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Research Paper

Merger and its impact on profitability of commercial banks

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ABSTRACT

The aim of this study was to investigate the impact of mergers and acquisitions on the profitability of Nepalese commercial banks. The research was conducted by analyzing various financial ratios that reflect profitability, employing a statistical approach. Two prominent commercial banks were selected as the sample, both of which had merged in the same fiscal year. The analysis focused on comparing pre-merger and post-merger profitability, utilizing a t-test to assess the significance of the merger's effects. Key profitability ratios, including Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM), and Earnings Per Share (EPS), were evaluated to determine the influence of the merger on overall profitability. The findings indicated that the merger did not lead to an improvement in returns for the banks involved. This leads to the conclusion that mergers and acquisitions alone cannot guarantee an enhancement in the profitability of commercial banks. Instead, it is essential for regulatory authorities and stakeholders to take proactive measures to improve the financial health of banks without solely relying on mergers as a solution. Policymakers should consider implementing strategies that focus on the operational efficiency, risk management, and customer service quality of banks, which can contribute to sustaining profitability in a competitive environment.

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1. INTRODUCTION

In the Nepalese context, merger was a completely new concept for Nepal's Banking and Financial Institutions (BFIs) when the Nepal Rastra Bank, the regulator of all BFIs, introduced merger regulations in May 2011. The Nepalese financial and banking sector faced a very critical period in 2010. The International Monetary Fund (2008) highlighted that nearly one third of the Nepalese BFIs were characterized by excess liquidity, high operational costs, poor working capital, unhealthy competition, and mismanagement [1]. The third quarter balance sheets showed that except for some banks, the revenues of all banks declined and the percentage of bad loans increased. Political instability and uncertainty not only reduced bank revenues but also discouraged investors from undertaking any projects. This led to low demand for loans for major projects. Consequently, banks faced increasing pressure to invest in high-risk real estate and housing sectors or choose not to use their capital effectively to generate more cash, which pushed them towards mergers.

Nepal Rastra Bank, as the main regulatory body for all banking financial institutions (BFIs), has expressed concern regarding the deteriorating condition of the sector. To address this, the Central Bank of Nepal has planned to enhance the stability of the financial sector by introducing the Merger By Law 2011, which is based on the Company Act 2063, article 177, BAFIA 2063, articles 68 and 69. These legal provisions aim to push all BFIs towards merger as a consolidation strategy to increase capital and improve their capacity to compete in the market. Otherwise, many BFIs may be forced to exit the market. NRB has announced that it may direct certain BFIs for a forced merger under specific conditions. In a circular issued to BFIs, NRB stated that it may order BFIs not meeting minimum capital requirements to pursue merger or acquisition. According to the circular, the central bank can instruct any BFI to either merge or acquire with a peer if it fails to meet the minimum capital requirement set by NRB within a specified deadline. Additionally, a BFI that incurs losses for five consecutive years is another condition under which the central bank may compel it to undergo merger or acquisition [2].

Nepal Rastra Bank (NRB) has announced that it may send bank and financial institutions (BFIs) to forceful merger in certain conditions. Issuing a circular to BFIs, the NRB said that it may instruct BFIs with poor financial health to go for merger and acquisition. According to the circular, the central bank can tell any BFI to go for either merger or acquisition with a peer if it fails to meet its minimum capital requirement as set by the NRB within the deadline. Similarly, any banking institution that goes into losses for five consecutive years is another condition when the central bank can force it to go for merger or acquisition. Those licensed institutions who do not maintain contingency reserve may also be asked to go for merger by the NRB [3].

The study aims to determine and identify the impact of merger on the profitability of Nepalese commercial banks. The study will address the following research questions:

- Is there a relationship between mergers and the profitability of commercial banks?
- Can mergers serve as a solution for inefficiencies in the banking sector?
- What has been the effect of mergers on the profitability of commercial banks in Nepal between 2017 and 2023 A.D.?

The objective of this study is to clarify the relationship between merger and profitability in commercial banks.

