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# *A Study On The Factors Affecting Merger And Acquisition Decision In Nepalese Banking Sector*

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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 thesis 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. Four theories: neo-classical, agency, behavioral and resource dependency; have been taken into consideration for purpose of finding out factors affecting decision to go for merger and acquisition. 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.

200 completely filled questionnaires (out of 250) were collected from the informants for the purpose of data analysis. Similarly, Statistical Packages for Social Sciences (SPSS) was used for the purpose of data analysis such as reliability analysis, factor analysis, descriptive analysis, correlation and regression analysis.

The results of the analysis illustrated that out of nine factors; emphasis on providing service, emphasis on cost efficiency and emphasis on fulfilling capital requirement had significant positive relationship with decision to go for merger and acquisition while emphasis on better branding had significant negative relationship with merger and acquisition decision.

This research is useful for banking sector to consider whether taking merger and acquisition decision or not. Similarly, the policymakers can help in making policies and rules to influence the frequency of merger and acquisition based upon this research. In the same way, this research is useful for other sectors too if they consider making merger and acquisition decision.

**Key words:** merger, acquisition, SPSS, neo-classical, agency, behavioral, resource dependency, income, cost, position, branding, security, regulations, capital, reliability analysis, factor analysis, descriptive analysis, correlation, regression analysis, decision

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| | |
|---|---|
| AGM | Annual General Meeting |
| ANOVA | Analysis of Variance |
| BFI | Banking and Financial Institution |
| CEO | Chief Executive Officer |
| FSS | Financial service sector |
| GDP | Gross Domestic Product |
| KMO | Kaiser-Meyer-Olkin |
| LOI | Letter of Intent |
| M&A | Merger and acquisition |
| MoU | Memorandum of Understanding |
| NRB | Nepal Rastra Bank |
| SPSS | Statistical Packages for Social Sciences |
| US | United States |

# CHAPTER 1: RESEARCH BACKGROUND

## 1.1 Background of study

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 (Renaud, 2016).

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 (Hussey, 1999).

Authors like Shleifer and Vishny (2003) as well as Rhodes-Kropf and Viswanathan (2004) have developed models in which merger waves resulted from managerial timing of market overvaluations of their firms. Mitchell and Mulherin (1996) argued that merger waves resulted from shocks to and industry’s economic, technological or regulatory environment.

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 (as activities are the execution of decisions). The studies conducted by Novickytė and Pedroja (2015) have shown that the causes of bank mergers and acquisitions can be put into three categories: maximization of bank’s assets/return, seeking to satisfy selfish ambitions of bank’s management, and factors that create a favorable environment for such transactions to take places. 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.

## 1.2 Nepal as a location of research

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.

## 1.3 Introduction to Nepalese banking sector

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 depositary 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.

## 1.4 Motivation for research and research objectives

Merger and acquisition in the banking sector of Nepal has been an interesting phenomenon to study about. Since the Merger Act was introduced in 2068 B.S. by Nepal Rastra Bank, a total of 68 banking and financial institutions have gone through merger and acquisition, which is quite a large number as compared to total number of 248 (until mid July, 2014) institutions in Nepal which means, 27 percent of banks have gone through merger and/or acquisition. The service sector in Nepal, which includes wholesale and retail trade, hotel and restaurant, transport, storage and communications, financial intermediation, public administration and defense, education and health and social services sub-sectors had a contribution of 49.8, 51 and 52.2 percent in the fiscal year 2011/12, 2012/13 and 2013/14 respectively. Out of this, banks and financial institutions alone have the contribution of 11 percent. (Nepal Rastra Bank, 2014). This shows that financial sector has an important role in the economic development of country by redistributing the savings of general public for various investment and developmental purposes.

