The Impact of Consolidation on the Performance of Banks in Nigeria-Profitability Perspective (2004-2012)

Dr. Chioma, Oleka & Dr Christopher Orga
Faculty of Management Sciences, Enugu State University of Science and Technology, Enugu, Nigeria.
E-mail: Uchebrowntak@yahoo.com

Abstract
This paper investigates the effects of consolidation on banks performance in Nigeria, using the profitability as measure of performance. The study used an Ex-post-facto research in design by analyzing the CBN publications and published audited accounts of 21consolidated banks out of 25 banks that emerged after the exercise. These banks were classified into stand-alone and merged banks. The study covers a ten year-period (2002-2012). Based on the objective, a hypothesis was formulated and tested using t-test statistic. The study found that there is a significant difference in the performance of the banks that stood alone and the banks that merged. Consolidation has increased significantly the profitability of merged banks as against that of the stand-alone banks. Thus the value gains that have been alleged to accrue from consolidation have been substantiated and this implies that the CBN consolidation decision is a right step in a right direction. The study recommends among other things that for the consolidated banks to avoid going back to the "distress syndrome" era the CBN has to ensure that all loop-holes are blocked to avoid abuse of funds especially from the banks chiefs. Again, these banks should be seriously checkmated against the un-professional and unethical way of sending young girls to source for deposits in forms of targets. Furthermore, the authority should make it a half-decade affair and more is to be done on adequate timing. Finally, the paper calls for an urgent implementation of the remaining reform agenda as planned by the former CBN Chief, Prof. Charles Soludo.
Keywords: Banks, performance, consolidation, profitability, merged and stand-alone banks.

Introduction

Suffice it to note that since the beginning of the 1990s, rapid changes have occurred in the banking industry structure around the globe right from the inception of banks in various countries to date. But it is more intensified in recent time because of the impact of globalization which is precipitated by continuous integration of the world market and economies. For instance, in the United States of America, the banking industry went through a dramatic consolidation wave in which many of the nation's largest banks merged with one another. In 1991 about 600 banks in USA merged at the value of over $30 billion, (Linder and Crane, 1994). In Western Europe there was massive consolidation of banks within countries so also in Asia and South America there was series of intensified consolidations carried out through merger and acquisition, (Brain, 2000).To say the least, Africa is not left out in the game; Uche (1998) noted that a lot of banks reforms have taken place in so many African countries, Nigeria inclusive. Mahmud (2005) confirmed this by noting that in Nigeria the decades of 1960s and 1970s up to 1990s can be described as periods of constant banks reforms which in most cases resulted to relative calmness and stability within the banking industry. Enendu (2005) confirmed this assertion by stating that during these periods no bank failed and no bank distress was recorded but unfortunately the periods between 1985 and 2000 witnessed dramatic negative changes in the banking industry in Nigeria. The issues which engaged the attention of both the Federal Government and the regulatory authorities during these periods were the mass distress and failures in the banking industry, (Imala, 2005). For instance, in 1989 seven banks were declared distressed; between 1990 and 1991 nineteen cases of distress were recorded. In 1992 and 1993 sixteen and forty nine banks were declared distressed respectively. The list is endless, in 1996, fifty seven banks were declared distressed out of which twenty eight were taken over by the Nigerian Deposit Insurance Corporation (NDIC) while the remaining eight were out-rightly declared failed, hence were liquidated, (CBN, 2006). Sequel to this, defensive measures that would strengthen the remaining existing banks and put the new ones on a good start up were needed, hence the introduction of 13-point reform agenda in 2004 by the then CBN Governor. These have resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures.

According to Okagbue and Aliko, (2005), the reforms were to ensure a diversified, strong and reliable banking industry where there is safety of depositors' money and re-positing of banks to play active intermediation and developmental roles in the economy. One of the key elements out of the 13-point reform agenda which is our major concern in this study is the issue of consolidation of banks through mergers and acquisitions. The policy-induced consolidation of banks which started in July 2004 was completed by December, 2005. Only 25 banks out of 89 banks that existed at the end of 2004 emerged from the consolidation exercise. The remaining14 banks which had negative shareholders' funds and could not find merger partners had their licenses revoked. Only six banks survived as stand-alone entities, (Ngama, 2005).

