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BANK CONSOLIDATION AND RECAPITALIZATION IN NIGERIA: AN EVALUATION OF MERGER AND ACQUISITION OPTION

BY: I. B. ABDULLAHI
Department of Accounting and Finance University of Ilorin

Abstract

This paper evaluates merger and acquisition option in meeting up with the new reform on bank consolidation and recapitalization in Nigeria. It is hoped that it would serve as reference point to the technocrats, public and other relevant regulatory agencies charged with the task of achieving credible reforms in the Nigerian banking industry. The issues evaluated related to historical perspective of capital Reforms and mergers & acquisitions, meaning & procedure, objectives, conceptual clarification, legal framework, problems and risks associated with merger & acquisition in Nigeria. This paper concluded that merger and acquisition is a very complex process, though it holds great potentials for the consolidation and recapitalization reform in the banking industry, if consciously implemented.

Background of the study

The issue of capitalization is as old as the evolution of banking itself. Capitalization is the level of capital necessary to ensure the bank's financial health and soundness.

The Governor of Central Bank of Nigeria (CBN), at the Bankers Committee meeting on Tuesday, July 6, 2004 announced new minimum shareholder's fund unimpaired by losses from earlier set limit of N25 billion by the end of December 2005 (Abdul 2004). This new capital reform was as a result of National Economic Empowerment and Development Strategy (NEEDS) document launched by President Olusegun Obasanjo in May, 2004 to introduce some reforms in the banking industry. The non-compliant banks by the terminal date are to be prevented from participating in the official foreign exchange market and to have no access to public sector funds among others. The desire of the reforms is to encourage Mergers and acquisitions to form mega banks with a view to strengthening and consolidating the industry so as to assist in achieving the noble objectives of NEEDS on one hand and to comply with global and uniform measuring yardstick for capital adequacy level put at 8%.

Historical perspective of capital reforms

Under-capitalization of the banks was one of the major reasons for collapse of a number of banks in early 50s in Nigeria. Other factors were poor management, hostile and unfair competition. The period was described as unregulated banking activities. As a result of these problems, Mr. G. O. Patron was commissioned to enquire generally into the business of banking in Nigeria and recommendations were made to the Government

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on the form and extent of control to be introduced. This led to the formulation of the Banking Ordinance of 1952. A provision in that ordinance prescribed as part condition for entry into commercial banking a minimum paid-up capital of € 25,000 for bank incorporated in Nigeria and € 200,000 for banks incorporated outside Nigeria. Since then, various increases have been made in the minimum capital requirement. The level for expatriate banks rose to € 400,000 while that for indigenous banks remain the same. Another increase was prescribed in 1962, the requirement for indigenous banks rose to € 500,000 while in 1969, expatriate banks needed € 1.5 million, and only € 600,000 for indigenous banks.

From the work of Elekama (2005), banks were initially differentiated by type of ownership with high level of minimum paid-up capital stipulated for expatriate banks. The deregulation in the banking sector in 1988 brought about proliferation of banks and this gave impetus for differentiation of banks in terms of their function i.e. commercial and merchant banks. The capital requirement was put at N10 million for commercial banks and N6 million for merchant banks. These were increased to N20 million and N12 million in 1989, N50 million and N40 million in 1991 respectively.

With the introduction of Universal banking system, it created a level playing field for all banks, the differentiation of banks between commercial and merchant in terms of function and minimum paid-up capital were harmonized. The same minimum capital requirement of N500 million was stipulated in 1997, N1 billion in 2001, N2 billion in 2004 and now at N25 billion to be met on or before 31st December, 2005.

The importance of this reform cannot be over emphasized because an international media has once described the Nigerian banking industry as "ramshackle". The objective of this capital reform is in line with the risk-based capital adequacy standard proposed by Basle Committee of Banks for international settlement, which was adopted in December 1998. The requirements are based on the assumption that different assets carry different level of risk and therefore require different levels of capital backing to match with the perceived risk. The Basle capital accord introduced in essence capital adequacy requirement based on risk-weighted composition of banking including its off-balance-sheet exposures.

The Basle Accord is based on three re-enforcing pillars i.e minimum capital requirement, Supervisory Review Process and Market Discipline. It is expected that when all nations complied with Basle Accord, it will present a global and uniform measuring yardstick for capital adequacy level at 8% (Fashanu 2004).