As indicated, since Nepalese banking sector is going through merger and acquisition activities, the factors leading to merger and acquisition decision are the subject of study. There have been studies conducted by Nepal Rastra Bank as well as some other scholars regarding the effectiveness of merger and acquisition based upon post merger performance of banks. Since the factors affecting the decision to go for merger and acquisition have not been the subject of research so far, the proposed research will try to highlight the major factors that have led to large range of merger decisions in Nepalese banking sector. Moreover, this research will provide the banks and financial institutions a comprehensive framework for highlights those points that might lead them towards merging with other companies as well as going for acquisition. The analysis and findings will also help the financial policy makers, researchers and the like for finding out the current situation of the merger and acquisition activities in the context of Nepal.

## 1.5 Problem statement

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 (DeYoung et al., 2009). 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.

## 1.6 Research objectives

The objectives of this research are as follows:

1. To find out about the factors affecting merger and acquisition decision in Nepalese banking sector and their significance.

## 1.7 Research question

As there is no previous study on the relationship between the factors leading to decision for merger and acquisition, the authors want to find answers to the following question:

1. What are the factors leading to merger and acquisition decision in Nepalese banking sector?

## 1.8 Significance of the study

This research will provide a framework of the factors or causes that lead to the merger and acquisition decision in Nepalese banking sector. 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. This research can also be useful for the researchers that look for information regarding the BFIs of Nepal.

## 1.9 Organization of the Thesis

The remaining part of research is structured as follows:

**Chapter 2:**

This section presents literatures which are relevant to this research such as neo-classical theory, behavioral theory, agency theory and resource dependency theory as well as past studies which helps to generate the hypothesis.

**Chapter 3:**

This section reflects the merger (and acquisition) requirements, steps and risks in Nepalese banking sector.

**Chapter 4:**

This section presents the conceptual framework as well as hypotheses, defining conceptual framework briefly and description of relationship among the variables.

**Chapter 5:**

This section discusses about research methodology and include detail discussion about research procedure, design and data collection methods which we select for this research.

**Chapter 6:**

This chapter present the findings of the result with the help of SPSS as well as discussion of hypotheses.

**Chapter 7:**

This chapter encapsulates the research by summarizing the main findings and also check whether research objectives that are presented in chapter 1 are met or not and conclusion from the research as well as limitations of this research.

# CHAPTER 2: LITERATURE REVIEW

## 2.1 Introduction to Merger and Acquisition

**Merger:**

A merger is the complete absorption of one firm by another, wherein acquiring firm retains the identity and the acquired firm ceases to exist as a separate entity (Ross et al., 2003).

Types of Mergers:

1. Horizontal Mergers:

Horizontal mergers happen when a company merges or takes over another company that offers the same or similar product lines and services to the final consumers, which means that it is in the same industry and at the same stage of production. Companies, in this case, are usually direct competitors. (Different types of Mergers and Acquisitions (M&A) ,2015). Example of horizontal merger is between Bank of Madura with ICICI Bank.

2. Vertical Mergers:

A vertical merger is done with an aim to combine two companies that are in the same value chain of producing the same good and service, but the only difference is the stage of production at which they are operating. (Different types of Mergers and Acquisitions (M&A) ,2015). The example of vertical merger can be between Time Warner Incorporated and Turner Corporation.

3. Concentric Mergers:

Concentric mergers take place between firms that serve the same customers in a particular industry, but they don’t offer the same products and services. Their products may be complements, product which go together, but technically not the same products. (Different types of Mergers and Acquisitions (M&A) ,2015). For example, Coca Cola working with Six Flags Entertainment Company.

4. Conglomerate Merger:

When two companies that operate in completely different industry go for merger regardless of the stage of production, then such merger is known as conglomerate merger. This is usually done to diversify into other industries, which helps reduce risks. (Different types of Mergers and Acquisitions (M&A) ,2015). The example of conglomerate merger can be between Walt Disney Company and American Broadcasting Company.

