

# SHORT TERM EFFECT OF CONSOLIDATION ON CAPITAL APPRECIATION OF NIGERIAN BANKS

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The regulatory authorities usually assess the performance of any financial institution on the basis of five ratios known as the *Camel* ratings (acronym for Capital adequacy, Asset quality, Management competence, Earnings strength and Liquidity position) (Adewoyin, 2006; Ojo, 2000). The outcome of these ratings between 2001 and 2004 shows that 17 (19 percent) of the 90 existing banks were either marginally sound or unsound in 2001. The figure rose to 23 (26 percent) in 2002 and remained at 26 percent in 2003. Although, the total number of banks reduced to 87, one out of every three banks (30 percent) was either marginally unsound or totally unsound in 2004. Bank failure had earlier been experienced in the 1990s, of which one out of every two banks was distressed (Adewoyin, 2006).

The situation was described this way by Kareem (2008):

*.... by May 1996, 60 out of the nation's remaining 115 banks were distressed (five banks out of the previously existing 120 banks had earlier been liquidated). The 60 banks had non-performing loans of N35.88 billion, amounting to 62 per-cent of the banking industry's total of N57.87 billion. The total deposits of the distressed banks stood at N93.52 billion (45%) out of the banking industry's total of N208.73 billion while their insured deposits stood at N52.61 billion (50%) as against the industry's total of N105.9 billion....*

With the above scenario in mind, the (then) Governor of The Central Bank of Nigeria (CBN), Prof Chukwumah Soludo, in an attempt to prevent a repeat of the crisis of the last decade, at a special meeting with the Bankers Committee on July 6, 2004 read out an on-going reform agenda, which has permanently altered the Nigerian banking literature for good. (Adewoyin, 2006).

The main components of the reforms include the following:

- ♦ Minimum capitalisation of N25 billion for banks with full compliance by December 31, 2005.
- ♦ Consolidation of banking institutions through mergers and acquisition.

One of the benefits of the consolidation exercise to shareholders as enumerated by Nwude (2008) is that it assures stability, potential for

growth (share price appreciation) and sound shareholders' funds, as the banks take on bigger investment opportunities.

The financial objective of any commercial concern is to maximise the value of the firm to its owners. If this and other objectives intended are achieved, the effects should be reflected in the share price of the firm and in turn benefit the owners, including those who invest for capital gain or income. (Ebo, 2008).

The next question to ask is: is it really true that potential for growth (as measured by share price appreciation) has been achieved by the banks three years after the consolidation exercise? It is the desire to answer this and other similar questions that motivated this research work.

The rest of the paper is divided into four sections. Section two is on review of related literature, section three on research methodology and model specification. Section four is on findings and discussions, while section five concludes it.

## Review of Related Literature

Over the past decade, the banking industry has experienced an unprecedented

level of consolidation, as mergers and acquisitions among financial institutions took place worldwide at record levels (Pilloff and Santomero, 1996). To a large extent, this consolidation is based on the belief that gains can accrue through expense reduction; increase market power, reduced earnings volatility, and scale and scope economies. Whether or not bank mergers actually achieve the expected performance gains is the critical question. If consolidation does, in fact, lead to value gains, then shareholders' wealth can be increased. On the other hand, if consolidating entities does not lead to the promised positive effects, then mergers may lead to a less profitable and valuable banking industry.

A reading of the literature suggests that the value gains that are alleged to accrue to the large and growing wave of merger and acquisition activity have not been verified. This has left the research community in a quandary. Has the industry followed a path of massive restructuring on a misguided belief of value gains? Is management in this sector incompetent? Or are they merely lying to shareholders about the effect of their activity on shareholders' value?

Most academic studies follow one of two approaches to estimate and evaluate the significance of merger-related gains. The first compares the pre-merger and post-merger performance of institutions using accounting data to determine whether consolidation leads to changes in reported revenue or profit figures. The second approach to analysing merger benefits evaluates the stock market reaction to merger

announcements. Turning to studies of stock market reactions to merger announcements, researchers generally fail to find total gains from consolidation. Hannan and Wolken (1989) conducted a study on the value-weighted abnormal returns experienced in 43 deals announced between 1982 and 1987. The authors found that on average, total shareholders' value was not significantly affected by the announcement of the deal. They did however, find that one determinant, target capitalization, cross-sectionally influenced expected synergistic gains. The capital was negatively related to the change in total value. The only serious study to the European market on this issue was carried out by Cybo-Ottone and Murgia (1996). In it, they analysed 26 mergers of European financial services firms (not just banks) taking place between 1988 and 1995 in 13 European banking markets. Their results were qualitatively similar to much of the analysis conducted on American banking organizations. Average abnormal returns of targets were significantly negative and those of acquirers were essentially zero.