Historical Perspective of Mergers and Acquisitions

Mergers and acquisitions take place worldwide as a result of economic or technological changes. The early mergers were recorded between 1897 and 1904 in the United States and Europe. Most companies that merged then had monopoly undertone.

However, the 50s and 60s witnessed a very considerable increase in mergers and acquisitions activity, particularly in the United States, Britain and in Western Europe under the influence of the common market. Some of the most dramatic growths in earnings via acquisitions have come from companies like GEC, which successfully absorbed AEI and English Electric, the mergers between American online and Time Warner were other typical examples.

In the last two decades, mergers and acquisition activities have been at a lower pitch and all signs point to an acceleration of deal making spurred in large part by the breath-taking influx of capital into the internet space. Many executives will be placing bets on mergers and acquisitions that will put their company's future at stake (Carey 2000). The mergers between Mccaw Cellular and AT&T in 1993 and between Geocities and Yahoo in 1999 in America are very important in the history of mergers and acquisitions globally.

Mergers and acquisitions over the years have also taken place in the financial services sector especially in the banking industry. There have been over 700 cases of bank mergers since 1980, worldwide. For instance in the United kingdom and other European countries, specifically in the period between 1997-1998, 203 bank mergers and acquisitions took place (Ottawa, Mckinsey and Company, 1998).

It was revealed in the speech made by Professor Charles Soludo at the 273rd Bankers Committee meeting on July 6, 2004 that in 1998 a merger in France resulted in a mega bank with a capital base of US $688 billion, while the merger of two banks in Germany in the same years created the second largest bank in Germany with a capital base of US $541 billion. He went further in his analysis to reveal that as a result of mergers and acquisitions 80 banks in Malaysia shrunk to 12 banks within one year in order to meet the minimum paid-up capital for $526 million to $870 million.

The Nigerian experience of mergers and acquisitions is recent and limited. The earliest experience of mergers and acquisitions in Nigeria was between West African Soap Company Limited and Van Berg Limited (Producers of margarine) to form Lever Brothers Limited in 1962 (Onwu 1994).

However, not much merger activity was recorded thereafter until the first phase of indiginization programme in the 70s which entailed the divestment by foreign investors of potions of their equity to Nigerian Investors. Most mergers and acquisitions that took place then were "in-house" arrangement. For instance, a combination involving Paterson and Zochonis $ Company Limited and Associated Industry Nigeria Limited to form PZ Industry Limited was a typical example of the in-house arrangement. Between 1982 and 1988, the Nigerian Security and Exchange Commission (SEC) actually handled only thirteen merger proposals. This suggests that merger and acquisition is still at its infancy stage and not yet popular in Nigeria. Out of the thirteen cases of mergers proposals handled by SEC, only eleven were successfully executed while the two other cases, although approved by SEC, failed to be consummated eventually. Six of the successful mergers were affected through exchange of shares as determined by SEC while the remaining cases were consummated by cash payments. (Mayaki 1992).

One of the successful mergers was between public companies, AG Leventis Company Nigeria Limited and Leventis Stores Limited. The Commission approved of 60k and 50k shares for AG Leventis and Company Nigeria Limited and a per price of 50k each for the shares of Leventis Stores. Perhaps the most publicised mergers and acquisition in that era was between Lipton Nigeria Limited and Lever Brothers Nigeria Limited in 1984. The transaction was consummated by exchange of shares at the ratio of 150 ordinary shares of Lever Brothers Nigeria Limited for 100 ordinary shares of Lipton.

The opening years of 1990s have not witnessed intense merger activity even in the face of abundance of factors to justify the exercise (Onwu 1994). Hoever, in recent times, and sequel to the new banking reforms the Nigerian banking industry and oil industry are currently witnessing mergers and acquisitions activities and this may be the beginning of many merger activities in Nigeria.

Meaning and Procedures of Mergers and Acquisitions

Mergers and acquisitions is not specifically defined by the Investment and Securities Act 1990 (ISA), However, part of section 99 of the Act defined 'take over' to mean "the acquisition by one company of sufficient share in another company to give the acquiring company control over the other company."

