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# PROBLEMS AND PROSPECTS OF MERGER AND ACQUISITION DECISION IN BANKING SECTOR IN NEPAL

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## ABSTRACT

The main purpose of this study is to find out the factors that would lead to making decision regarding going for merger and acquisition among the banks in Nepalese banking sector. This paper finds out various factors that would affect merger and acquisition decision in banking sector based upon previous studies, and tries to check whether these are significant in case of Nepalese banking sector or not. Based upon the previous studies done by various scholars, nine factors along with their corresponding hypothesis have been used for study. The nine factors are: emphasis on increasing income, emphasis on increasing sales of services, emphasis on financial diversification, emphasis on cost efficiency, emphasis on obtaining stronger position in market, emphasis on better branding, emphasis on achieving security, emphasis on fulfilling regulations requirement from regulatory authorities and emphasis on fulfilling capital requirement.

**Key words:** Merger, acquisition, behavioral, resource dependency, income, cost, position, branding, security, regulations, capital, reliability analysis.

## INTRODUCTION:

Mergers and acquisitions (M&A) are a recurring phenomenon in global scenario. Merger and acquisition activities are found in all sectors over the world including banking sector. Merger and acquisition in banking sector is influenced by various factors. The most dominant reason for M&A to take place is the synergy that can be created by the combination of business activities which will lead to better, faster and low cost performances. Essentially, a business will attempt to merge with another business that has complementary strengths and weaknesses.

M&A is now renowned for being an action commonly undertaken by management, although research studies over many years have suggested that there is a consistent failure of 30-50 percent (Booz and Hamilton, 1985). However, in the most recent research done which covered 314 companies from several European countries, it was found that some 80 percent of the acquisitions were successful. The report stated that M&A is not a corporate objective in itself but is a means of achieving corporate goals although the results of the survey show that M&A objectives are geared to the company's visibility in its markets rather than hard edged economic returns.

While considering the banking sector, it is of no exception to be affected by the waves of merger and acquisition. Global mergers and acquisitions in banking sector have led to the study on determinants of these M&A activities and decision. Based upon the types of synergies, they could be income synergy, cost synergy, market power synergy and intangible synergy. This paper tries to find out the significant causes based on which the banks would decide to go for merger and acquisition in Nepal since merger (and acquisition) have gained momentum in the Nepalese banking sector in the current decade. Such factors shall be analyzed as per the information provided by experts working in various levels in Nepalese banking sector.

## CONCEPTUAL FRAME WORK OF MERGER AND ACQUISITION:

Merger and acquisition activity in the United States has typically run in cycles, with peaks coinciding with periods of strong business growth. Indian merger activity has been marked by five prominent waves: One around the turn of the twentieth century, the second peaking in 1929 the third in the latter half of the 1960s the fourth in the first half of 1980s and the fifth in the latter half of the 1990s.

Merger is defined as combination of two or more companies into a single company where one survives and the other lose their corporate existence. The survivor acquires the assets as well as liabilities of the merged company or companies. A merger is a combination of two companies where one corporation is completely absorbed by another corporation. The less important company losses its identity and becomes part of the more important corporation, which retains its identity. A merger extinguishes the merged corporation and the surviving corporation assumes all the right, privileges, and liabilities of the merged corporation. A merger is not the same as a consolidation in which two corporations lose their separate identities and unite to form a completely new corporation.

Acquisition in general sense is acquiring the ownership in the property. Acquisition is the purchase by one company of controlling interest in the share capital of another existing company. This means that even after the takeover although there is change in the management of both the firms retain their separate legal identity.

## NEPAL: ATAGLANCE

Nepal is one of the countries located in South Asia, with agriculture as the main source of occupation, but currently dominated by service sector when analyzing the Gross Domestic Product (GDP). Nepal is a landlocked country with China in north and India in other remaining sides.