**Acquisition:**

“An acquisition is a transaction in which an individual or company, known as the offeror (or acquirer) gains control of the management and assets of another company, known as the offeree (or target), either by becoming the owner of these assets or indirectly by obtaining control of the management of the company, or by acquiring the shares" (Firer et al., 2004, 759).

Types of acquisition:

i. Stock Acquisition: The acquirer buys the target's stock of from the selling shareholders. In a stock purchase, *all* of the assets and liabilities of the seller are sold upon transfer of the seller's stock to the acquirer. As such, no tedious valuation of the seller's individual assets and liabilities is required and the transaction is mechanically simple. The acquirer does not receive a stepped-up tax basis in the acquired net assets but, rather, a *carryover* basis. Any goodwill created in a stock acquisition is not tax- deductible (Asset and Stock Deals, retrieved 2016).

ii. Asset Acquisition: The acquirer buys some or all of the target's assets/liabilities directly from the seller. If all assets are acquired, the target is liquidated. The acquirer can choose ("cherry pick") which specific assets and liabilities it wants to purchase, avoiding unwanted assets and liabilities for which it does not want to assume responsibility. The asset purchase agreement between the buyer and seller will list or describe and assign values to each asset (or liability) to be acquired, including every asset from office supplies to goodwill (Asset and Stock Deals, retrieved 2016).

Takeovers can be friendly or hostile. As per Hanks (retrieved 2016), a friendly acquisition occurs when the acquiring company gives information to the target company's Board of Directors that it plans to purchase a controlling interest. The proposed buyout is then voted upon by the Board of Directors. The votes would decide whether the proposal should be accepted or not. If they voted in favor of proposal, then the acquiring company then takes control of the target company's operations. However, the acquiring company may or may not choose to keep the target company's board of directors in place.

A hostile acquisition happens when the target company's board of directors do not vote in favor of the stock sale to the acquiring company. Agents of the acquiring company then will try to buy the target company's stock from other available sources, gain a controlling interest and force out the board members who voted against the acquisition. When this happens, the acquiring company will aggressively go after shares of the target firm, while the target's board of directors prepares to fight for survival (Hanks, retrieved 2016).

Though merger and acquisition term is used interchangeably, there are some differences between them. S.S (2015) has indicated following as the types of differences between merger and acquisition:

1. A type of corporate strategy in which two companies amalgamate to form a new company is known as merger. A corporate strategy, in which one company purchases another company and gain control over it, is known as acquisition.
2. In the merger, the two companies dissolve to form a new enterprise whereas in acquisition, the two companies do not lose their existence.
3. Generally, two companies of the same nature and size go for merger unlike acquisition, in which the smaller company is overpowered by the larger company.
4. In a merger, the minimum number of companies involved are three, but in acquisition, the minimum number of companies involved is two.
5. The merger is done voluntarily by the companies while acquisition is done either voluntarily or involuntarily.
6. In a merger, there are more legal formalities as compared to acquisition.

Merger and acquisition in the banking sector is not a new phenomenon. Many international as well as national banks have been through merger and acquisition activities. Normally there is involvement of at least two parties in merger and acquisition process. Merger and acquisition normally occurs when both parties see a chance to increase the advantage of working together rather than performing alone. Both parties hope to benefit from the greater efficiency and competitive strength found in the combined company (Giddy, 2006**).** Therefore, the variables discussed are the factors that affect both parties prior to merger and acquisition for the decision to undertake M&A.

## 2.2 History of merger and acquisition

Both mergers and acquisitions are aspects of strategic management, corporate finance and management dealing with buying, selling, dividing and combining of different companies and similar entities that can help and enterprise grow rapidly in its sector or location of origin, or a new field or new location, without creating a subsidiary, or child entity or using a joint venture (CTI Reviews, 2014). The history of merger and acquisition started from 19th century. However, there were few exceptions like: East India Company merged with an erstwhile competitor to regain its monopoly over Indian Trade in 1708, Italian Monte dei Pachi and

Monte Pio banks were united as the Monti Reuniti in 1784, Hudson's Bay Company merged with North West Company in 1821.