The procedures to be followed in any mergers and acquisition exercise are stated in section 100 of ISA. These include the approval of the scheme by percentage shareholders at the separate court ordered meetings of the scheme by Securities and Exchange Commission (SEC) and the making of adequate provisions for dissenting members and adequate provisions by way of compensation to employees that may be affected by the exercise.

Under Companies and Allied Matters Act (CAC) of 1990, section 590, merger is defined as "any amalgamation of two, undertaking or interest of two or more companies or the undertaking of one or more corporate bodies". This definition could be simply summarized as the coming of two or more separate companies to form a single company. Where the merging entities are of equal size a new name may emerge; but where one of the merging companies has size advantage, its old name may be retained.

On the other hand, acquisition refers to the take over or absorption of a company by another company with the resultant company retaining the name of the acquirer for strategic reasons. Mergers and acquisition can be horizontal i.e the same line of business or vertical; different line of business. (Elakama 2005).

However, relevant to this study is the horizontal mergers and acquisitions because of the introduction of universal banking. According to the Central Bank of Nigeria (CBN), the type of merger in contemplation is not group or family merger. The apex bank wants merger that would entrench good corporate governance at best practices. Therefore it is not mere monetary compliance to minimum paid-up capital of N25 billion, it is rather a strategic alliance and consolidation.

To actualise this, the CBN and other regulatory agencies have put various incentives in place to encourage such strategic combinations and mergers. These include free consultancy advice, prompt treatment of application reduced fees chargeable by SEC, NSE and CAC and a whole lot of other incentives (Elakama 2005).

Objectives of mergers and acquisitions

Why do companies merge? The conventional answer is that the merged companies are better off compared to the individual of the un-merged/un-paired company. For instance, suppose firm A wants to analyse the possible purchase of firm B. The first thing to think of is whether there is an economic gain from the merger. There is an economic gain only if the two firms are worth more together than apart. Then the gain from mergers is Gain = PVAB – (PVA + PVB).

Where PVAB = Present Value of Firms A and B

PVA = Present Value of Firm A

PVB = Present Value of Firm B

Gain from mergers may reflect economies of scale, improved efficiency and equity base, full use of tax shields and the combination of complementary resources or redeployment of surplus funds.

The following are some possible economic and financial objectives of mergers and acquisitions.

i. *Improvement of equity base:* In a situation where a company has a lot of liabilities, if such a company combines with another company with less liabilities, the consequence is a broadened base and improved borrowing power.

ii. *Economic of scales:* A company which has surplus capacity might consider combining its operations with another company thereby, be in a position to spread its fixed cost over larger units of production.

iii. *Maximization of company's value:* Maximization of the market price of a company's share is one of the objectives of merger. Although the immediate effect of a merger and acquisition is the dilution of the earning per share of the surviving company, the earning per share rises thereafter because the demand for the share is likely to strengthen in expectation of improved earnings per share and consequently the market price is likely to rise.

iv. *Company's growth:* A company may achieve growth through acquisition more cheaply than through internal expansion.

v. *Tax reduction:* Tax reduction could be another objective of mergers particularly in developing countries where a loss making company sells its assets, liabilities and operations to another company in the same line of operation to enable the merged companies minimise its tax bill.

In summary, a strategic approach to mergers and acquisition would imply that acquisitions are only made after a clear analysis of the underlying strengths of the acquirer company, and proper understanding of objectives expected to be achieved by the consummated acquisition.

Conceptual Clarification of Mergers and Acquisitions

Akamiokhor (1984) opined that "in making entry decision a profit oriented firm would always compare desirability of entry by internal means and entry by mergers and acquisitions and then choose the means most constant with corporate objective of sustaining or increasing profitability."

There are many and varied reasons that inform the choice of entry made. Thus, each merger proposal arises out of its peculiar reasons. It was further observed that mergers appear to be attractive when there exist possibilities to exploit economies of scale, the acquisitions of market power, diversification, and the acquisition of under-valued assets. Equally relevant are acquisitions that might reduce the likelihood of bankruptcy, un-competitiveness or that would lead to better blend between talents of corporate managers and the resources at their disposal.

Mergers and acquisitions in the light of what Akamaiokhor has described above could be seen to be the reasons that necessitated the CBN to prescribe it as the corporate strategy that can reposition the nation's banking industry.

