces the risk of one company becoming dominant over the other company. However, a takeover is the acquisition of share capital one company by another company usually through a money payment, a securities issue or a combination of these two. For instance, the bidding company is larger than the acquiring company (Trautwein, 1990). The fundamental principle of the free cash flow hypothesis is that managers and stakeholders have competing interests. That is, managers could use the company's resources for their own gain rather than acting in the best interests of the shareholders (Thanatawee, 2011).

According to synergy theory, "the amount of economic value that will result from a merger will depend on availability of opportunities to use this resource and the amount of the resource held by the firm, relative to total amount present in the economy" (Chatterjee, 1986). However, Barney (1991) explored a clear and comprehensive framework for determining the essential attributes of a firm's resources that can create a sustainable competitive advantage. Merger and acquisition are anticipated to enhance prospective cash flow and augment that the value of company through operational and financial synergies. This can be attributed to the realization of economies of scale by expanding the size of firm or the exploitation of specific combination advantages leading to economies of scope. These actions are expected to contribute positively to the overall economic performance and value of merged entities. The hypotheses of the study are as follows;

H_1: The merger of commercial banks has a significant effect on return on assets (ROA).
H_2: The merger of commercial banks has a significant effect on return on equity (ROE).

The mergers and acquisitions in Nepal's banking sector have had a significant impact on financial performance. These mergers aimed to consolidate the industry, improve efficiency, and enhance market competitiveness. Evaluating the post-merger financial performance helps measure the effectiveness of these efforts in achieving desired outcomes such as increased market share, cost synergies, and expanded product offerings. Based on agency theory, management of bidder banks involves in merger and acquisition for personal benefit without considering the economic reason (Asimakopoulos & Athanasoglou, 2013). Managers could underestimate the cost of post- merger incorporation or overvalue their ability to switch a larger organization (Roll, 1986). Mylonidis and Kelnikola (2005) conducted a study on the merging activities within the Greek banking system their primary goal was to evaluate the financial performance of recent mergers and acquisitions in Greek banking. The findings revealed that while profits, operational efficiency, and labor productivity ratios of the merging banks did not show improvement after the merger, a comparison with non-merging banks suggested a positive impact of the merger program on the operating performance of banks. However, it was noted that this impact had a downside as it negatively affected liquidity measures. Murthy (2007) evaluated the merger and acquisition of five selected banks. It assessed the case of several banks where mergers and acquisitions had enhanced affordability and effectiveness of the borrowing and lending processes of banking industry. The researcher concluded that mergers and acquisitions play a vital role in strengthening a firm's financial and operational structure, enhancing resource availability, expanding branch networks,targeting priority sectors, and improving penetration into rural markets. Muita (2011) did a study on the effects of mergers and acquisition on the profitability of commercial banks in Kenya. Researcher analyzed the profitability of the banks for five years before and after the merger. Patel (2017) examined how mergers impacted specific Indian banks between 2003 and 2014. It discovered that after mergers, certain banks like Bank of Baroda and Oriental Bank of Commerce saw reductions in key financial metrics like return on equity and overall profits. However, metrics such as earnings per share and profits per employee improved for these banks. After mergers, these banks expanded—they amassed more assets and investments. For instance, banks like State Bank of India and IDBI Bank showed varying trends in financial performance compared to the industry average. Generally, reduced spending on daily operations after mergers appeared to positively impact the financial performance of these banks. Shah and Dwa (2017) conducted a study on merger and operational performance of commercial banks in Nepal. The study selected three cases as a sample to investigate the profitability implications of mergers. The findings indicate that the merger does not play a significant role in the case of Nepal Bangladesh Bank and NIC Asia Bank. However, the impact of the merger appears to be positive in Machhapuchchhre Bank (MBL), where almost all operational ratios have improved post-merger. Merger a wise option to bring BFIs in strong and growing position and to meet the requirement of current paid up capital as per the latest NRB directive. However, it also must be considered that merger is not the ultimate solution to strengthen the financial position of BFIs. Shah and Khan (2017) conducted a study to explore the effects of mergers and acquisitions (M&A) on the operating performance of acquirer banks in Pakistan. They analyzed a sample of 18 M&A transactions involving acquirer banks listed on the Karachi Stock Exchange. However, they observed a slight and insignificant improvement in net interest margin and the ratio of administrative expenses to profit before tax. These findings highlight the importance of carefully assessing the potential risks and benefits of M&A activities in the banking sector to ensure favorable operating performance outcomes. Shrestha et al. (2018) investigated the post-merger financial performance of Nepalese commercial banks. The study analyzed financial ratios, including asset quality, liquidity, profitability, and capital adequacy, before and after mergers. The findings revealed that mergers had a positive impact on financial performance, with merged banks demonstrating improved asset quality, higher profitability, and enhanced capital adequacy ratios. The study suggested that mergers can contribute to the overall financial stability and soundness of Nepali commercial banks. Although, mergers and acquisitions activities have been commonly studied in the banking and financial sector globally, there is inadequate research on the specific influence of M&A on financial performance in terms of ROA, and ROE in commercial banks of Nepal. While studies have shown that M&A can have a significant influence on financial performance, there is a need for empirical evidence on the challenges faced by employees of commercial banks in Nepal during M&A activities and financial performance in terms of ROA and ROE.