The findings of Zhang (1995) on U.S data contradicted those of abnormal return studies. Among a sample of 107 mergers taking place between 1980 and 1990, the author found that mergers led to a significant increase over all value. In general, mergers were not associated with any significant change in performance, suggesting that managers were unable to generate benefits from deals on average. Moreover, the mean overall change in shareholders' value was quite small. Although, there was no average change in either operating

performance or shareholder' value, there was a great deal of variation among banks. Some mergers proceeded successfully and others resulted in failure. Likewise, the dispersion of changes in market values indicates that investors expected some mergers to increase and others to decrease firm value.

In summary, most studies fail to find positive relationship between merger activity and gains in performance or shareholders' wealth. This conclusion of no economic benefits holds across a wide variety of methodologies, samples, and levels of analysis, (individual bank or holding company). Moreover, there appears to be no relationship between changes in value at announcement and subsequent outcomes. Although Cornett and Tehranian (1992) found the existence of a relationship, Pilloff (1996) provided stronger evidence for non-existence.

As to the question on whether merger improves share prices, Economic Letters (1998) was of the view that there is a definite chance it might decrease the share value. However, it is likely that the merger is going to be favourable for at least one, if not both companies. Share value and the stock market is a very 'unsure' environment and the price of a share can change due simply to rumours and speculations, rather than financial fact!

## **Research Methodology and Model Specification**

### **Research Methodology**

Data used in this paper were secondary. The data are on the share prices of only 13 (thirteen) banks out of the "mega" banks that scaled

through the consolidation exercise of January 1<sup>st</sup>, 2006. They are in two categories: those for the pre-consolidation period of 2003-2005, and those of post-consolidation period of 2006-2008, making three (3) years for each period.

The banks used as case study cut across three (3) strata:

- *Old generation banks*; five (5) were selected: Afribank Plc, First Bank Plc, UBA Plc, Union Bank Plc and Wema Bank Plc.
- *New generation banks*, four (4) were picked: Guaranty Trust Bank Plc, Intercontinental Bank Plc, Oceanic Bank Plc and Zenith Bank Plc.
- *Up-coming banks* (neither old nor new generation), four (4) were selected: Access Bank Plc, Ecobank Plc, First City Monumental Bank Plc and First Inland (now Finland Bank) Plc.

**Note:**

The banks chosen in most cases are those that fairly retained their identities before and after the consolidation exercise and whose published financial reports and required data were available for the whole period under review.

The secondary data used were sourced from the Daily Official List (Equities) of The Nigerian Stock Exchange and The Nation Newspaper, December 30, 2008. The authors also made some computations.

The model used for this study is the descriptive (narrative) statistical method in conjunction with paired sample t- tests statistic. Paired

sample t-test statistic was used because among others, the t-test is a statistical tool used to test the significance of the difference between two sample means observed at two points in time (Carver and Nash, 2000). This is an improvement on the ordinary student t-test used by Adereti and Sanni (2007), Banjo (2007), Sanni, Akinpelu and Ademola (2007) and Sanni (2008a).

**Hypothesis Tested**

The paper tested only one hypothesis in its effort to make the research objective achievable. This is:

Ho: The banking consolidation of 2006 in Nigeria did not lead to a significant capital appreciation of shares of the affected banks.

Hi: The banking consolidation of 2006 in Nigeria led to a significant capital appreciation of shares of the affected banks.

**Model Specification**

The test of significant difference between two means carried out with calculated t-value is:

$$t_{cal} = \frac{\bar{X}_a - \bar{X}_f}{\sqrt{\frac{s^2_a}{n_a} - \frac{s^2_f}{n_f}}}$$

Where:

Xa = Mean of Post-consolidation share prices of the banks used as case study.

Xf = Mean of Pre-consolidation share prices of the banks used as case study.

S<sup>2</sup>a = Variance of Post-consolidation share prices of the banks used as case study.

S<sup>2</sup>f = Variance of Pre-consolidation share prices of the banks used as case study.

na = Number of post-consolidation years.

nf = Number of pre-consolidation years.

The calculated P-value (significance level) is compared with 0.05 level of significance.

**Decision Rule**

Accept Ho if Calculated P-value > 0.05.

Reject Ho if Calculated P-value < 0.05.