Geographically, Nepal can be divided into Mountainous region (15 percent), Hilly region (68 percent) and Terai region (17 percent). With the presence of world's tallest mountain Mt. Everest, various rivers, religious places and natural beauties, Nepal has got huge potentiality with regards to the utilization of the natural resources as well as boosting the tourism sector. With the lack of entrepreneurial dynamism in the various sectors of economy, Nepal stands at the rank of 151 in case of economic freedom index (based upon government spending relative to GDP, restrictions on international trade, minimum wage rights, and the like) as calculated by The Heritage Foundation in 2016. With the population of 28.1 million, Nepal has the Gross Domestic Product (GDP) at market prices of \$19.77 billion as shown by World Bank. The economic growth rate was 5.5 percent in 2014, which further decreased to 3.4 percent in 2015, and is subject to remain at 1.7 percent in 2016, after which the tendency is expected to go up to 5.8 percent in 2017; the decrease caused by political instability as well as earthquake of 2015.

As per World Bank, although the primary source of income in Nepal is agriculture, with its contribution of 34.35 percent in 2014; remittance has been playing a major role in the economic sector of Nepal thereby covering 25.4, 29.0 and 29.2 percentage of GDP in the years 2012, 2013 and 2014 respectively. Nepal Rastra Bank, the central bank of Nepal, states that GDP from Agricultural, Industrial and Service sector was 33.7 percent, 14 percent and 52.2 percent in the fiscal year 2013/14.

#### **BANKING SECTOR IN NEPAL :**

Nepal Rastra Bank is the central bank of Nepal which started its operation in 1956 under the Nepal Rastra Bank Act 1955. As per the information provided by Maskey and Subedi (2009), the history of banking sector in Nepal traces back to 1937 when the first ever bank was established in Nepal named as Nepal Bank Limited. In the study conducted by Maskey and Subedi (2009), they have stated that the history shows that Nepal Bank Limited was established was a semi government bank with NRs. 10 million as authorized capital and NRs. 892 thousand as paid up capital. The writers further indicate that in Nepal, metallic coins were in use until mid-forties because of which handling of money was very hard. Thus, the then Government of Nepal felt the need to establish separate body to handle the currencies as well as promote the financial organization in the country. The writers further indicate that when Nepal Bank Limited was formed, the need of governing bank was felt slowly as Nepal Bank Limited had to act as a central bank without necessary laws and foundations and thus, Nepal Rastra Bank was established. Then, with a view to develop the industrial sector of Nepal, Industrial Development Bank was established in 1957, which later reformed to Nepal Industrial Development Corporation. Later, Rastriya Banijya Bank was established in 1965 as second commercial bank and Agricultural Development Bank was established in 1968 to develop the agricultural sector of Nepal. After that, there were no new banks in Nepal for almost two decades. The banking sector began to see new banks along with joint ventures after

the liberalization and deregulation policy was adopted by Nepal Rastra Bank. Such financial sector policies, regulations and institutional developments were introduced from 1980. By introducing such policy, the government encouraged the private sector as well as foreign parties to increase their participation in the banking sector of Nepal. Currently, Nepalese banking sector consists of four categories of banks: category A as commercial banks, category B as development banks, category C as finance companies and category D as micro-finance development banks. Commercial banks of Nepal mostly specialize in accepting deposit and providing loans. Apart from that, they are allowed to provide service of currency exchange as per the direction provided by Nepal Rastra Bank. Development banks are more concerned with utilizing savings from the customers and redirecting them for various investment and development purpose. The function of finance company is also like that of any other depository institution in Nepal performing depository and lending service. Microfinance development bank is more related with the rural areas and providing the deposit-loan function at the micro level to poor and disadvantaged groups. As per the Annual Report of Nepal Rastra Bank for the fiscal year 2013/14, the number of banks and financial institutions (including the cooperatives and non-government organizations with limited banking) licensed by the NRB decreased to 248 in mid-July 2014 from 254 a year ago. The decline in the total number banks and financial institutions (BFIs) was due to the merger of 64 BFIs into 25 after the promulgation of Merger By-Law, 2011. Accordingly, in mid-July 2014, the number of commercial banks remained 30, development banks 84, finance companies 53 and micro-finance development banks remained 33. Out of 37 "D" class microfinance institutions, there were 5 Grameen Bikas Banks (rural development banks), 28 replicators of Grameen Bank and 4 wholesale microfinance institutions in operation in mid-July 2014. On July 3, 2014, approval has been granted from NRB for the establishment of one national-level "Nepal Grameen Bikas Bank Ltd" with the merger of 4 rural development banks into Paschimanchal Grameen Bikas Bank. The number of deposit accounts and borrowers in these microfinance institutions reached 1.2 million and 1.1 million respectively. These microfinance institutions have provided services in 71 districts in mid-July 2014. The financial intermediary sector, in overall, grew by 1.8 percent in 2014, as opposed to 0.8 percent decrease in the previous year.