However the Synergies resulting from mergers and acquisitions in relation to the Nigerian banking industry include:

— Production of a stronger capitalization for banks and positioning them as a strong retail and wholesale financial institutions for the future with strong core deposit base and high domestic and international standing
— Creation of greater access to new opportunity, new markets, new products and better competencies.
— Enhanced strategic positioning and viability as the driving force
— Reduced operational costs resulting from improved efficiency

— The introduction of scales economies

The Legal Framework for Mergers and Acquisitions in Nigeria

In Nigeria, the Securities and Exchange Commission (SEC) liase with Federal High Court to sanction or approve and regulate activities of mergers and acquisitions. The SEC Decree No. 29 of 1988, charge SEC with the responsibility of reviewing and approving mergers and acquisitions between companies in Nigeria.

The manual for mergers and acquisitions in Nigerian banking industry are contained in relevant Acts. These include:

— The Companies and Allied Matters Acts 1990
— Bank and Other Financial Institution Act No. 25 of 1991
— The Investment and Securities Act (ISA) No. 45 of 1999
— The Rules and Regulations of SEC pursuant to the ISA

Following the CBN Governor's speech and address to the Bankers Committee on July 6, 2004 on the Nigerian banking sector reform and subsequent interaction with various stakeholders, the board of the Central Bank of Nigeria approved the guideline and incentives to facilitate consolidation in the industry in order to assist banks in meeting the approved capital base of N25 billion by December 2005. The guidelines are contained in paragraph 6.2 of the 'Guidelines And Incentives On Consolidation in Nigeria Banking Industry' issued by the CBN on 5th August 2004.

Recent trends in the mergers and acquisitions in Nigerian Banking Industry

In recent time the banking industry has witnessed effort made to encourage potential marriage among them. Topmost on the agenda of any serious-minded member of board of directors and management of any bank is how to meet the deadline set by the CBN with regards to the new paid-up capital of N25 billion either through mergers or acquisition or both. From the work of Bamidele (2005), it was observed that at least nine cases of mergers and acquisitions proposals were recorded in the half of the year 2004. He further observed that more consolidating groups are beefing up with those already on ground. As at November, 2005, the stand of banks are shown below:

Successful Merger Groups

1. **UBA Group:** UBA and STB
2. **Access Group:** Access Bank, Marina Int. Bank, Capital Bank Int.
3. **Diamond Group:** Diamond Bank, Lion Bank.
4. **Intercontinental Group:** Intercontinental, Equity, Gatewaybank, Global Bank.

Those that made the N25 billion alone

1. First Bank of Nigeria Plc
2. Union Bank Nigeria Plc
3. Zenith Bank Plc
4. Guaranty Trust Bank Plc
5. Oceanic Bank Plc
6. Standard Chartered Bank Plc
7. NIB (CitiGroup)

Those set to make it

1. **Afribank Group:** Afribank, Trade Bank, NNB Int. Bank, IMB Int. Bank.
2. **IBTC Chartered Group:** IBTC, Chartered Bank, Regent Bank.
3. **Skye Group:** Prudent, EIB, Bond, Reliance
4. **Wema Group:** Wema, National Bank, Lead Bank
5. **FCMB Group:** FCMB, Cooeperative Development Bank, NAMBL.
6. **Fidelity Group:** Fidelity, FSB Int., Manny Bank.
7. **First Inland Group:** First Atlantic, Inland Bank.
8. **ETB/Devcom:** Equitorial Trust Bank, Devcom Bank.

Those likely to make it

1. **Sterling Group:** Trust Bank of Africa, Magnum Trust, NBM, NAL, Indo-Nigeria Bank.
2. **First North Group:** BON, NUB Int., New Africa Bank
3. **Citizens Guardian Group:** Citizens Bank, ACB Int., Guardian Express Bank
4. **Unity Group:** Intercity Bank, Tropical Commercial, Pacific Bank, First Interstate Bank, CentrePoint Bank.
5. **Platinum Group:** Platinum Bank, Habib Nigeria Bank
6. **Bank One Group:** Trans Int. Bank, Omegabank, Fountain Trust Bank.

The Alliance Bank Group

Eagle Bank, Gulf Bank of Nigeria Plc, Afex Bank Plc, Fortune Bank, City Express Bank Limited, Metropolitan Bank, Liberty Bank, Trade Bank, Triumph Bank.