Research Methodology

This study was adopted both descriptive research design and causal comparative research design. The descriptive research design was employed to describe the changes in financial performance indicators (ROA and ROE) before and after the merger and acquisitions. The causal comparative research design was employed for pair t-test since the researcher examined the impact of before and after merger and acquisitions on financial performance of commercial banks. By the end of fiscal year 2022/23, Nepal Rastra Bank had listed 20 commercial banks, of which 15 had undergone mergers or acquisitions. From these 15 commercial banks, three merged commercial banks operating in the Pokhara Valley—Kumari Bank Limited, Rastriya Banijya Bank Limited, and Nepal Investment Mega Bank Limited—were selected as the study sample using a lottery sampling method. The study employed a quantitative approach using annual reports of sampled banks. This research was based on secondary data. The secondary data were collected from the Nepal Rastra Bank supervision report and sample banks annual reports for four years before and after merger and acquisitions. In this study, the paired t-test was employed to analyze the financial ratios before and after mergers and acquisitions (M&A). This statistical test enabled us to assess whether there were significant differences in the financial ratios for individual indicators measured by ROA and ROE. To measure financial performance, two key financial indicators, namely return on assets (ROA) and return on equity (ROE), were utilized. The ratios were calculated by taking the average of four years before and after the mergers and acquisitions. To assess the mergers and acquisitions impact, the study compares the average financial performance of the four years before the merger (t-4 to t-1) with the average financial performance of the four years after the merger (t+1 to t+4) for each commercial bank. Different statistical tools such as mean, standard deviation, correlation coefficient, and financial tools such as ROA, and ROE were used.

Results and Discussion

The focus is to analyzing the financial performance of the banks, with a particular emphasis on ROA and ROE. To examine the effect of the merger, the normal presentation of the four years before the merger (t-4, t-3, t-2, t-1) related with the performance of the four years next the merger (t+1, t+2, t+3, t+4) for respectively of the sampled commercial banks. Return on assets (ROA) evaluates how effectively commercial banks use their total assets to generate net income. A higher ROA indicates greater efficiency in asset utilization and a stronger profitability position for the sampled commercial banks

Table 1

Return on Assets of Sampled Commercial Banks Before and After Merger

Banks	Before merger (ROA)						After merger (ROA)					
	t-4	t-3	t-2	t-1	Mean	Std.	t+1	t+2	t+3	t+4	Mean	Std.
KBL	1.03	1.10	1.06	1.86	1.26	0.34	1.26	1.17	0.76	1.04	1.06	0.19
RBB	1.50	3.33	1.37	1.62	1.95	0.80	2.23	1.64	1.10	1.30	1.57	0.43
MEGA	1.49	1.40	1.38	1.74	1.50	0.14	1.65	1.02	1.28	0.94	1.22	0.28
Mean	1.34	1.94	1.27	1.74	1.57		1.71	1.28	1.05	1.09	1.28	
Std.	0.22	0.99	0.15	0.10			0.40	0.26	0.22	0.15		