Merger and acquisition in banking sector has been a frequent activity in Nepalese banking sector. Consolidation has been a widespread development in the banking industries of many countries in recent decades. As a consequence, the number of banking firms has declined significantly in many countries, and a number of large universal banking firms with international operations has emerged. In many emerging markets, bank M&As have been driven by government policy initiatives for restructuring the banking industry. Frequently such initiatives have followed a financial crisis, and have been directed towards stabilizing the banking system and the wider economy (Hawkins and Mihaljek, 2001).

Nepalese economic sector did not go through the larger economic crisis as felt in various countries in the decade 2000-2010. However, the need to restructure the banking sector through merger and acquisition was felt by Nepal Rastra Bank. So, it created the environment for M&A activities to occur. Nepal Rastra Bank (2014) has stated in Nepalese language that after the deregulation in Nepalese banking sector, the number of banking and financial institutions increased but it did not lead to healthy competitive environment. Also, it was felt that there were many banking and financial institutions looking for institutional stability while others looking for safe and easy exit, NRB introduced the Merger Act, 2068 B.S. as the second phase of liberalization as per financial consolidation.

Thus, although NRB paved a framework for M&A activities, the reasons behind the banks' decision to go for M&A have not been the subject of study. There are various problems faced by the Nepal banking sector or various opportunities that the BFIs see when merging with or acquiring other banks. These reasons and opportunities have not been studied so far. Thus, this paper tries to explain the relationships of various factors affecting the merger and acquisition decision of Nepalese banks.

#### RESEARCH OBJECTIVES:

The objectives of this research are as follows:

- To find out problems and prospects of merger and acquisition decision in banking sector in Nepal.

#### SIGNIFICANCE OF THE STUDY:

This will help the planners as well as policy makers to maximize the value of the concerned stakeholders based upon the merger and acquisition strategy. The BFIs will be able to find out the focused causes that might lead them towards the merger and acquisition activities in the future.

#### METHOD OF THE STUDY:

In order to obtain the variables for data, past knowledge were used in order to recognize the relevant independent as well as dependent variables. These variables were based upon various theories involved in merger and acquisition: neoclassical, agency, behavioral and resource dependency theories. Various researches on the factors affecting merger and acquisition and thus, its decision, were taken into consideration and the factors that affect the merger and acquisition decision in banking sector were selected from among them. After the identification of such variables, research question based upon research objective was developed. Taking the research question as a base, both hypotheses as well as conceptual framework were brought into light. After that, questionnaires were developed which would address the issues of hypotheses. With regards to the primary and secondary data collection methods; primary data were collected for the research purpose in order to find out if our hypothesis based on previous studies were correct or not. Thus, primary data were the main sources of data for the purpose of research paper analysis and the collection method of data was on 5 point Likert scale.

#### REVIEW OF LITERATURE:

Vardhana Pawaskar (2001), "Effect of Mergers on Corporate Performance in India" he studied the impact of mergers on corporate performance. It compared the pre- and post- merger operating performance of the corporations involved in merger between 1992 and 1995 to identify their financial characteristics. The study identified the profile of the profits. The regression analysis explained that there was no increase in the post- merger profits. The study of a sample of firms, restructured through mergers, showed that the merging firms were at the lower end in terms of growth, tax and liquidity of the industry. The merged firms performed better than industry in terms of profitability.