Still Searching

African International Bank, Societe Generale Bank, Assurance Bank. Source: (Punch News Paper, 15th November, 2005).

Problems and risks associated with mergers and acquisitions

According to Merret and Sykes (1973) the possible and conceivable problems associated with merger might arise in merger bids. The problems include resistance to bid, subversive tendencies of aggrieved parties, under or over estimating of assets and liabilities by the appraisal team(s), concealment of strategic information, lack of competence to manage diversification resulting from the merger, cultural barriers between the companies, difficulty of terminating or sustaining existing contractual obligations and problems of settlement of outstanding financial obligations.

Agbakoba (2005) is of the opinion that mergers and acquisitions entail both risk and opportunities for banks. According to him mergers and acquisitions involve operational risk arising from the difficulty of integrating different risk management systems, as well as different accounting and control procedures. Also problems of reconciling the different corporate culture, including differences in working culture and practices among the staff and business units of the two entities, entail the risk of a loss of key employees and/or clients, entail the risk, of failing to achieve the expected rationalization gains owing to the complexity of the operation as well as other reasons like labour market rigidities. This will have a negative effect on the structure of financial services group because the services may be less transparent and initial skepticisms amongst merging entities and incoherent business activities difficult to manage are foreseeable problems merging entities could face. All these factors, have the tendency of raising the risk level associated with the banking industry in Nigeria.

Conclusion

The protagonists of mergers and acquisitions have the strong belief that the implementation of the strategy of mergers and acquisitions will make the industry more competitive. On the other hand, the antagonists are of the opinion that the consolidation and recapitalization of the industry through mergers and acquisitions will only result in buy off and kill competition thereby increasing the cost of credit, inject unintended crisis of loss of confidence in the system. This could lead to systematic failure through massive deposit withdrawal and investor flight. The antagonists also argued that size is not necessarily effectiveness to international competitiveness (Agbakoba 2005).

In the same line of argument, Agbakoba revealed that a study by the Bank for International Settlements (BIS) reports the experience of the majority of mergers as "disappointing" with organizational problems almost inevitably underestimated and most acquisitions overpriced, noting the creation of banks "too big to fail". These banks eventually become complacent and over confident and still face insolvency. A study carried out by Ajayi and Oyetunde (2005) observed that "Given the current philosophy of the CBN it is unlikely that any anti-trust regulator that may appear before December 2005 would require the unbundling of the newly amalgamated banking entities. Perhaps, the apex bank has unconsciously made the social accounting computation and concluded that the social benefits derivable from larger, more stable banks out weigh any attendant social costs flowing from the loss of vibrant competition and advance or rapacious monopoly.

However, taking note of the fears or inherent problems as identified by the antagonists to mergers and acquisitions, a lot of care could be taken by the appropriate regulatory agencies in implementing and actualizing the objectives of consolidation and recapitalization through mergers and acquisitions strategy.

Recommendations

Based on this study the following suggestions may suffix:

- Mergers and acquisitions is a very complex process though it might hold great potentials for consolidation and recapitalization reform in the Nigerian banking industry, if consciously implemented. The relevant regulatory agencies charged with success of these mergers and acquisitions activities should endeavour to ensure that only capable and reputable experts are allowed to carry out the process in order to prevent negative fall out such as under estimations and over estimations of assets and liabilities of the entities involved.
- The shareholders should not be left out of the scheme of things as the CBN directive was being driven majorly by the desire to ensure the safety of shareholders and depositors' money. Therefore there should be proper and up-to-date information on all happenings as to prevent opposition to planned compliance with the CBN's recapitalisation directive.
- The idea of mega banks is good for the financial system of a nation, but the concerned regulatory bodies should be careful not to create new monsters in the name of consolidation. The future of the industry according to Agbakoba (2005) will largely be influenced by the manner in which the challenges are resolved. These challenges are in respect of the macro economic environment, quality of manpower and associated corporate government issues, adoption of appropriate technology,

policy and strategy for resolving bank distress and overall efficiency of bank regulation and supervision.

- He further observed that for the smooth conduct of mergers and acquisitions exercise, the regulatory agencies like CBN, SEC, NSE, CAC and judiciary must streamline their operations to be able to manage the expected reformed financial system.

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