Note: Annual Reports from 2012/13 to 2022/23 AD

Table 1 illustrates the return on assets of three banks being bank of KBL, RBBL, and MEGA before and after merger of commercial banks in Nepal. The average ROA of KBL before and after merger is 1.26 and 1.06, which shows that average ROA has declined after merger. Similarly, RBB has average ROA of 1.95 and 1.57 which shows a decline in ROA after merger. Whereas, for MEGA, the average ROA has also decreased from 1.50 to 1.22. The highest average ROA before and after merger is of RBBL at 1.95 and 1.57 respectively. Table 1 revealed that average ROA of commercial banks before and after merger can be seen in decreasing state from 1.57 to 1.28 that shows that return on asset has decreased in overall. The highest standard deviation in the ROA is before merger of RBB at 0.80 and the lowest standard deviation is after merger of KBL at 0.19. Lower standard deviation can be seen after merger which states that the ROA is much more clustered and more reliable. The highest ROA was RBBL at year t-3 at 3.33 and lowest ROA was 0.76 of KBL at t+3. Return on Equity (ROE) is used to assess the profitability of commercial banks both before and after mergers and acquisition. It is derived by dividing net profit after tax by shareholders' equity, or net worth. ROE indicates how effectively management utilizes shareholders invested capital, with a higher ratio reflecting stronger profitability performance of commercial banks in Nepal.

Table 2

Return on Equity of Sampled Commercial Banks Before and After Merger

Banks	Before merger (ROE)						After merger (ROE)					
	t-4	t-3	t-2	t-1	Mean	Std	t+1	t+2	t+3	t+4	Mean	Std
KBL	10.97	11.52	11.79	19.07	13.34	3.32	9.88	10.50	6.71	10.43	9.38	1.56
RBB	21.38	44.22	20.12	22.98	27.17	9.89	23.38	19.01	11.94	13.14	16.87	4.61
MEGA	11.14	11.26	13.19	13.52	12.28	1.08	12.06	8.81	11.45	9.44	10.44	1.35
Mean	14.50	22.33	15.03	18.52	17.60		15.11	12.77	10.03	11.00	12.23	
Std.	5.96	18.95	4.46	4.75			5.92	4.46	2.36	1.56		

Note: Annual Reports from 2012/13 to 2022/23 AD

Table 2 illustrates that average return on equity of KBL before merger and after merger is 13.34 and 9.38 respectively and standard deviation is 3.32 and 1.56 respectively. Similarly, the return on equity of RBB bank before merger and after merger is 27.17 and 16.87 respectively and its standard deviation is 9.89 and 4.61. Similarly average ROE of MEGA merger bank before and after is 12.28 and 10.44 and standard deviation is 1.08 and 1.35 respectively. Mean return on equity of sampled banks is 17.60 before the merger and 12.23 after the merger and its standard deviation is 5.39 and 5.82 respectively. Identifying that merger has positive effect on ROE. The paired two sample t- test for means in terms of ROA in table 3.

Table 3

Paired Two Sample t-Test for Means ROA

Particulars	Pre –merger		Post-merger
Mean	1.57		1.28
Observation	12		12
Correlation		0.308	
T-value		1.632	
Sig. (2- Tailed)		0.131	

Note: Authors Calculation

Table 3 illustrates the outcomes of a paired t-test conducted to assess the shift between pre- and post-merger mean values for specific ratios, showing a decrease in the mean return on assets (ROA) from 1.57 to 1.28 across 12 observations. The t-value of 1.632 and a two-tailed significance of 0.131 indicate that the observed change in ROA after the merger is not statistically significant at the 5 percent level. Table 3 presented that there exists a positive correlation of 0.308 between pre- and post-merger ROA, signifying relationship between the variables, this correlation does not provide evidence for a statistically significant change in ROA following the merger based solely on the t-test results and associated significance level. The paired two samples t- test for means ROE presented in table 4.