The study conducted by Shanmugam (2003) in Malaysia stated that the zeal to achieve higher efficiency and competitiveness were the main determinants for M&A deals in Malaysian banks. Mergers and acquisition decisions are usually driven by an ambition to gain as much weight as possible in the international banking space, to eliminate competition from profitable areas of business, to procure added financial benefits for the share- holders, to expand the range of services, and to effectively manage the resources available.

Vanitha. S (2007) "Mergers and Acquisition in Manufacturing Industry" she analyzed the financial performance of the merged companies, share price reaction to the announcement of merger and acquisition and the impact of financial variables on the share price of merged companies. The author found that the merged company reacted positively to the merger announcement and also, few financial variables only influenced the share price of the merged companies.

Smirnova (2014) has stated that attempts to analyze the merger and acquisition in banking sector were performed quite recently. The studies show that in case of developed countries, there is negative relationship between a bank's profitability and the likelihood of being acquired (Amel and Rhoades, 1989; Wheelock and Wilson, 2000).

#### MERGER AND ACQUISITION IN BANKING SECTOR IN NEPAL:

In recent years, mergers and acquisitions have been the burning issue in the banking sector. Complying with the global scenario, Nepalese banks and financial institutions are currently going through the situation of merger and acquisition. The first banks to merge in Nepal were Himchuli Bikash Bank (category "B") and Birgunj Finance Limited ("C") on which the banks were renamed to H & B Development Bank Limited (National Level category "B") and the banking operation started from 6/15/2011 after merger. In Nepal, the banks have not gone for acquisition so far. The Banks and Financial Institutions Acquisitions Bylaw came into practice only from 2014 (Nepal Rastra Bank Allows Acquisitions of Financial Institutions, 2014). The following table shows the list of merger activities in Nepal so far:

Table : 1

## List of bank merger cases in Nepal until 2015, obtained from Nepal Clearing House (2015)

Before Merger	After Merger
Machhapuchre Bank Ltd. Standard Finance Ltd.	Machhapuchhre Bank Ltd.
Global Bank Ltd. IME Finance Ltd. Lord Buddha Finance Ltd.	Global IME Bank Ltd.
Pashupati Development Bank Ltd. Uddhyam Bikash Bank	Axis Development Bank Ltd.
Butwal Finance Ltd. Alok Everest Finance Ltd. CMB Finance Ltd.	Synergy Finance Ltd.
Annapurna Development Bank Ltd. Surya Darshan Finance Ltd.	Supreme Development Bank Ltd.
Himchuli Development Bank Ltd. Birgunj Finance Ltd.	H & B Development Bank Ltd.
Kasthmandap Development Bank Ltd. Sikhar Finance Ltd.	Kasthmandap Development Bank Ltd.
Viber Bikash Bank Ltd. Vajuratna Finance Ltd.	Vibor Bikas Bank Ltd.
Business Development Bank Ltd. Universal Finance Ltd.	Business Universal Development Bank Ltd.
Nepal Industrial and Commercial Bank Ltd. Bank of Asia Ltd.	NIC Asia Bank Ltd.
Diyalo Bikas Bank Ltd. Professional Bikas Bank Ltd.	Professional Diyalo Bikas Bank Ltd.
Global IME Bank Ltd. Social Development Bank Ltd. Gulmi Bikas Bank Ltd.	Global IME Bank Ltd.
Prabhu Finance Ltd. Baibhav Finance Ltd. Sambridhi Bikas Bank Ltd.	Prabhu Bikas Bank Ltd.
Royal Merchant and Banking Finance Ltd. Api Finance Ltd. Rara Bikas Bank Ltd.	Apex Development Bank Ltd.
Araniko Development Bank Ltd. Surya Development Bank Ltd.	Araniko Development Bank Ltd.
Manakamana Development Bank Ltd. Yeti Finance Ltd. Valley Finance Ltd.	Yes Development Bank Ltd.
Global IME Bank Ltd. Commerce and Trust Bank Nepal Ltd.	Global IME Bank Ltd.
Civil Bank Ltd. Axis Development Bank Ltd. Civil Merchant Bittiya Sanstha Ltd.	Civil Bank Ltd.
Reliable Finance Ltd. Nepal Consumer Development Bank Ltd. Subhalaxmi Finance Ltd.	Reliable Development Bank Ltd.
Reliance Finance Ltd. Lotus Investment Finance Ltd.	Reliance Lotus Finance Ltd.
Imperial Finance Ltd. Siddhartha Finance Ltd.	Siddhartha Finance Ltd.
Biratlaxmi Bikas Bank Ltd. Chandbari Development Bank Ltd.	Biratlaxmi Bikas Bank Ltd.
Lumbini Bank Ltd. Navadurga Finance Ltd.	Lumbini Bank Ltd.
Bageshwori Development Bank Ltd. Shangrila Development Bank Ltd.	Shangrila Development Bank Ltd.