Statement of the Problem

The worry of this study is that there is no clear evidence that the structural changes especially the consolidation reform that have taken place in the Nigerian banking industry has yielded the desired result of improving the performance of banks in Nigeria. To the best of our knowledge, everything appears to be a sort of guise work; one would like to know econometrically if there has been any significant improvement in the performance of the merged following the consolidation exercise. It therefore becomes imperative that an econometric study would be carried out to find out whether the reform is relevant or not instead of guising.

Objective of the Study

The main objective of this study was to determine the effect of the consolidation on the performance of Nigerian banks using profitability as performance indicator. Other objectives include to:

1. Determine if there is any significant difference between the Return on Assets (ROA) of merged banks and that of the stand-alone banks
2. Determine if there is any significant difference between the Return on Equity (ROE) of merged banks and that of the stand-alone banks
3. Determine if there is any significant difference between the Earning per share of (EPS) of merged banks and that of the stand-alone banks

Hypotheses of the Study

The following hypotheses were tested using t-test statistic at 5% level of significance:

H_0 Consolidation has no effect on the performance of banks in Nigeria

$H_{0:}$ There is no significant difference between the Return on Assets (ROA) of stand-alone banks and that of the merged banks.

H_0 There is no significant difference between the Return on Equity (ROE) of stand-alone banks and that of the merged banks.

H_0 There is no significant difference between the Earning per share of stand-alone banks and that of the merged banks.

Theoretical Framework of the study

The issue of bank consolidation and banks performance can best be traced to the emergence of banks concentration theories. Our understanding of the impact of consolidation on the performance of banks is found in many and varied models in the areas known as concentration theories, (Levine 1997), Boyd and Smith (1998), Huybens and Smith (1999) Demirgüç-Kuntz and Huizinga, (2001) Houston and Ryngaert (2002). These theories of concentration have built on the degree to which banking system structure matters for competition and performance, (Abrime, 2008). He noted that the outcomes of numerous researches have resulted in the existence of numerous bank concentration theories in the literature. According to him, we have pro-concentration theories and pro-de-concentration theories. However, our theoretical analysis of the impact of banks consolidation reform on the performance of Nigerian banks should be based on these theories. Demirguc-Kunt and Levine, (2000) the chief proponents of the pro-concentration theory argued that economies of scale give rise to bank mergers and acquisitions, hence, increased concentration goes hand-in-hand with banks efficiency improvements. In digging deep into this, Boyd and Runkle (2000) carried out a study on 122 U.S. bank holding companies and found an inverse relationship between size and the volatility of asset returns. However, these findings were based on situations in which the consolidation was voluntary, unlike the case in Nigeria where the exercise was made compulsory for all banks irrespective of size. As seen in the work of Aburime (2005), some theoretical arguments and country comparisons suggested that a less concentrated banking sector with many small banks is more prone to financial crises than a concentrated banking sector with a few large banks. This is partly because reduced concentration in a banking market results in increased competition among banks and vice-versa. Allen and Gale, (2003) submitted that concentrated banking systems enhance profit and thereby lower bank fragility as high profit provides a buffer against adverse shocks and increases the franchise value of the bank, hence, reduces incentives for bankers to take excessive risk. Ezeuduji, (2005) emphasized that a few large banks are easier to monitor than many small banks, so corporate control of banks is more effective and the risks of contagion less pronounced in a concentrated banking system. On the contrary, a study carried out by Rose and Hudgins, (2005) on the topic" *the impact of consolidation on banks' portfolios"* indicated that bank consolidation tends to increase the risk of banks' portfolios, hence decreased in return on investment (ROI).Proponents of banking sector de-concentration like Berger and Strachan, (1999) and Huygens and Smith (1999) also argue that concentration would intensify market power and political influence of financial conglomerates. This can occur by reducing efficiency and destabilize financial systems as banks become too big to discipline and can use their influence to shape or water banking regulations and policies. They argue that in concentrated banking system, bigger-politically-connected banks may become more leveraged and take on greater risk since they can rely on policymakers and influence them to help them when the adverse shocks hurt their solvency or profitability position.

Similarly, large politically influential banks may help shape the policies and regulations influencing banks' activities in ways that would help banks but not necessarily in ways that would help the overall economy. This is exactly what is happening in Nigeria, it is so glaring and rampant that even an illiterate can notice that political system and banking system in Nigeria are becoming inseparable. The clarity is showcased properly in the on-going banks reform, where a politically not-connected big Bank that was doing very well were subdued to be acquired by a smaller but well-politically-connected bank. This is ridiculous as the move has political-under-tone and this demands that the authorities should take note. Any economy that allows politics to play romance with its banking industry is digging enough graves for the going down of so many banks, hence the overall economy.