The primary objectives of the study are as follows:

- To analyze the effect of the merger process on the profitability of different commercial banks in Nepal.
- To assess whether the merger process is an effective way to address existing inefficiencies in the banking sector.
- To examine the profitability of commercial banks that underwent a merger during the period from 2017/18 AD to 2022/23 AD.

2. RELATED WORK

[4] Examined critical factors in the merger and acquisition of Nepalese financial institutions and concluded that merged firms enhanced the ability to attract loans, increased employee productivity, and achieved net assets growth, which was evident in the Nigerian banking industry. This study also pointed out that mergers and acquisitions might lead to improved productivity of employees and the general performance of the banks due to the integration of information and communication technologies and good corporate governance.

A thesis paper researched by [5] on Merger and Acquisition as an indispensable tool for strengthening Nepalese Banking and Financial Institutions focuses on the impact of merger on the different stakeholders such as employees, shareholders, and customers, and uses earning per share (EPS) and market value per share (MVPS) to evaluate the financial position of merged entities. It does not provide an in-depth analysis of the financial situation of the merged banks, both pre- and post-merger. Secondary analysis has not been done much in the past due to unavailability of data. However, in this paper, the researcher has attempted to analyze the impact (pre and post analysis) of merger with the help of secondary data.

[6] Merger and acquisitions are based on the assumption that it creates a synergistic value for the potential stakeholders involved and in the hope of realizing an economic gain.

Apart from garnering tax advantages and achieving economies of scale, M&A provides financial benefits and career growth and advancement as well. The benefits of the M&A are not only limited to one side of the organization rather it develops all aspects of the organization if conducted with proper guidance and supervision.

[7] Observed that the Nepal Rastra Bank implemented the merger bylaws policy in 2011, the Nepalese market was able to observe an increasing trend in merger and acquisition in banking and financial institutions (BFIs) of Nepal. This study focused on the post-merger impact on the employees, customers, and shareholders of the merged bank. [8] Found no significant impact of mergers on shareholder wealth in the Nepalese capital market, as abnormal returns for bidding and target firms were not significant before or after merger announcements.

This suggests that the market did not react significantly to merger events, indicating no clear creation or destruction of shareholder wealth in this specific context.

[9] Primarily focuses on corporate governance challenges and their legal resolution within Nepalese Banks and Financial Institutions (BFIs). It highlights that weak corporate governance, including frequent boardroom disputes, can lead to the application of statutory provisions regarding the acquisition of BFIs, as stipulated in the Bank and Financial Institutions Act, 2017. The paper suggests how the lower economic government takes banking institutions by using mergers.

[10] Government is focused to the enhancement of economic areas by keeping eyes on NBL, RBB, ADBL and NIDC. These financial institutions should work well to achieve targeted goal otherwise financially the country may face worst situation. It suggests that concerned authorities should think a lot to give permission to initiate something new.

[11] Examined the impact of mergers and acquisitions on both the acquiring firms' stock prices and financial performance using a sample of 20 Taiwanese corporations between 1987 and 1992. They analyzed accounting measures of profitability, financial health, and growth of the acquirers. They observed that the stock market reacts positively to the announcements of mergers and acquisitions, but profitability tends to decline from pre-merger to post-merger periods.

[12] Analyzed the value implications of 98 large mergers and acquisitions of publicly traded European banks that occurred between 1985 and 2000. The study found that for the entire sample, shareholders of target banks earned significant positive cumulative abnormal returns across all intervals studied, while shareholders of the bidding banks did not achieve significant cumulative abnormal returns. From a combined perspective of the target and bidder, European bank mergers and acquisitions were found to be significantly value-creating on a net basis.'

Merger refers to a process where two or more firms are combined into a single entity to strengthen their market position and increase market share by removing competition and improving operational efficiency through the integration of resources [13]. The Oxford dictionary describes a merger as "the conversion of two or more business entities into one." Therefore, a merger can be defined as the merging of two or more firms through acquisition or shared interests, but it differs from consolidation, where the firm continues its operations without forming a new entity [14]. To evaluate the effect of mergers on profitability, Kemal utilized ROA, ROE, NPM, and operating profit margin as dependent variables. In order to examine the liquidity and operational performance of banks, he used secondary data from audited financial statements including Balance Sheets, Profit and Loss Accounts, and Cash Flow Statements of commercial banks [15].