Kist Bank Ltd. Prabhu Bikas Bank Ltd. Gaurishankar Development Bank Ltd. Zenith Finance Ltd.	Prabhu Bank Ltd.
Citizens Bank International Limited Nepal Housing and Merchant Finance Ltd. People's Finance Ltd.	Citizens Bank International Limited
Triveni Bikas Bank Ltd. Public Development Bank Ltd. Bright Development Bank Ltd.	Triveni Bikas Bank Ltd.
Bishwa Bikash Bank Ltd. Fewa Finance Ltd.	Fewa Bikas Bank Ltd.
NDEP Development Bank Ltd. Rising Development Bank Ltd.	Deva Bikas Bank Ltd.
Muktinath Bikas Bank Ltd. Civil Development Bank Ltd.	Muktinath Bikas Bank Ltd.
Garima Bikas Bank Ltd. Nilgiri Bikas Bank Ltd.	Garima Bikas Bank Ltd.
Sagarmatha Merchant Banking and Finance Ltd. Patan Finance Ltd.	Sagarmatha Finance Ltd

The above table shows the various cases of merger among various banks until 2015. It shows the list of all bank names prior merger and the new name of banks post merger performance.

#### RISK IN MERGER AND ACQUISITION:

Merger and acquisitions are not hundred percent risk free activities/achievements. With regards to various uncertain events there can be problems in or problems created by merger and acquisition. Clashes related to difference between organization culture, inadequate information flows, lack of transparency etc. are the risks factors involved. Similarly, merger also means that there will be sharing of confidential information among the companies involved and by chance if the merger fails to occur, then it would result in the companies knowing things about each other that were supposed to be confidential.

A study was conducted by Nepal Rastra Bank (2015) among Nepalese banks with regards to the changes in risk management caused by merger and acquisition. Among the participants who were founders, 51.4 percent stated that the result was positive, 41.1 percent stated that the situation had not changed and 7.5 percent state that the situation had worsened. Among the participants who were employees and managers, 41.1 percent stated that the result was positive, 47.1 percent stated that the situation had not changed while 11 percent stated that the situation had worsened.

#### CONCLUSION:

The main purpose of making this research paper was to find out about the factors that have their significant contribution in the merger and acquisition decision carried out in the context of Nepalese banking scenario. Studies regarding factors affecting merger and acquisition in the banking sector have been done in the past with regards to various countries as well as settings. For instance, Smirnova (2014) has drafted various internal and external motives of merger and acquisition.

Similarly, Novickyte and Predroja (2015) have also identified various factors related to synergy based on neoclassical, agency and behavioral theories that are related to merger and acquisition. With regards to banking sector of Nepal, such factors affecting merger and acquisition has not been the prime subject of study so far. Research paper on post-merger performance of banking sectors in Nepal has been conducted by Nepal Rastra Bank but the factors that would make the bank consider merger and acquisition has not been studied.

In case of nine possible variables: emphasis on increasing income, emphasis on increasing sales of services, emphasis on financial diversification, emphasis on cost efficiency, emphasis on obtaining stronger position in market, emphasis on better branding, emphasis on achieving security, emphasis on fulfilling regulations from regulatory authorities and emphasis on fulfilling capital requirement; only four of them were significant in Nepalese context: emphasis on providing service, emphasis on cost efficiency, emphasis on better branding and emphasis on fulfilling capital requirement. However, emphasis on better branding was found to be negatively significant.

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