**Findings and Discussions**

**The Pre-Consolidation Period (2003-2005)**

The combined share prices of all the banks used as case study appreciated from N110.32 in 2003 to N116.40 in 2004 (Table 1), thus recording a marginal 5.5 percent increase. The combined share price appreciated in 2005 by 20.40 percent over the previous year, ending at N140.13. On the whole, the share prices recorded a 27.02 percent appreciation in 2005 over that of 2003.

The result for individual banks is mixed. The share prices of 5 (five) banks appreciated throughout the pre-consolidation period; the shares of First Bank Plc for instance, appreciated by 15.5 percent in 2004 and 38.5 percent in 2005. That of First Inland Bank Plc appreciated by 13.8 percent, and 69.2 percent, Guaranty Trust Bank Plc was by 2.7 percent and 6.1 percent, Intercontinental Bank

Plc 88.6 percent and 18.4 percent, and UBA Plc was by 0.2 percent and 42.9 percent in 2004 and 2005 respectively.

The share prices of eight (8) of the banks however, either appreciated but later depreciated (and vice versa) during the period. The share prices of Access Bank Plc for an example appreciated by 17.5 percent in 2004 only to depreciate by 12.6 percent in 2005. The same pattern was witnessed by Wema Bank Plc (1.3 percent gain followed by 4.8 percent loss). The shares of Afribank Plc on the other hand recorded a 3.0 percent loss in 2004 before bouncing back to record a 37.3 percent gain in 2005. A similar scenario occurred for Ecobank Plc (6.50 percent loss, 4.6 percent gain), First City Monumental Bank Plc (0.02 percent loss, 3.2 percent gain), Oceanic Bank Plc (1.6 percent loss, 6.49 percent gain), Union Bank Plc (12.60 percent loss, 24.0 percent gain) and Zenith Bank Plc (2.0 percent loss, 5.2 percent gain).

That the combined share prices in 2005 appreciated by as much as 20.40 percent over 2004 did not come as a surprise. The apex bank in Nigeria (The Central Bank of Nigeria (CBN) had earlier on set aside 31<sup>st</sup> December 2005 as the deadline for all banks to increase their minimum paid up share capital from N2billion to N25billion. This led to a rush into the capital market and aggressive competitions among the banks.

### Post-Consolidation Period

The combined share price of the banks appreciated from N140.13 in

**Table 1: Share Prices of Selected Nigerian Banks as at 31 December 2003-2005 (The Pre Consolidation Period)**

	A 2003 N	B 2004 N	% Change	C 2005 N	% Change 04/05	Total (A+B+C) N
<b>Banks</b>						
1. Access	2.91	3.42	17.5	2.99	(12.6)	9.32
2. Afribank	6.83	6.63	(3.0)	9.10	37.3	22.56
3. Ecobank	2.31	2.16	(6.5)	2.26	4.6	6.73
4. FirstBank	20.00	23.10	15.5	32.00	38.5	75.10
5. FCMB	5.03*	4.95	(0.02)	5.11	3.2	15.09
6. FinBank	0.94	1.07	13.8	1.81	69.2	3.82
7. GTBank	9.30	11.69	2.7	12.40	6.1	33.39
8. Intercontinental	4.14	7.81	88.6	9.25	18.4	21.20
9. Oceanic	6.40*	6.30	(1.6)	6.49	3.0	19.19
10. UBA	9.08	9.10	0.2	13.00	42.9	31.18
11. Union Bank	23.50	20.55	(12.6)	25.48	24.0	69.53
12. Wema	3.88	3.93	1.3	3.74	(4.8)	11.55
13. Zenith	16.00*	15.69	(2.0)	16.50	5.2	48.19
<b>Total</b>	<b>110.32</b>	<b>116.4</b>	<b>5.5</b>	<b>140.13</b>	<b>20.4</b>	

\*Provisional

Sources: Daily Official List (Equities) of the Nigerian Stock Exchange.

The Nation Newspaper, December 30, 2008.

Computations by the authors

**Table 2: Share Prices of Selected Nigerian Banks as at 31<sup>st</sup> December 2006-2008 (The Post-Consolidation Period)**

