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Effect of Mergers and Acquisitions on Performance of Lebanese Banks

Hiyam Sujud
Finance Department, Faculty of Business
Lebanese University, 1st Branch, Lebanon

Boutheina Hachem
Finance Department, Faculty of Business
Lebanese University, 1st Branch, Lebanon
E-mail: boutheinahachem@gmail.com
Tel: +961 3 731502

Abstract

This article attempts to analyze the pre- and post-merger effects on financial performance of Audi-Saradar Group. To achieve this aim, two research methods are used to compare pre- and post-merger financial performance: an analysis of ratios is used to compare the performance of Audi-Saradar Group during the pre-merger period (2000-2003) and the post-merger period (2004-2007), second, paired sample t-test determines the significant differences in financial performance before and after the merger. MS Excel 2010 was used to calculate ratios and SPSS software was used to analyze the findings. The results show that return on assets and return on equity improved but only insignificantly. The merger had no significant positive impact on the rate of return on shareholders' equity and on return on assets. Earnings per share increased significantly after the merger. The merger had significant positive impact on earnings per share.

Keywords: Merger, Acquisition, Lebanese banks, Financial Performance, paired t-test, ROA, ROE, EPS.

1. Introduction

The banking industry is one of the sectors that has been significantly affected by the manifestations of financial globalization which is the most important benchmark in financial liberalization, the shift towards universal banks, privatization of banks, the restructuring of banking services and the expansion of the banking merger. The financial services industry has been, over the last three decades from the last century, grown significantly and developed in its services as well.

The merger & acquisition process is one of the banking necessities required to develop the performance of small banks. Increasing their ability to grow and prosper in the market, successive developments in the information and technology fields, and the orientation towards large economic blocs are indicators of good development. This requires the composition of large banking units which would be able to contribute to the financing of large investment projects to serve the plans and programs of economic development. Additionally, the global financial crisis has enhanced the integration practice significantly in the banking sector. One of the main repercussions of the worldwide fiscal crisis that began in the US real estate market in September 2008 was the bankruptcy of the US's fourth largest investment bank, Lehman Brothers and Bank Washington Mutual in 2008. The bankruptcy of these two banks is one of the biggest bankruptcies in US economic history. The difficulties facing Merrill Lynch, the third-largest investment bank, are a clear indication of the depth of the crisis since it was bought by Bank of America for $ 50 million.

In this research, the merger process that took place in 2004 between the two Lebanese banks: Saradar and Audi Bank and its impact on the financial performance of Audi-Saradar Group are highlighted. For this purpose, we examine the return on assets and the return on equity pre- and post-merger of these two banks.

2. Background

The term merger and acquisition are used universally to attain business development and sustainability. Merger is the practice of uniting two or more separately companies to make one big company while the acquisition is the process of capturing another company for the same motives (Kathy L., 2005; Amedu S., 2004; Bello M.S., 2004). This action can be aggressive or sociable, and the acquirer retains its governance over the obtained company (Jimmy, 2008: Alao 2010).

Merger and acquisition occur in order to realize effectiveness by diversifying economies of scale and increasing the level of business goings-on to progress performance (Soludo C., 2004).

Mergers and acquisition can be classified into three main types: horizontal, vertical and conglomerate merges (Avulala. E. 2015).

Firstly, Horizontal M & A cartels two parallel firms in the same industrial sector (Beaver, 2015). Usually, horizontal mergers and acquisitions are driven by the desire to increase the strength of the market. For example, Adidas already got its competitor, Reebok, to eliminate some rivalry and enlarge their marketplaces.

Secondly, Vertical Merger & Acquisition are made between two companies that are related to the buyer's seller type and are grouped under one ownership. For example, the manufacturer may agree to join with the supplier. These companies are generally at different stages of production (Arnold, 2011).

Finally, M & A conglomerate occurs when two or more companies whose businesses are not related either vertically or horizontally merge to create a sole business (Economywatch, 2010). These businesses are usually not rivals. For example, the union between Procter & Gamble, the consumer goods company and Gillette in 2005.

3. Previous Studies

A number of studies have been conducted to investigate whether the process of merger and acquisition is the solution to the banking operations' problems.