Methodology

This study employed secondary data obtained from Central Bank of Nigeria (CBN) and the annual reports and accounts of sampled banks between 2000 and 2012 period. An analytical technique was employed to test the equality of the mean of the key profitability ratios of the merged banks and stand-alone banks using t-test statistic. The study used all the insured and quoted banks in the nation totaling 18 banks as our sample study to give good representation.

The variables used in this study are dependent variables and independent variables. While profitability constitutes the dependent variable, the number of banks constitutes the independent variable of this work. The previous work of Akinbola (2006) revealed various measures of profitability to include return on total assets (ROTA), Return on Equity, (ROE), Earnings per share (EPS), Dividend per share (DPS), Price Earnings Ratio (PER), Earnings Yield (EY) and Dividend Yield (DY). From among these, this study adopted the composition of the following profitability indicators, ROA, ROE and EPS as seen in the work of Rose and Hudgins (2005). These were applied to evaluate the performance of banks five years before the 2005 consolidation exercise comparing it with the performance of the banks five years after the 2005 consolidation.

We tested the hypothesis using the t- Test formula as shown below:

H_0: $\mu_1 - \mu_2 = 0$

H_1: $\mu_1 - \mu_2 = 0$

Applying a considerable significant level (α) of 5% and a critical value of: 2t $\alpha/2$, df (degree of freedom) or $t\alpha/(n_1 + n_2 - 2)$ $t\alpha/2$, df= $t0.05/_2$, 18 = t0.025, 18= 1.112

Decision rule: Accept the null hypothesis $\mathbf{H_0}$ if the calculated value of t is greater than the critical value; otherwise accept the alternate hypothesis $\mathbf{H_1}$.

Results and Discussion

$\mathbf{H_0}$**:** There is no significance difference between the mean profitability positions of merged banks and that of the stand-alone banks

Table 1 T-Test Data and Results

	ROE		ROA		EPS	
Year	Merged	S-A	Merged	S –A	Merged	S-A
2004	48.542	71.242	0.186	0.166	0.148	-0.098
2005	49.414	38.322	0.187	0.146	0.058	-0.076
2006	20.216	19.728	0.202	0.238	0.037	-0.191
2007	21.923	31.621	0.201	0.202	0.104	-0.113
2008	32.466	29.212	0.150	0.201	0.122	-0.039
2009	19.998	41.518	0.155	0.212	0.401	-0.046
20010	52.199	43.111	0.121	0.102	0.154	0.152
2011	58.454	65.442	0.145	0.118	0.899	0.722
2012	78.884	88.626	0.182	0.164	0.124	0.096
Mean	42.455	47.647	0.170	0.172	0.222	0.045
Variance	1523.603	20567.639	0.052	0.005	0.077	0.084
Pooled Variance	11045.6		0.028		0.080	
t-Statistic	0.912		0.841		0.068	
Critical	1.112		1.112		1.112	

Source: Author's Computation

S.A = Stand-alone

The table revealed that for all the banks' measures of profitability (ROE, ROA and EPS) applied in this work, the calculated values of t (0.912, 0.841 and 0.068 respectively) are less than the critical values (1.112). Hence, the alternate hypothesis is accepted whereas the null hypothesis is rejected. This implies that there is significant difference between the profitability of standalone banks and that of merged banks. We deduced from the result that the profitability positions of merged banks are higher than that of the stand-alone banks; hence, consolidation is a right step in a right direction.

Summary of Findings

1. Consolidation has effect on the performance of banks in Nigeria
2. There is significant difference between the Return on Assets (ROA) of stand-alone banks and that of the merged banks.
3. There is significant difference between the Return on Equity (ROE) of stand-alone banks and that of the merged banks.
4. There is no significant difference between the Earning per share of stand-alone banks and that of the merged banks.

Discussion of Findings

The study found that there is a significant difference in the performance of the banks that stood alone and the banks that merged. Consolidation has increased significantly the profitability position of merged banks as against that of the stand-alone banks. Thus the value gains that have been alleged to accrue from consolidation have been substantiated and this implies that the CBN consolidation decision is a right step in a right direction.