The merger in the 19th century is greatly related in the U.S. business arena which occurred in the period 1895-1905. At this period of time, small firms having little market share consolidated with firms of similar type in order to form larger as well as powerful companies in order to dominate the markets. Till date, the total mergers as waves can be divided into six different waves which are described below:

**First wave:**

The first wave occurred from 1897 to 1904. This period is characterized by monopolistic market that had resulted from horizontal mergers. This period of wave is considered to be the period in which large monopolies were created.

O'Brien (1988) has stated that the mergers at this time occurred were mostly influenced by the companies that wanted to have strong presence and power in the market rather than economies of scale. Although monopoly was supposed to be highly discouraged by the Sherman Antitrust Act which was implemented in 1890, the companies used merger as a tool to get around this law. Gaughan (2011) has stated the inefficiency of Justice Department being responsible for improper execution of Antitrust Act. Gaughan (2011) has further stated that corporations were better able to hold stock in other companies and increase their business operations thereby creating merger environment because of relaxation of corporate laws. During the period 1898-1904, the firms were disappearing for the sake of merger and acquisition in the rate of 301 per year with 1028 firms disappearing into merger in 1899 alone (Nelson, 1959).

The period of 1905 to 1914 is described as a decade of lower merger activity. The momentum reappeared from 1915.

**Second wave:**

The second occurred from 1916 to 1929. This period is supposed to be affected from oligopolies. After the equity market had declined in first wave, it began to develop in this phase. Investment capital was easily accessible and stock market began to boom because of economic growth.

In this period, the government of United States had executed hard and strict rules in antitrust law. Clatyon Act was executed in 1914 which was like back force for Sherman Act. According to Sundarsanam (2010), with strict antitrust laws, vertical mergers began to flourish and thus industries not related to each other, began to go for merger. This led to demolition of monopolies and formation of oligopolies. This period is also characterized by small scale companies merging with each other in order to gain economies of scale. This period ended with the decrement in equity market.

Because of Second World War, merger and acquisition activities remained low until around 1950s after second wave.

**Third wave:**

The third wave occurred from 1965 to 1969. This period is characterized by conglomerate mergers resulting from booming economies in the 60s. With the intention of companies to execute diversified strategies along with diversified product lines, such conglomerate mergers came into practice.

As per Shleifer and Vishny (1991), such conglomerate mergers were a because of antitrust laws that did not allow mergers between companies belonging to the same industry. In order to tackle the monopolies and oligopolies, Cells Kefuaver Act was implemented which did not allow the companies of same organization to merge. Such conglomerates were also a result of the companies wanting to reduce the fluctuation or volatility in their income (Sundarsanam, 2010). The third wave ended with oil crisis in 1973 as well as the economic recession of the 70s.

**Fourth wave:**

The fourth wave occurred from 1984 to 1989. This period is termed as a period of hostile merger by Gaughan (2011). With the aim to earn high returns in short period of time, hostile takeovers and mergers took place. As conglomerate mergers had some negative points too, there were significant mergers which were formulate to either specialize operations or downsize them. Also in fourth wave, large size companies were the prominent players of merger and acquisition while such were middle and small companies in previous merges. Mitchell and Mulherin (1996) have stated that oil price shocks, deregulation, financial innovation, competition were the prime factors resulting takeover activities in this period. Sundarsanam (2010) has stated that fall of Berlin Wall and Schengen Agreement in this period was the cause of rise in merger in Europe. Also, because of high inflation rates and thus high borrowing costs, big companies began to opt for merger and acquisition so that they could reduce operating and financing costs.

With the collapse of stock market as well as highly leveraged companies, the fourth wave came to end.