The Impacts of M & A on Banks' Act in Egypt (Badreldin, Kalhoefer, -2009) Study

Its main goal is to measure the performance of the banks acquired by other banks in Egypt, during the period of banking reform from 2002 to 2007. The sample included ten banks operating in Egypt. Four of those banks are local and the rest are transboundary. To achieve the objective of the study, ROE was calculated. A range of financial ratios has been used in the basic rate of return on equity such as interest margin, profit of margin, extraordinary income, other income margins, gross income margin and operating expenses margin. The financial indicators for two pre- merger years and two post-merger years were caculated as 2014 is the base year. The results of the study showed that only 14% of the studied banks showed a significant improvement in their performance or return on their equity when comparing with their performance prior to consolidation or acquisition. The results revealed that M & A did not have a clear impact on the cost-effectiveness of the banking sector in Egypt. The results also showed that merger and Acquisition had a positive effect on credit risk.

- **Effect of Merger on the Cost-Effectiveness of Commercial Banks in India (Kaur; Kaur, 2010) Study**
  The aim of this study was to quantify cost-effectiveness in Indian commercial banks and to study the influence of merger on cost-effectiveness in combined banks. The sample included all public and private banks operating in India during the period from 1990 to 2008. The study data were compiled using the annual publications issued by the Association of Indian Banks and the annual publications issued by the Reserve Bank of India. The analysis technique was used for nonlinear data. The study was based on unbalanced panel data for the period from 1990-1991 to 2007-2008. To assess the changes in efficiency between public and private banks, scientific and unscientific valuations were used. The results of the study indicate that the middling cost-effectiveness of the public-sector banks is 73.40% and for private-sector banks, it is 76.3%. In other words, the merger programs were, to some extent, successful. The study also found that policymakers should not encourage mergers between robust and troubled banks as a means to enhance the interests of investors in troubled banks, as this would have an adverse influence on the quality of assets in the stronger banks.
- **Effect of Merger on Financial Act of Banks- a Case Study of HDFC Bank (Saluja; Sharma; Lal, 2012) Study**
  The study main objective was to measure the effect of merger on the financial act of HDFC Bank, which has voluntarily merged with the Bank of Punjab to increase its volume and bring benefits to the economy. The impact of the merger on the studied bank was assessed using the CAMEL Financial Assessment Model. The study period extended from 2006-2007 through 2010-2011 and it was divided into two periods: a period before the merger and a period after the merger. The study data were collected based on HDFC Annual Reports. A variety of statistical methods were used in this study, such as mean, standard deviation, and coefficient of variation. The results of the study showed that the financial act of the studied bank has enhanced in the after-period merger in nearly all factors of the KAMEL model.

Furthermore, (Stiroh, 2002) conducted a study on US banks and recommended that as an outcome of mergers and acquisitions, there might be greater effectiveness from the bigger size of the banks. Whereas, based on (Straub, 2007), mergers and acquisitions failed to demonstrate the cost-effectiveness of the banking industry. Unexpectedly, many studies assess the performance of pre- and post-merger companies and found that these opportunities of efficiency, in the case of mergers and acquisitions, are seldom achieved. Some researchers found that they had no effect on gains (Beitel al, 2003). But (David and Weiner, 2004) concluded that merger and acquisition have a significant role in the development of financial performance and effectiveness. In spite of (Straub, 2007 and Roedas, 1993), many researchers found that M & A have a strong contribution to the banking sector's profits.

4. Significance of the Study

The difference in the results of previous studies has led researchers to provide further evidence of the influence of merger & acquisition on the financial performance of the banks. This is because in the Arab banking environment, mergers are still very limited, especially when compared to the banking mergers that took place in the international banking arena.

The significance of this study is highlighted by the scarcity of mergers that have occurred in the Arab world, which gives particular importance to identifying the impact of mergers on banking financial performance. Moreover, there is limited research conducted in this field. As far as we know, very little research has been done on M & A in the Lebanese banking industry, none of which has examined the act of the banks after mergers or acquisitions. This study aims help both academics and experts as the academic researchers will continue to use this study to discover various features of mergers and acquisitions and the experts will use it to make the best choice in assessing the ongoing mergers and acquisitions deals.

5. M & A between Banks in Lebanon

“The banking sector in Lebanon is almost the leader in the Middle East and North Africa banking industry, and has a distinct role all over the world” (Hiyam Sujud & Boutheina Hashem, 2017).

“The Lebanese banking sector is sound and stable regarding the financial terms. It plays a major role in the Lebanese economy, where banks control the financial system of the country and are the main source of credit to businesses and individuals” (Hiyam Sujud & Boutheina Hashem, 2017).

The Lebanese banking sector is the most dominant sector in the Lebanese market economy. There are 66 banks operating and distributed between 49 commercial banks and 17 investment banks in 2016. The major Lebanese banks are seeking to expand domestically and outside to improve their profitability, expand their sources of profits and assets and intensify the scope of their products. Companies and banks want to rapidly grow their market, share or diversify their products.