[16] Merger in important to convert the financial institutions from low stage to high. Institutions should think about society before going to merger. BFIs can take advice from investment banks and other advisory authorities to eliminate unwanted interruptions specially in the context of Nepal.

[17] Uses paired t-tests of different ratios of two financial institutions to take out the conclusion of mixed effect of merger. First bank improves its some profitability ratios whereas second one faces lower profitability ratios except dividend payment as comparison to post merger. In conclusion of [16] the implementation of the Merger Bylaws Policy by Nepal Rastra Bank in 2011 has led to a notable increase in merger and acquisition activities within Nepalese Banking and Financial Institutions (BFIs). This paper highlights that while employees were satisfied with work conditions, they faced challenges related to human resource issues such as cultural clashes and favoritism. Customers noticed changes in value and service offerings post-merger but sought more innovative solutions.

The research of [18] summarized that after liberalization in India merger shows better result than before. Banks operated form government were slightly better performer than private financial institutions. It suggests that merger should be done with equally capable financial institutions because of risk. Authorities should be aware about the use of merger as technique to provoke poor financial institutions. Article of [19] shows likely and unlikely effects of merger in financial institutions of Nepal. Some of them are showing impactful positive result in profitability on the other hand some of them are dealing with irregular EPS, uncertain benefits, inefficient operation and risk of non-performing loans.

[20] Has negative results of merger, Sample financial institutions relatively declined their profitability ratios after merger. Downward slope of profitability ratios of them increasing challenges. The decision making capability of merger decision is being a question. Although the study acknowledges potential long-term benefits, it urgently calls for detailed planning, synergy realization, and stakeholder coordination to transform M&A from a disruptive event into a value-creating strategy.

During the process of searching for relevant articles on related topics, the researcher came across various reports addressing the current situation of Nepalese banks and financial institutions, the challenges they face, and the prevailing conditions regarding mergers and acquisitions within the Nepalese financial sector.

During the search for relevant articles on related topics, the researcher encountered various reports discussing the current status of Nepalese banks and financial institutions, the challenges faced by them, and the prevailing conditions regarding mergers and acquisitions within the Nepalese financial sector. Furthermore, previous research on this topic dates back several years, highlighting a notable gap in both time and relevance. A lot of research works have been done by scholars by including the topic of employee environment, communications after merger, hierarchy issue and motivation before and after merger. As the profitability is the major concern of business enterprises like financial institutions also work around it. Researcher focuses Profit as the focal point of the work by ignoring all other factors.

3. METHODOLOGY

The total number of merged commercial banks represents the total population for this study. Out of the total population, two commercial banks are selected as samples. These are Global IME Bank Limited and Prime Commercial Bank Limited. The researcher employed purposive sampling in this study as these two banks are considered suitable for the research. This study is based on secondary data collected from various sources such as bank supervision reports and banking and financial statistics published by Nepal Rastra Bank, as well as journals and published and unpublished research from different researchers and institutions. Secondary data related to earnings per share, return on equity, liquidity position, and earnings per share around the event study period was gathered from financial records of the financial institutions involved in the study. The data was also collected from the bank supervision report documents issued by the Central Bank of Nepal. The data collected was time series, covering both the pre-merger and post-merger periods. For the purpose of the study, two merger cases were randomly selected. To evaluate the impact of merger on profitability, the profitability performance of the selected banks before and after the merger was analyzed by calculating various financial and accounting ratios such as ROA, ROE, EPS, and NPM.

[21] Serves as a focused, sample-based resource for analyzing profitability trends among Nepal's listed commercial banks, constrained by time and data accessibility. Research based upon two financial institutions because researcher was not capable to select all financial institutions to find out the impact of merger. Large number of samples may lead to better result but it is irrelevant in research work due the lack of availability of data.