In agreement with these findings of this work, Pioneers contributions of Brock and Rojas-Suarez (2000) and Saunders and Schumacher (2000) are of the same view that banking sector consolidation reforms are necessary ingredients for improvements on banks development, healthiness, profitability and stability. This view has been variously corroborated by other scholars like Hannah and Welkin (1989), Gorton and Frank (2000), Berger (2000), Brock and Rojas-Suarez (2000), Hunter (2002), Hall, (2004) and Basher (2005). Their works revealed that classical economists of the Nineteenth Century have paid attention to the impact of consolidation on running the wheels of banking system growth and development smoothly both in developing and developed economies. For instance, Basher (2005) gave explicit examples of how consolidated banking industry in England could boost capital flows across the country to ventures that are in search of the highest rate of return on investment.

Though, the works of Houston, James and Ryngaert (2002), Hall (2004), Dennis and Levine, (2004) and Beck and Hessen (2006) contradict the findings of this study, their findings revealed that bank consolidation has not improved the values of banks in developed economies of Germany, US, Japan and the UK. Their works found evidence of no clear overall gains on the merged banks while the sample of stand-alone banks yields evidence of overall gains. To bring home the point, in Nigeria, the findings of Ndukwe, (2005) and Imala, (2005) whose studies revealed that the overall impact of a higher concentrated banks on banks profitability, banks values and banks stability is negative in the average but significant in some specifications contract the findings of this work. However, our findings are in agreement with the results of earlier studies carried out by Mahmud (2005), Nnanna, (2005), Okagbue and Aliko (2006), Balogun (2007), Enyi (2008), Aneke, (2012), who had earlier found that before the consolidation, no bank would fund any huge project that involved huge amount of money but today banks would virtually be on your door step to give you credit facilities of any amount as a result of consolidation synergy. According to them, today business is expanding because of the increased access to bank loans; revenue generation is also on the increase to enable the beneficiaries repay the loans and make good profit too. They concluded that banks can now participate in investing into the downstream sector of oil and gas industry which was not possible before for them to participate because of huge financial involvement. Hence, consolidation is said to have strengthened the banks and that would mean investing in the oil and gas sector despite the huge financial involvement

Conclusion

In conclusion, therefore, the consolidation reform has impacted positively on the performance of banks as evidenced in the increased profitability positions of the consolidated banks. In affirmation with our work, there is significant relationship between consolidation and banks performance in emerging economy like Nigeria. That is to say the consolidation impacts strongly on banks profitability and this is in line with the assurance given by the then CBN Governor Professor Charles Soludo that consolidation would serve as an instrument for enhancing banks performance in terms of improved profitability, values, efficiency, size and intermediation roles.

Recommendations

This study suggests that regulators of the Nigerian banking industry should consider the option of making consolidation a five-year-interval affair to ensure adequate timing. Equally recommended is the need to increase the degree of foreign ownership participation in the industry via comprehensive policies. In order to ensure a continued enjoyment of dividends of consolidation, the study equally recommends that for the consolidated banks not to go back to the "distress syndrome" era the CBN has to ensure that all loop-holes are blocked to avoid abuse of funds especial by the banks' chiefs. More serious, these banks should be seriously checkmated against the un-professional and unethical way of sending young girls to source for deposits in forms of targets. Finally, the paper calls for an urgent implementation of the remaining reform agenda as planned by the former CBN Chief, Prof. Charles Soludo.

Policy Implication of the study

The study has important policy implication as it could help regulatory authorities determine the future policy action to be pursued in the matter of banking industry reforms that will increase banks values for better returns in investment. This will go a long way to attract foreign direct investments into the industry and the economy at large.

References

Aburime, T. U. (2005) "Concentration Implications of the Banks Consolidation Saga in Nigeria", *UNEC Journal of Banking and Finance,* Vol.4, No. 8, pp. 12-16.

Akinbola (2006) "Consolidating the Nigerian Banking Industry, The journey so far" *Bullion,* . *Vol.* 4, No. 6, Abuja: CBN Publications

Enyi Patrick Enyi (2008) Banks Consolidation in Nigeria: A synergistic Harvest, Journal of Finance, (12) 224-250, Ebonyi State University, Abakaliki.