Because of the importance of the Lebanese banking sector in Lebanon's economy, it is necessary to confirm that the market is operating efficiently. The basic pillar of effectiveness is to assess whether the companies in the market as a whole has a healthy competition in the market.

Competition among banks can be reached through integration in the sector. Act No. 192 of 1993 are evidence of this. Based on the Association of Lebanese Banks, the Lebanese laws facilitate M & A between banks and aims to assist small banks to be well supported in the face of hard times and to avoid insolvency. The law provides for merger and acquisition because it provides the bank's soft loans that cover the fees and commissions resulting from the transaction, such as adverse net asset value of the obtained bank if any.

M & A will also ensure improved outcomes if they are controlled by banks of similar or close size. If only big banks are developing through merger and acquisition activities, a large gap will arise between large and small banks. Such a gap would undesirably affect the profit margins of small banks that can attract customers only by receiving lower charges on their services. Moreover, this gap would also allow large banks to retain a large scale of profit margins due to the little competition.

To know why mergers and acquisitions are taking place in Lebanon, we must examine the context in which Lebanese banks operate. The system applied by banks in Lebanon has been based on the attraction of deposits, on profitable loans to the government and on loans to the private sector, specifically housing loans and trade loans with the proportion of low loans to deposits, which amounted to only 39% of private deposits, which represent 326% of GDP in 2016. It is obvious that the Lebanese banks have accumulated plentiful liquidness. Indeed, their conventional administration is always keen to keep high levels of liquidity because it operates in a difficult political, economic and safety environment at the local and external levels.

Some of mergers and acquisitions in Lebanese banking sector are as follows:

In May 2014, Fransabank fully got the operations of Ahli international bank in the Lebanese market; the deal was valued at $102 million.

October 2014, ZR Group, a Beirut based Multinational Corporation, bought 80% of Banque Pharaon and Shiha’s shares through a deal was valued around $90 million.

Banque de L’Industrie et du travail & the Near East Commercial Bank declared, in July 2014, their merging; their combined assets was valued at $1.1 billion.

Cedrus Invest Bank signed a contract, in June 2014, to get the trade operations of Standard Chartered Bank for $27 million.

Lebanon’s largest bank merger was signed between Bank Audi and Saradar in 2004. Bank Saradar signs a merger agreement with Bank Audi Sal, entitling Saradar Holding to become one of the largest shareholders of Bank Audi SAL-Audi Saradar Group.

6. Problem Statement

It appears clearly that merger and acquisition, to a certain extent, not only allow the banks to overcome many of the problems they face, but also offers a variety of new chances that will help banks to ameliorate their finances in different ways. By evaluating the financial indicators of banks in Lebanon, the study will ascertain if merger and acquisition influence on the capability of these banks to meet their immediate commitments. Furthermore, it is vital to investigate if M & A have any consequence on profitability effectiveness of banks in Lebanon over a specified period of time.

7. Objectives of the Study

The particular objectives of the study could be specified under the following:

1. To examine the impacts of merger and acquisition on the profitability of bank Audi -Saradar Group.
2. To compare the pre-and post-merger profitability of merged banks, Audi and Saradar with Audi-Saradar Group.

8. Hypotheses of the Study

H01: Merger and acquisition have no significant effect on the return on assets of the Lebanese banks.

H02: Merger and acquisition have no significant impact on the return on equity financial of the Lebanese banks.

H03: Merger and acquisition have no significant impact on the earnings per share of the Lebanese banks.

9. Methodology

The main objective of the study is to answer the following question: does merger and acquisition affect the profitability of Lebanese banks?

For this objective we compute the return on assets (ROA), the return on equity (ROE) ratios, and the earnings per share (EPS). We use the annual audited reports of Bank Audi – Saradar Group, bank Saradar and association banks of Lebanon.

10. Results and Discussion

Profitability is an indicator of the financial performance of banks; high income indicates that there are no financial difficulties at the bank and is likely to diminish the risk of bank failure. Thus, the rate of return on total assets, the rate of return on equity and the earnings per share (EPS), are of the most important financial ratios used to measure profitability.

10.1 Descriptive of Statistical Study

The study period extended from 2000-2003 through 2004-2007 and it was divided into two periods: a period before the merger and a period after the merger.

In table (1), we have computed the Return on Assets (ROA) of Saradar and Audi banks from 2000 to 2007. This rate measures the Bank's ability to generate profits through available assets. The higher the rate, the higher the profitability (Brigham Eugene F.; Houston Joel. F., 2011). It is calculated as follows:

ROA = (Net Income after Tax / Total Assets) × 100.