	2005/2006 % Change	A 2006 N	B 2007 N	% Change 06/07	C 2008 N	% Change 07/08	Total (A+B+C) N
<b>Banks</b>							
1. Access	140.80	7.20	23.00	219.4	6.93	(69.87)	37.13
2. Afribank	26.48	11.51	30.49	165.0	9.83	(67.76)	51.83
3. Ecobank	121.24	5.00	7.95	59.0	27.96	251.70	40.91
4. FirstBank	1.84	32.59	44.70	37.2	22.00	(50.78)	99.29
5. FCMB	(18.59)	4.16	18.88	353.8	5.98	(68.33)	29.02
6. Finbank	90.06	3.44	13.30	286.6	4.40	(69.92)	21.14
7. GTBank	(43.15)	7.05	34.63	391.2	13.09	(62.20)	54.77
8. Intercontinental	50.05	13.88	40.60	192.5	11.77	(71.00)	66.25
9. Oceanic	149.61	16.20	37.40	130.8	12.00	(67.91)	65.60
10. UBA	104.62	26.62	49.50	86.0	12.00	(75.76)	88.12
11. Union Bank	(5.81)	24.00	43.06	79.4	16.30	(62.12)	83.36
12. Wema Bank	13.10)	3.25	15.00	361.5	14.29	(4.73)	32.54
13. Zenith Bank	48.30	24.47	46.09	88.3	23.28	(49.49)	93.84
<b>Total</b>	<b>28.00</b>	<b>179.37</b>	<b>404.60</b>	<b>125.6</b>	<b>212.10</b>	<b>(47.57)</b>	

Sources: Daily Official List (Equities) of the Nigerian Stock Exchange.

The Nation Newspaper, December 30, 2008.

Computations by the authors.

**Table 3: Paired Sample T-Test (Post Consolidation Mean of Share Prices less Pre-Consolidation Mean of Share Prices)**

### Consolidation Mean of Share Prices).

Banks	Mean	t-cal	2- tail Sign level	Std Dev	Paired sample correl
1. Access	9.27	1.798	0.214	8.93	0.987
2. Afribank	9.76	1.366	0.305	12.37	(0.621)
3. Eco bank	11.39	1.580	0.255	12.49	0.720
4. First Bank	8.06	0.858	0.481	16.28	(0.687)
5. FCMB	4.64	0.994	0.425	8.09	(0.804)
6. FinBank	5.77	1.788	0.216	5.59	(0.292)
7. GTBank	7.13	0.896	0.465	13.77	0.491
8. Intercontinental	15.02	16.45	0.242	15.81	0.180
9. Oceanic	15.47	1.955	0.190	13.70	(0.943)
10. UBA	18.98	1.585	0.254	20.74	(0.793)
11. Union Bank	4.61	0.492	0.672	16.24	(0.992)
12. Wema Bank	6.99	1.834	0.208	6.61	(0.211)
13. Zenith Bank	15.22	2.000	0.183	13.18	(0.819)
<b>Total</b>	<b>143.07</b>	<b>1.972</b>	<b>0.187</b>	<b>125.69</b>	<b>(0.193)</b>

Source: Computations from SPSS.

2005 to N179.37 in 2006, thereby recording a 28.00 percent increase in just a year after the consolidation exercise. The result was however mixed for individual banks: Oceanic Bank Plc recorded the highest gain of 149.61 percent, while Guaranty Trust Bank Plc had the worst loss of 43.15 percent (Table 2). The combined share price of banks appreciated by 125.60 percent in the second year, while that of individual banks appreciated in value, with those of Guaranty Trust Bank Plc leading with 391.20 percent and the least from First Bank Plc with 37.2 percent.

The share prices recorded a landmark appreciation (as had earlier been mentioned), due to the recapitalisation of each of the banks from N2billion to N25billion, effective from January 1, 2006 as ordered by the CBN.

Other factors include the domestic money market that remained largely stable during the period under review, reflecting the macroeconomic stability that prevailed in 2007. The real GDP grew by 6.20 percent in 2007 compared with 6.00 percent in 2006 (Yakubu, 2008). The boom witnessed in the capital market in 2007 continued until the first quarter of 2008. Since early March 2008, however, to the consternation of one and all (stockbrokers inclusive), stock market prices have been experiencing a free-fall due to the global financial crisis.

The overall effect of the global financial crisis is that the combined share price of the banks depreciated by as much as 47.58 percent in 2008 when compared with 2007 prices, and by 18.25 percent when

compared with the 2006 prices; UBA Bank Plc was the worst hit, recording a 75.76 percent loss. Of interest is the fact that the share prices of some of the banks were worse off in 2008 compared to 2005; the share price of First Bank Plc for an example declined from N32.00 (in 2005) to N22.00 (in 2008), UBA Plc from N13.00 to N12.00 and Union Bank Plc from N25.48 to N16.30. The most astonishing increase was that of Eco Bank Plc that increased from N7.95 in 2007 to N27.96 in 2008, a 25.1 percent increase, the global financial crisis notwithstanding.