[22] Among all financial analysis techniques, profitability ratios are better because of their broader areas where they concern about income, cost, plant and properties and equity. They are crucial to know the effectiveness of resources to create profit. [23] To compare averages of different ratios t-test should be vital and scientific for research work. We should select right variants by analyzing the demand of research. For t-test we have to find out the difference of various ratios before and after the merger. Following are the two hypothesis which may help researcher to conduct t-test.
Null hypothesis (H0): Different lies in profitability ratios before and after the merger.
Alternative hypothesis (H1): No changes in profitability ratios before and after the merger.

For T-Test, We Should Find Out T Values by Using Giver Formula:

$$t=\frac{\overline{X1}-\overline{X2}}{\sqrt{\frac{\delta^2}{n1}+\frac{\delta^2}{n2}}}$$

Where,
$\bar{X}1$ = Mean of different profitability ratios before merger
$\bar{X}2$ = Mean of different profitability ratios after merger
δ^1 and δ^1 are standard deviations of ratios before and after the merger respectively
n1 and n2 refers the no of samples taken

4. RESULTS AND DISCUSSION

In this research, a major secondary data source was gathered from Prime commercial bank and Global IME Bank. The data was collected with an operating history of at least three years before and after the merger. Quantitative methods such as mean, standard deviation, and t-test were employed. [24] Trend analysis serves as a vital analytical method for studying fluctuations and directional patterns in data over time, making it indispensable across finance, marketing, and strategic planning. [25] Concludes the impact of profitability ratios to the fluctuation of stock price in the market. It suggest the measurement of profitability ratios can cover all other areas of financial environment.

To conduct the overall research work, researcher has taken these two sample banks and their profitability ratios to know the impact upon them of merger after the incident of merger.

Global IME Bank Limited

Table 1. Profitability Ratios (ROA, ROE, NPM, EPS) for Global IME Bank Limited (Fiscal Years 2017/18 - 2022/23)

	Fiscal Years	ROA (%)	ROE (%)	NPM (%)	EPS (Rs)
Pre-merger	2017-18	1.63	16.19	41.24	23.64

	2018-19	1.82	18.47	41.06	26.46
	2019-20	1.06	12.88	28.49	17.99
Post- merger	2020-21	1.20	13.38	35.26	19.25
	2021-22	1.37	13.93	38.03	20.84
	2022-23	1.38	12.36	36.79	20.77