The above two banks were merged on 2004. Thus, we calculated (ROA) of pre-and post-merger. Pre-merger outcomes of Saradar have return on assets of 0.65, 0.50, 0.63 and 0.64 for the year 2000 to 2003 respectively. However, pre-merger returns on assets of Audi of 0.97, 0.82, 0.85 and 0.89 for the year 2000 through 20003. Thus, the average return on assets of the two banks before merging was 0.81, 0.66, 0.74 and 0.77 for the year 2000 to 2003 respectively. In addition, we have computed the post-merger return on assets; the first post-merger year return on assets improved by 6.50 % and it continued to increase after.

Table 1: Saradar, Audi, and Audi-Saradar group (ROA)

Banks	2000	2001	2002	2003	2004	2005	2006	2007
Saradar	0.65	0.50	0.63	0.64				
Audi	0.97	0.82	0.85	0.89				
Average	0.81	0.66	0.74	0.77				
Audi-Saradar group					0.82	0.96	1.28	1.27

We have computed in table (2) the Return on Equity (ROE) of Saradar and Audi banks of pre- and post-merger (2000 to 2007). This rate measures the trend of return on invested funds. This compares to previous years or industry standard. Thus, the higher the percentage, the greater is the extent to which the bank has a profit on equity and vice versa (Ahmed, E.; Rahman, Z.; Ahmed, R. I., 2006) , this rate is calculated as follows:

ROE = (Net Income after Tax / Equity) × 100

The pre-merger returns on equity of Saradar are 15.64, 9.77, 10.44 and 11.17 from 2000 through 2003. The pre-merger results of Audi showed returns on equity of 14.42, 12.53, 11.23 and 12.11 from 2000 through 2003 respectively. Thus, we have calculated the pre-merger average return on equity of both banks of 15.03, 11.15, 10.84 and 11.64 for the year 2000 through 2003 respectively. Whereas, the post-merger return on equity of merging banks was gradually increased in the first three years, it was decreased in the fourth year (-8.16%). The results are related with the findings of Knapp et al. (2005) and Ong et al. (2011).

Table 2: Saradar, Audi, Audi-Saradar group (ROE)

Banks	2000	2001	2002	2003	2004	2005	2006	2007
Saradar	15.64	9.77	10.44	11.17				
Audi	14.42	12.53	11.23	12.11				
Average	15.03	11.15	10.84	11.64				
Audi-Saradar group					12.32	12.82	12.38	11.37

In table (3), we have calculated the earnings per share (EPS), of Saradar and Audi banks of pre- and post-merger (2000 to 2007). Earnings per share measures the amount of net income earned per share of stock outstanding. This ratio is calculated by the following formula:

Earnings per share = Net Profit after Taxes / Number of outstanding Shares

The pre-merger earnings per share of Saradar were 402.18 L.L., 331.42 L.L., 417.74 L.L. and 480.64 L.L. from 2000 through 2003. While, the pre-merger earnings per share of Audi were 3065.57 L.L., 2903.58L.L. 3294.58L.L. and 4325.07 L.L. from the same time period. Thus, we have calculated the pre-merger average earnings per share of both banks of 1733.9 L.L., 1617.5 L.L., 1856.1 L.L. and 2402.8 L.L. for the year 2000 through 2003 respectively. Whereas, the post-merger of earnings per share show positive improvement during the two years post-merger period and then dropped in third year and increased in the fourth year with respect to the average of both banks. These results are associated with the findings of Lin et al. (2006). They found that there is an increase in EPS after M & A.

Table 3: Saradar, Audi, Audi-Saradar group (EPS)

Banks	2000	2001	2002	2003	2004	2005	2006	2007
Saradar	402.18	331.42	417.74	480.64				
Audi	3065.57	2903.58	3294.58	4325.07				
Average	1733.9	1617.5	1856.1	2402.8				
Audi-Saradar group					5188.38	7007.36	6445.6	7959.6

10.2 Interpretations

To answer the research question: does M & A affect the profitability of Lebanese banks? The researchers decided to use Paired Sample T-Test. The calculations are easily accomplished using SPSS.

Paired sample t-test is a statistical procedure that is utilized to compare two population means in the case of two samples that are associated. Paired example t-test is utilized between the 'before-after 'or 'pre and post' studies.

a) Return on Assets Measures of Banks (Paired Sample T-Test):
Table (4) reveals the results of paired sample T-Test; a low value p of 0.05 is used as a basic level of significance. The low value of p of 0.05 for each variable test the null hypothesis; which means that the low p (< 0.05) implies that the null hypothesis is rejected. In other words, an indicator that has a low value of P is likely to be a useful addition to your form because changes in the value of an indicator associated with changes in the dependent variable. In contrast, the larger (insignificant) P value indicates that changes in prediction are not associated with changes in response.