Table 4

Paired Two Sample t-Test for Means ROE

Particulars	Pre –Merger		Post-Merger
Mean	17.59		12.23
Observation	12		12
Correlation		0.664	
T-value		2.546	
Sig. (Two Tailed)		0.270	

Note: Authors Calculation

Table 4 illustrates that the findings from a paired t-test used to evaluate the difference between pre-and post-merger mean values for specific ratios, revealing a decline in the mean return on equity (ROE) from 17.59 to 12.23 across 12 observations. Further, it exhibits that the computed t-value of 2.546 and a two-tailed significance of 0.270 suggest that the observed shift in ROE after the merger lacks statistical significance at the 5 percent. Despite a considerable positive correlation of 0.270 between pre- and post-merger ROE, indicating a clear association between these measures, this correlation alone doesn't provide conclusive evidence supporting a statistically significant change in ROE after the merger, solely based on the t-test outcomes and associated significance level.

The analysis of pre- and post-merger financial performance of Kumari Bank Limited (KBL), Rastriya Banijya Bank Limited (RBBL), and Mega Bank Limited (MEGA) indicates a decline in both Return on Assets (ROA) and Return on Equity (ROE) after the mergers, with average ROA decreasing from 1.57 to 1.28 and average ROE from 17.60 to 12.23. Although, paired t-tests show these changes are not statistically significant. Shah and Dwa (2017) and Patel (2017), stronger pre-merger banks tended to retain relatively better performance, as reflected in the positive correlations for ROA (0.308) and ROE (0.270) with consistent result. Standard deviations also decreased post-merger, indicating more stable and clustered financial performance, aligning with findings that mergers can enhance operational stability (Murthy, 2007; Shrestha et al., 2018). However, as profitability ratios declined rather than improved, contrasting theoretical expectations of synergies and economies of scale (Chatterjee, 1986; Peng & Wang, 2004). This suggests that integration costs, operational challenges, and external economic conditions may offset immediate post-merger gains, highlighting that mergers may stabilize banks however do not automatically enhance short-term profitability. The study provides that evidence, that there is not a statistically significant change in ROA following the merger based on the paired t-test results, hence H_1 is rejected. Patel (2017) states that there is a negative impact on ROA from merger which is opposite from the finding of Bakari (2011) stating the firm's profitability increased for the five years before the merger than before. Similarly, the study revealed that the return on equity has decreased for KBL, RBBL, and MEGA bank after the merger, as there is no significant change in ROE after the merger based on the paired t-test result, hence H_2 is rejected. The result is opposite from the finding of Shrestha et al. (2018) stating the firm's ROE improved like Cornett et al. (2006) state that a large merger produces greater performance than a smaller merger. This outcome stands in clear contrast to the prediction of synergy theory, which assumes that mergers should result in improved financial performance through the realization of synergetic benefits.

Conclusions

In conclusion, the overall assessment of the pre- and post-merger financial performance of Kumari Bank Limited, Rastriya Banijya Bank Limited, and Mega Bank Limited highlights several important findings. The purpose of the study is to analyzed the impact of mergers and acquisition on financial performance of commercial banks. The data indicates a reduction in return on assets (ROA) and return on equity (ROE) after the merger, suggesting a decline in the efficiency of asset utilization and profitability. However, it shows a more clustered and reliable post-merger performance, possibly due to operational streamlining. These findings provide valuable guidance for post-merger strategies. Understanding that these factors remain paramount in shaping, even in the wake of significant structural changes like mergers, can inform effective management decisions and contribute to long-term success in the banking industry. The study indicates a decline in financial performance metrics (ROA and ROE) post-merger. Banks should conduct thorough analyses to address the factors contributing to this decline, potentially focusing on operational efficiency and resource utilization. Despite financial decline, the post-merger period showed a more clustered and reliable performance. Banks could leverage this reliability by further streamlining operations for better efficiency. Future research directions could be the impact of mergers and acquisitions on financial performance of insurance companies in Nepal.

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