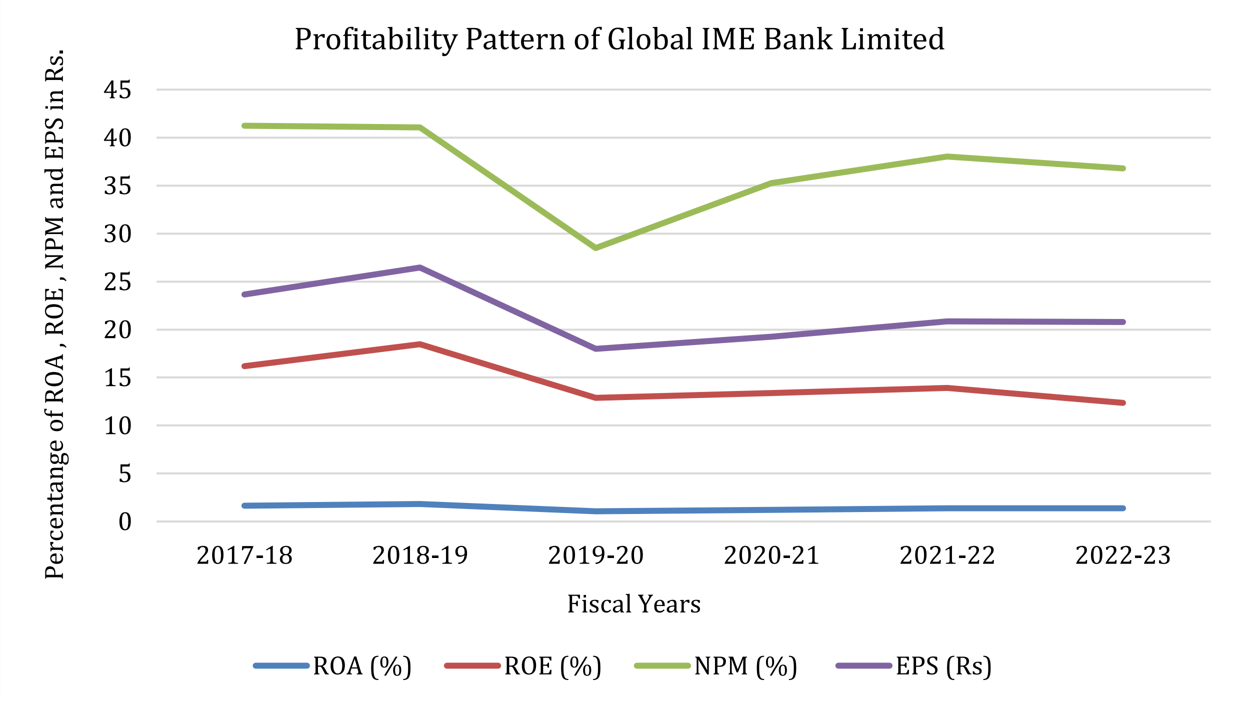

Figure 1. Trend Analysis of Profitability Ratios (ROA, ROE, NPM, EPS) for Global IME Bank Ltd. (Fiscal Years 2017/18 - 2022/23)

As shown in Table 1 that all profitability ratios are declining recent before the merger in 2019-2023. It would be the reason behind the decision of merger. As shown in Figure 1, ROA increased from 1.63 percentage to 1.82 percentage from 2017-18 to 2018-19. Just before the merger it declined to 1.06 Percentage. After the merger it shows slight recovery of 1.38 percentage from 1.20 percentage, which indicated Global IME was efficient to improve its assets after the merger. ROE has not too far different pattern from ROA before the merger but in this case, merger showing negative impact in 2022-23, expressing challenges in ROE. NPM was relatively stable in first two years but it fell to 28.49 percent from 41.06 just before the merger. It shows fluctuation even after the merger in which starting from 35.26 percentage in 2020-21 to 38.03 percentage to 2021-22 again it dissatisfied the authorities by decreasing slightly to 36.79 percentage

Prime Commercial Bank Limited

Table 2. Profitability Ratios (ROA, ROE, NPM, EPS) for Prime Commercial Bank Limited (Fiscal Years 2017/18 - 2022/23)

	Fiscal Years	ROA (%)	ROE (%)	NPM (%)	EPS (Rs)
Pre-merger	2017-18	1.82	12.87	47.62	21.49
	2018-19	2.15	10.71	47.75	23.60
	2019-20	1.48	9.40	38.81	16.10
Post- merger	2020-21	1.71	13.45	41.67	20.32
	2021-22	1.32	10.32	36.37	14.94
	2022-23	1.02	7.96	25.39	11.66