#### **Paired sample t-tests statistic.**

The paired sample t-test statistic of the combined mean is N143.07 (Table 3). The paired sample t-tests statistics for each of the banks are all positive, the highest of N18.98 by UBA Plc, and the least of N4.61 by Union Bank Plc. This indicates that the post-consolidation mean of the combined share price is more than the pre-consolidation mean. This is also true of the shares of individual banks. The paired sample correlation for the combined share prices is negative and very low (0.193). The bulk of those of individual banks are also negative but very high.

Looking at the significance however, none of the values is significant at 0.05 (0.672 being the highest for Union Bank Plc and 0.183, the least for Zenith Bank Plc). One is therefore tempted to conclude that there is no significant difference in the values of the shares after the consolidation exercise. This will lead to Type II error. The problem arose due to the small number of years used (3 years) and the

resultant small degree of freedom (which is 2).

As rightly pointed out by Fagoyinbo (2004):

*The higher the degree of freedom (df) used, the closer is the t-distribution towards the shape of normal distribution. Theoretically, (the) t-distribution is equal to normal distribution when the df is infinite in size (i.e. over 30 or more).*

This was collaborated by Sanni (2008c). For this reason, we fail to accept  $H_0$  and conclude that the share prices of the banks used as case study appreciated significantly after the banking consolidation exercise.

#### **Conclusion**

One of the reasons given for consolidation of Nigerian banks is to increase shareholders' wealth as measured by share price appreciation. To know whether this was achieved three years after the exercise, the paper compared three-year pre-consolidation share prices of thirteen (13) carefully selected banks with three-year post-consolidation share prices. Combining descriptive (narrative) statistic with paired sample t-test statistic, the results showed that the combined share prices of the banks appreciated significantly after the consolidation exercise. Individually, the shares of all the banks also appreciated significantly, two years after the exercise, the three top gainers coming from the three categories the sampled banks had been divided. The shares of Guaranty

Trust Bank Plc (representing “New generation” banks) appreciated by 391 percent between 2006 and 2007 followed by Wema Bank Plc (“old generation” bank) by 362 percent and First City Monumental Bank Plc (“upcoming” bank) by 353 percent.

The 2008 global financial crisis (that was first noticed in the U.S in 2007) took its toll on the banking sub-sector as the share prices of all the banks (except one) crashed in 2008. The three top losers cut across the three categories the sampled banks had been divided. The shares of UBA Bank Plc (an “old” generation bank) topped the pack with 75.76 percent loss, followed by Intercontinental Bank Plc (a “new” generation bank) by 71 percent loss and First Inland Bank Plc (an “upcoming” bank) by 69.92 percent loss.

Of interest is the fact that the share prices of some of the banks were worse off in 2008 when compared with 2005 prices. The shares affected are all those of “old” generation banks: First Bank Plc whose shares declined from N32.00 (in 2005) to N22.00 (in 2008), UBA

Plc (from N13.00 to N12.00) and Union Bank Plc (from N25.48 to N16.30). That the shares of ‘old generation’ banks were so badly affected did not come as a surprise as it had earlier been predicted by The New Age Banking Annual (2004) that the biggest threat to market shares of the existing big banks will come from the newly consolidating groups of new generation banks that are known for their aggressive marketing push. It can however be seen that none of the banks, on the average, is worse off after the consolidation as shown by computations in the paired sample t-test on Table 3.

Only one bank, Eco Bank Plc which surprisingly is an ‘upcoming bank’ survived the global financial crisis. Its shares appreciated by as much as 251 percent from N7.95 in 2007 to N27.96 in 2008, the global financial meltdown notwithstanding. The conclusion one is tempted to reach therefore is that the shares of most of the banks used as case study (and indeed all the shares quoted in the Nigerian Stock Exchange) might have been grossly

over-valued prior to the 2008 global financial crisis. This is evident from the fact that the Nigerian capital market lost N9 trillion (from N14 trillion to N5 trillion, representing a 64.30 percent loss) to the global financial meltdown (Bankole, 2009) that started in 2008, thus making the Nigerian stock market the world’s second worst performing equity market for the year (Oniyitan, 2009).

That the shares might have been grossly overvalued or manipulated was buttressed by Nwude (2008) when he observed that some companies’ stocks might record persistent price appreciation in spite of their dwindling fortunes due to alleged artificial scarcity of such stocks and manipulations by some operators. This was confirmed by Oshiomhole (2009) when he remarked that the regulators manipulated virtually every rule and rigged the share prices of stocks to unprecedented levels.

The only limitation to this work, which must be pointed out, is that the time value of money/ effects of inflation had not been taken into consideration. 

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