Allen F. and Gale (2003) *Comparative Financial System Cambridge,* London: MIT Press

Balogun, E. (2007) "Banking Sector Reforms and the Nigerian Economy: Performance Efficiency, Pitfalls and Future Policy Options" *Journal of Finance,* 22, 244-340

Basher, B.A. (2005) "The Impact of Banking Industry Consolidation on the Developing Economy: The Ugandan Experience". *Journal of Banking and Finance*, 22, 456-50

Beck, H. and Hessen, A. (2006) "Banks Capital Regulation and Banks Performance in Uganda: Issues and Effects" *African Economic and Business Review Vol.5 No. 1009- 5508*, the African Education and Business Research Institute, Inc.

Berger, A. N. (2000), "The Integration of the Financial Services Industry: Where Are the Efficiencies?" *FEDS Paper,* No. 2000: 36.

Boyd, J.H. and Rankle, F.H. (1993) "Size and Performance of Banking Firms: Testing the Predictions of Theory", *Journal of Monetary Economics, 31, pp. 47-67.*

Brain, T. (2000) "The Relationship between Banking Industry Consolidation and Economic Growth", *Journal of Money, Credit and Banking*, Vol. 27, pp. 404-431

Brock and Rojas-Suarez (2000) "The gains and losses from industry consolidation", *Journal of Finance and Economics,* 24, 244-268

Central Bank of Nigeria (2006): *Bullion*-Annual Report and Statement of Accounts, Abuja: CBN Publication

Demirgüç-Kuntz, A. and Huizinga, (2001) "Financial Structure and Bank Profitability" in *Financial Structure and Economic Growth: A Cross-Country Comparison of Banks Markets, and Development*, Cambridge, MA: MIT Press.

Dennis, D. A. and Levine, A. N. (2004) "The Impact of Consolidation on Bank Equity Infusion", *Journal of Banking and Finance, Vol. 14, No. 5, pp 12-18.*

Enendu, T. (2003) "Empirical Analyzes of the Ex-ante Commercial Banks Capital Regulation in Nigeria: Issues and Implications. *CBN Bullion 24, 3, 12-14*

Ezeuduji, F. U. (2005) "Banks Consolidation in Nigeria- the journey so far" *The CBN Bullion,* Lagos: The CBN Publication.

Hall, D. (2004). "Banking Consolidation" Federal Reserve Bank of San Francisco (FRBSF) *Economic Letter,* June 18.

Hannah and Welkin (1989) "Banking System Consolidation in Developing and Transition Countries: Diagnosis and Predictions" *Working Paper 39 Bank for International Settlements.*

Houston, J.F. James, C.M. and Ryngaert, M.D. (2002) "Where merger gains come from? Bank mergers from the perspective of insiders and outsiders" *Journ of Financial Economics, 60, 285-331.*

Imala, O. I. (2005), "Consolidation in the Nigerian Banking Industry: A Strategy for Survival and Development" A Paper Presented during the Visit of the Nigerian Economics Students' Association (NESA), University of Abuja Chapter.

Linder, J.C. and Crane, D.B. (1992) "Bank Mergers: Integration and Profitability", *Working Paper* (Harvard Business School)

Nigerian Deposit Insurance Corporation (2007), *NDIC Annual Report and Statements of Account:* Abuja.
Mahmud, A.S. (2005) "Banks Consolidation and Economic Growth" *The Nigerian Journal of Finance* Vol.2, No.2, 188-192
Ndukwe, (2005) "Merger and Acquisition as consolidation options: The Journey so far" *The Guardian*, Lagos: Guardian Newspaper Limited, May 12, p. 12.
Ngama, G. O. (2005) Challenges of Banking Sector Reform and Banks Consolidation in Nigeria, *CBN Bullion, Vol. 28, No 4*. Lagos: CBN Publication.
Nnanna, O.J. (2005) "Consolidation in Nigerian Banking: What a long trip it could be". *Vanguard Newspaper,* Lagos: Vanguard Media Publication Limited, May 2nd, p.14.
Okagbue, S.N. and Aliko, T.B. (2005) "Banking Sector Reforms in Nigeria" International Legal News, Vol. 1, No. 2.From *http://www.imakenews.com/iln/e_article000336415. Cfm? x=b11, 0, w.*
Rose, P. S. and Hudgins, S. C. (2005), *Bank Management & Financial Service* New York: McGraw Hill.
Soludo, C.C. (2005) "Banking Sector Reform in Nigeria: Issues and Challenges" *CBN Annual Report and Statement of Accounts.* Abuja: CBN Publications.
Uche, C.U. (1998) "Bank Share Capital Regulation in Nigeria". *Journal of International Banking Law*, Vol. 13 (1), pp. 30-34.