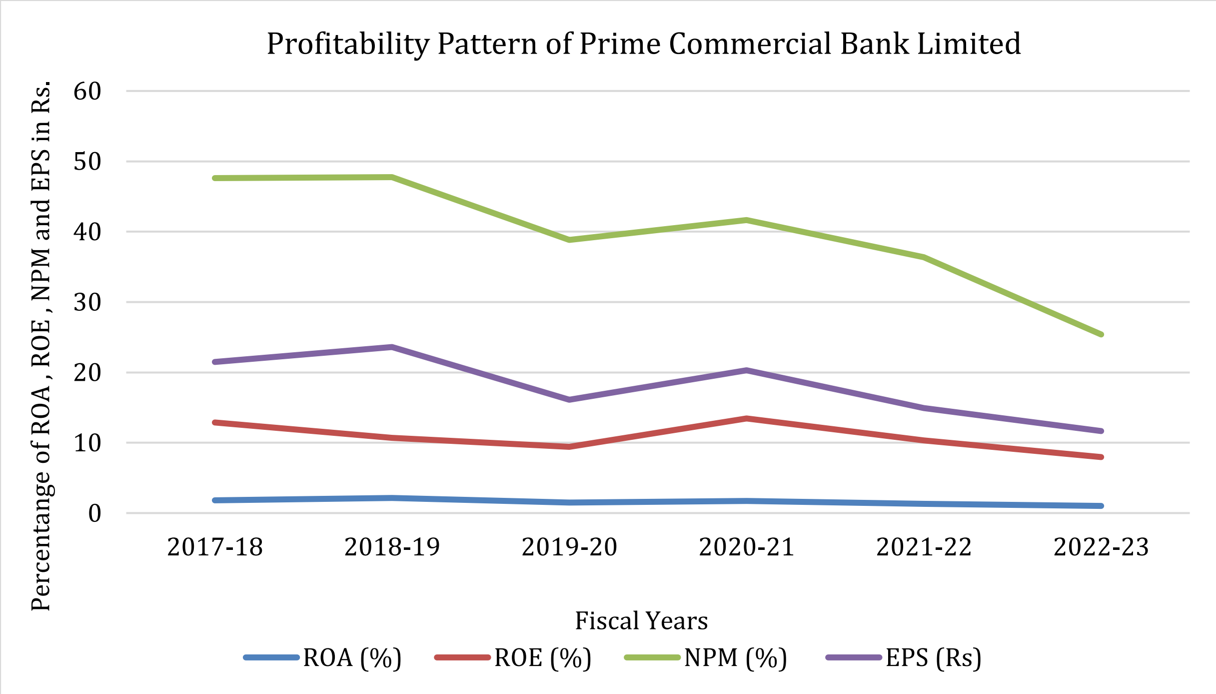

Figure 2. Trend Analysis of Profitability Ratios (ROA, ROE, NPM, EPS) for Prime Commercial Bank Limited (Fiscal Years 2017/18 - 2022/23)

The data presented in Table 2 for Prime Commercial Bank Limited from the fiscal years 2017-18 AD to 2022-23 AD reveals notable fluctuations in profitability ratios. Beginning with Return on Assets (ROA), there was a slight increase from the first year to the second year. As shown in Figure 2 the upward trend was short-lived, as ROA decreased just before the bank's merger. Following the merger in 2019-20 AD, ROA saw a rise to 1.71 percent in 2020-21 AD. Unfortunately, Prime Commercial Bank Limited was unable to maintain this upward trajectory, ultimately experiencing a decline in ROA to 1.02 percent by 2022-23 AD. In terms of Return on Equity (ROE), the trend was downward leading up to the merger. However, there was a noticeable improvement in the trend immediately following the merger with Kailash Bikash Bank. Despite this positive shift, the bank struggled to maintain consistency, as ROE fell significantly again in the fiscal years 2021-22 and 2022-23.

Table 3. Presentation of Mean and Standard Deviation of Different Profitability Ratios of Global IME Bank Ltd before and After Merger

Before Merger					**After Merger**				
Year	ROA	ROE	EPS	NPM	Year	ROA	ROE	EPS	NPM
2017/18	1.63	16.19	23.64	41.24	2020/21	1.20	13.38	19.25	35.26
2018/19	1.82	18.47	26.46	41.06	2021/22	1.37	13.98	20.84	38.03
2019/20	1.06	12.88	17.99	28.49	2022/23	1.38	12.38	20.77	36.79
Mean	1.50	15.85	22.70	36.93		1.32	13.25	20.29	36.69
Standard deviation	0.3955	2.8107	4.3130	7.3098		0.1012	0.8083	0.8985	1.3875

As shown in Table 3 the overall financial performance of Global IME Bank Ltd contrasting the status of essential profitability ratios before and after the merger. Following the merger, bank faced decline in key matrices. The average ROA, ROE, EPS and NPM dropped by noticeable margin. The post-merger scenario signaling low efficiency and need for further improvements. Standard deviations are reduced by huge margin.

Sample T-Test

With the degrees of freedom (df) calculated as n-before + n-after - 2 = 3 + 3 - 2 = 4, and assuming a significance level of alpha = 0.05, we can refer to a t-table or use statistical software to find the critical t-value. For a two-tailed test, the critical t-value at alpha = 0.05 and df = 4 is approximately ±2.776.