**Fifth wave:**

The fifth wave occurred from 1992 to 2000. The mergers here were characterized by friendly and long-term commitment type of deals. With the boom in the economy again, as well as rocketing of stock market, the companies opt for merger in order to fulfill the demand. In the fifth wave merger, the companies opted for equity financing rather than debt financing. Also, this wave is characterized by international mergers with companies going for cross merger deals. Deregulations also played the great role in such international mergers with Europe, America and other countries having many companies going for merger and acquisition. This merger waves were greatly supported by various multinational trade zones like European Union, North Atlantic Free Trade Agreement etc. This period ended with economic recession.

**Sixth wave:**

The sixth wave occurred from 2003 to 2007. Martynova and Renneboog (2005) stated that the merger wave occurred after the market began to return to normal post terrorist attack on September 11, 2000. In this period, even though economy began to recover, the interest rate was kept low. In this period, the trend of cross-border merger and acquisition continued. Many private equity firms came into rise because of low interest rate thereby making it easier to obtain credit availability.

The sixth wave came into end with subprime debt crisis in 2007 (Ferris and Pettit, 2013).

Studies have shown that the takeovers did not occur evenly, rather there was a cluster of different waves.

Past studies have been less successful, however, in determining the reasons why takeover activity varies over time. As such, the treatment of takeover waves has tended to be ad hoc, with each of the four takeover waves in the past century having its own label: the 1890s for monopoly, the 1920s for oligopoly, the 1960s for conglomerate takeovers, and the 1980s as the decade of hostile bust-up takeovers (Mitchell and Mulherin,1996).

Since a long time, researchers have been trying to investigate the causes or determinants of merger and acquisition. Analysts like Gort (1969) and Jensen (1993) point out that the main motives behind merger and acquisitions are to obtain benefit from synergy, or to increase operational areas, or to obtain the dominance in the market. Jensen and Ruback (1983) have backed up this concept by stating that positive wealth creation in takeovers could stem from either the efficiency gains of synergistic transactions or from the collusive combination of former industry rivals. Another theory backing up merger and acquisition is known to be behavioral and agency theory. Agency perspective recognizes that there is divergence between goals of the owners and goals of the managers (Pangarkar, 2000).

## 2.3 Neoclassical theory

Neoclassical theory has an assumption of a rational economic man with total information. When used this concept in merger and acquisition, neoclassical theory defines the merger and acquisition activity based upon the view of value maximization.

In case of neoclassical theory, the assumption is made that the structure of an industry, including the number and size of firms, is a function of factors such as technology, government policy, and demand and supply conditions. Major changes, or shocks, in any of these factors cause shifts in industry structure.

Also known as traditional view, neoclassical theory argues that industry shocks are unexpected or exogenous. For example, Andrade et al. (2001) in their survey of the merger literature argue that unexpected industry shocks lead to time clustering of industry-level takeover activity.

Neoclassical theories assume that managers maximize profits or shareholder wealth and thus that mergers increase either market power or efficiency. These hypotheses were developed by Gugler et al. (2005) while defining the determinants of merger waves.

Harford (2005, 530) has argued that

"...merger waves occur in response to specific industry shocks that require large scale reallocation of assets. However, these shocks are not enough. There must be sufficient capital liquidity to accommodate the asset reallocation. The increase in capital liquidity and reduction in financing constraints that is correlated with high asset values must be present for the shock to propagate a wave.... Thus, the explanation for merger waves is intuitive: they require both an economic motivation for transactions and relatively low transaction costs to generate the large volume of transactions."

Neoclassical theories find mergers as a way of reallocating the assets between the firms that are efficient and inefficient in response to industry shocks and provide suggestion that merger waves occur in industries experiencing fundamental changes (Andrade and Stafford, 2004; Harford, 2005; Jovanovic and Rousseau, 2002; Mitchell and Mulherin, 1996).

Gugler et al., (2006) have argued that industry shocks and q theory of mergers, the two neoclassical theories explain the causes of merger waves.

### 2.3.1 Industry Shocks hypothesis

As per this theory, various innovations related to technology as well as deregulations lead to merger as a profitable activity and thus, lead to merger waves.

