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MERGERS AND ACQUISITIONS: THE NIGERIAN BANKING CONSOLIDATION PROGRAM

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Abstract

This paper examines the determinants of the exit behaviour of banks in the Nigerian consolidation program during July 2004 and December 2005. We conceptualise the exit process in a flexible bivariate competing risks model to examine the importance of macroeconomic and industry-specific factors for both merged banks *and* failed banks jointly. The preliminary results suggest that bank-specific characteristics mattered more for preventing bank failure than they did for emergence of the M&A banks. Second, the Central Bank of Nigeria's assistance was highly influential in preventing bank failure, and, for banks that benefited, the assistance increased their probability of being merged or acquired. Also, we found no strong evidence suggesting that the prevailing macroeconomic conditions and industry-specific factors had influenced exit behaviour of banks during the consolidation exercise. We found evidence of structural dependence between failure and merger and acquisition hazards induced by CBN incentive.

Key Words: Bank Merger and Acquisition, Nigeria, Duration Analysis

JEL Classification: C41, G21, G34, N27

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1. Introduction

On July 6, 2004, the Governor of the Central Bank of Nigeria (CBN) announced a 13 point reform program expected to reposition the Nigerian banking industry in its role of enhancing economic growth and development of the country.[1] An important component of the reform agenda was the recapitalization of banks with a minimum shareholders fund of ₦25 billion prescribed to be met by December 31, 2005. Towards this end, the CBN encouraged banks to

[1] For a review of the rationale for banking reform in Nigeria, see Imala (2005).

enter into mergers and acquisitions (M&A).[2] The CBN also provided a range of incentives to accompany the implementation of the program. For example, a number of committees were instituted, whose terms of reference were expected to assist weaker and problem banks in facilitating their M&As (CBN 2004, 2005).

As at the end of the program on December 31, 2005, the number of banks operating in Nigeria declined from 89 to 25, about 72 percent. Nineteen banks emerged from M&A involving 70 banks and six banks remaining as stand-alone banks (i.e. banks that met the ₦25 billion without M&A). The remaining 13 banks did not scale through (or failed). Accordingly, the emerging 25 banks jointly accounted for about 93.5 percent of the total market deposits, while the remaining 13 failed banks accounted for the rest (6.5%): see CBN (2006).

The Nigerian banking consolidation exercise represents an unprecedented change in institutional context in which bank M&A and failures occur. Firstly, it represents a regulatory policy-induced bank consolidation accompanied by a framework of facilitating incentives that permit banks to exit the industry through either M&A or failure. This differs markedly from the conventional situation in which bank M&A and failures result from voluntary decisions of the affected banks. The exit process in the Nigerian exercise was induced as part of an overall sectoral reform policy. Also, the regulatory authority provided a range of incentives to assist banks in the exit process. This differs from the commonly observed situations where the regulatory authority merely approves the M&A decisions or liquidates failed banks.

The different institutional context in which exit of banks had occurred raises certain questions of policy interest. These include: (i) How important were bank-specific characteristics in the emergence of M&A banks and those that failed? (ii) In what ways do these factors differ between M&A banks and failed banks? (iii) How important were the incentives provided by the CBN in facilitating exit among banks? (iv) How important were the prevailing macroeconomic and industry specific conditions in facilitating the outcome of the consolidation program? There had been no attempt to address these questions, despite their relevance to policy makers. This may be due largely to the generally held view that the exercise was intended to prevent mass failures (i.e. meeting the CBN capitalisation requirement). This is the reason for our research.

Meanwhile, the economics of bank consolidation treats M&A decisions as any other investment decisions of both acquiring and target banks driven by potential synergies that may

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[2] In this study, we use merger and acquisition interchangeably, hence we use the acronym M&A.