Table 4. Result of T-Test of Different Profitability Ratio of Global IME Bank Ltd

Criterion	Tabulated Value	Calculated Value	Result
ROA	2.776	0.83	Accept Ho
ROE	2.776	1.62	Accept Ho
EPS	2.776	0.98	Accept Ho
NPM	2.776	0.14	Accept Ho

As shown in Table 4 all calculated values are less than the tabulated value. The null hypothesis (Ho)is accepted, indicating no significant differentce in profitability ratios.

Table 5. Mean and Standard Deviation of Different Profitability Measurement of Prime Commercial Bank Ltd before and After Merger

Before Merger					**After Merger**				
Year	ROA	ROE	EPS	NPM	Year	ROA	ROE	EPS	NPM
2017/18	1.82	12.87	21.49	47.62	2020/21	1.71	13.45	20.32	41.67
2018/19	2.15	10.71	23.60	47.75	2021/22	1.32	10.32	14.94	36.37
2019/20	1.48	9.40	16.10	38.81	2022/23	1.03	7.96	11.66	25.39
Mean	1.82	10.99	20.40	44.73		1.35	10.58	15.64	34.64
Standard deviation	0.3350	1.7523	3.8677	5.1244		0.2329	2.754	4.3722	8.3059

As shown in Table 5 the mean of various profitability ratios of Prime commercial bank ltd declining slowly whereas daviation of ratios ae inclining except ROA before and after the merger. Like Global IME bank ltd, this bank also has declining profitability ratios following the merger.

Table 6. Result of T-Test of Different Profitability Ratio of Prime Commercial Bank Ltd

Criterion	Tabulated Value	Calculated Value	Result
ROA	2.776	2.008	Accept Ho
ROE	2.776	0.73	Accept Ho
EPS	2.776	0.70	Accept Ho
NPM	2.776	0.45	Accept Ho

Calculated values of Table 6 are less than the tabulated value. The null hypothesis (Ho) is accepted, indicating no significant differentce in profitability ratios.

5. CONCLUSION

The research work explained the effect of mergers in the profit components commercial banks of Nepal. Against the expectations, the result shows insignificant effect of merger in financial benefits. The t-tests results showed no statistically significant changes in ROA, ROE, EPS, or NPM before and after the merger. Although some financial ratios showed short-term improvements, long-term profitability either decreased or remained stagnant. We can conclude that only the merger is not sufficient to strengthen financial performance of banks. Factors such as operational efficiency, risk management, and governance must also be considered. Policymakers and regulators should not depend solely on forced mergers for sector consolidation.

Instead, they should focus on sustainable approaches that reinforce core banking activities. Future research could enlarge the sample size and incorporate qualitative perspectives from stakeholders. Financial institutions should pay concern in green financial initiatives, sustainable practices, development of financial literacy rather than merger and focus on quantity only.

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Author Contribution Statement

Name of Author	C	M	So	Va	Fo	I	R	D	O	E	Vi	Su	P	Fu
Mr. Suraj Khatiwada	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

C : **C**onceptualization
M : **M**ethodology
So : **So**ftware
Va : **Va**lidation
Fo : **Fo**rmal analysis
I : **I**nvestigation
R : **R**esources
D : **D**ata Curation
O : Writing - **O**riginal Draft
E : Writing - Review & **E**diting
Vi : **Vi**sualization
Su : **Su**pervision
P : **P**roject administration
Fu : **Fu**nding acquisition

Conflict of Interest Statement

No conflict of interest.

Informed Consent

I have taken data from the website of Prime commercial bank and Global IME bank. I have obtained informed consent from both institutions.no personal or confidential data were accessed.

Ethical Approval

This study based entirely on publicly available secondary data from the official websites of the respective banks and the Nepal Rastra Bank. No primary data involving human or animal subjects was collected. Therefore, ethical approval was not required.

Data Availability

The data that supports the finding the study are openly available in https://www.globalimebank.com/annual-report/ and https://www.primebank.com.np/investor-relation/annual-reports .

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