Based on the results we got in the table (1), we have performed the paired sample T-Test. The results in table (4) indicate that the post-merger return on assets of the two banks: Saradar and Audi with a level of significance of 0.959 which is greater than the p-value 0.05, and are not significant in explaining the overall incremental profitability of Audi-Saradar group after merging. As a result of this finding, we accept the null hypothesis and conclude that the merger and acquisition have no significant effect on return on assets (ROA). This result was verified in table (2). It shows that the merger had no significant positive impact on the rate of return on assets by comparing the average of the means of pre-merger with the mean of post-merger of ROA.

Table 4: Paired Sample T-Test Paired differences (Level of Confidence = 95%)

Mean	Standard deviation	Standard. Error Mean	Lower	Upper	T-Test	Difference	Sig. (2 – tailed)
0.0575000	2.0464828	1.0232414	-3.3139107	3.1989107	-.056	3	.959

Significant at 5 %

b.) Return on Equity Measures of Banks (Paired Sample T-Test):
Table (5) shows the results of the paired sample T-Test. Based on the results we got in the table (2), we have performed the paired sample T-Test. The results in table (5) indicate that the post-merger return on equity of the two banks: Saradar and Audi with a level of significance of 0.069 which is greater than the p-value 0.05 are not significant in explaining the overall incremental profitability of Audi-Saradar Group after merging. As a result of this finding, we accept the null hypothesis and conclude that the merger and acquisition have no significant effects on return on equity (ROE). This result was verified in table (2). It shows that the merger had no significant positive impact on the rate of return on shareholders' equity by comparing the average of the means of pre-merger with the mean of post-merger of ROE.

Table 5: Paired Sample T-Test Paired differences (Level of Confidence = 95%)

Mean	Standard. deviation	Standard. Error Mean	Lower	Upper	T-Test	difference	Sig.(2-taied)
-.33750	.2422636	.1211318	-.7229955	.0479955	-2.786	3	.069

Significant at 5 %

c.) Earnings per Share (Paired Sample T-Test):

Table (6) shows the results of the paired sample T-Test. Based on the results we got in table (3), we have performed the paired sample T-Test. The results in table (6) indicate that the post-merger earnings per share of the two banks, Saradar and Audi with a level of significance of 0.02. As it is less than the p-value 0.05, the results are significant in explaining the overall incremental profitability of Audi-Saradar Group after merging. As a result of this finding, we reject the null hypothesis and conclude that the merger and acquisition have a significant impact on earnings per share (EPS). This result was verified in table (3). It shows that the merger had a significant positive impact on the earning per share by comparing the average of the means of pre-merger with the mean of post-merger of EPS.

Table 6: Paired Sample T-Test Paired differences (Level of Confidence 95%)

Mean	Std. deviation	Std. Error Mean	Lower	Upper	T	df	Sig.(2-taied)
-4747.7	960.08	480.0405	-6275.4882	-3220.0818	-9.890	3	.002

11. Conclusion and Recommendations

11.1 Conclusions

This study examines the relationship between banks' merger and return on assets (ROA), between banks' merger and return on equity (ROE) and between banks' merger and the earnings per share (EPS). Thus, three hypotheses were formulated to study the significance of banks' merger in affecting positively, the return on assets, the return on equity and the earnings per share of those banks. It is worth to note that the data of other banks was not easily available which is one of many limitations of this study.

In conclusion, by applying the paired sample T-Test we can conclude that merging of banks does not affect significantly the profitability of Lebanese banks.

Particularly, merging does not affect significantly return on assets and return on equity. But, in respect of earning per share, the null hypothesis is rejected; the p-value is less than 0.05. It is concluded that significant difference was found in this standard after merger.

All in all, it cannot be concluded that banks merging potentially leads to higher return on assets and higher return on equity and thus higher profitability. These banks do not need to create a random situation, but must do a full analysis before merging with another bank. However, mergers can have a significant positive impact on the quality of bank assets, capital adequacy, management efficiency, and liquidity of banks.

11.2 Recommendations

To generalize the results, a more detailed study is recommended to include all Lebanese banks that experienced merging or acquisition to check the merger and acquisition impacts on their profitability. A detailed study can be carried out to determine whether the implementation of merger and acquisition contributed to incremental revenue in banks or not.

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