Mitchell and Mullerin (1996); Mulherin and Boone (2000); Andrade, Mitchell and Stafford (2001); and Harford (2005) have stated that shocks to industries like technological innovations and deregulation suddenly make mergers profitable and lead to industry merger waves.

### 2.3.2 Q theory of mergers

The Q theory explains why some firms buy other firms. Q is the ratio of market value to the replacement cost of capital. Jovanovic and Rousseau (2002) have stated that a firm's investment rate should rise with its Q. They argue that a firm's merge and acquisition investment responds to its Q more that its direct investment does because M&A investment is a high fixed cost and a low marginal adjustment cost activity; and also because the typical firm wastes some cash on M&A's, but not on internal investment. Also, high Q firms usually buy low Q firms. Also, Andrade et al. (2001) had mentioned that in more than two third of mergers since 1973, the acquirer's Q exceeded the target's Q. Since Q measures returns on a firm's existing assets, it would seem that Q theory the measures would only allow one to explain horizontal mergers, i.e., additions to existing capital stock.

Neoclassical theory has the simple criterion: if the firms are worth more together than apart, the acquisition will create value (Brealey et al. 2008).

Goold and Campbell (1988) have suggested that synergy is the ability of two or more units or companies to generate greater value working together than they could working apart. Synergy is often expressed as two plus two equals five. Synergy aspirations can be used as a key driver behind mergers, acquisitions, and alliances (Gruca et al., 1997).

Neoclassical theory is one of the important tool in predicting the merger and acquisition activities. As discussed above, merger activities are carried out if the $q>1$, which highlights the concept of why acquiring or merging with other company has more advantage than opening new branch. It displays the fact that both acquiring and target banks are driven by potential synergies that may arise from merger and acquisition.

Thus, it is evident that such synergies are related to economies of scale, expansion into new geographical markets, technology and so on. These are the prime determinants of merger and acquisition obtained from neoclassical theory and further described in other topics below.

## 2.4 Agency theory

A merger can end up destroying value rather than creating synergies even though managers act fully rational. "The literature of agency theory throws light on how managers' interest in maximizing their own utility can lead to decisions that are not in the interest of the shareholders. However, the decisions are fully conscious and are a result of opportunism rather than irrational behavior." (Bjarke and Peter, 2010).

Agency problems come into surface when there is conflict of interest between the managers of the firms and the firm's shareholders and when the managers have the possession of small portion of the share of the firm. Agency theory states that mergers take place to correct situations where there is a separation between what the managers want and what the owners want. Low stock prices put pressure on managers to take actions to raise the share price or become the target of the acquirers, who perceive the stock to be undervalued (Fama and Jensen, 1983).

Mehran and Peristiani (2010) have stated that agency problems are an important factor contributing to management-initiated buyouts, particularly when managers and shareholders disagree over how excess cash flow should be used. Masulis, Wand, and Xie (2007) stated that managers sometimes are motivated to make acquisitions to build their spheres of influence and augment their compensation to the extent that such compensation depends on the size of firms they manage.

Agency theory consists of various factors that lead to merger and acquisition and the decision to go for it. With the assumption that the agent will always work in personal interest and will take advantage of the superior information to own benefit, this theory highlights the factors such as agents' action on capturing the market, branding the company and the like which are related to merger and acquisition in order to obtain private benefit and also for some sort of company benefit.

## 2.5 Behavioral theory

The behavioral theory or its hypothesis is more focused on correlation between merger activity and stock market valuation. As per behavioral theory, merges and acquisitions occur because of overvalued markets and managerial timing. The behavioral hypothesis assumes that merger waves are the result of overvalued markets and managerial timing (Eckbo, 2010). Here, managerial timing refers to time horizon in which decision regarding merger and takeover by management takes place.

According to Shleifer and Vishny (2003), the overpriced bidder stocks are supposed to possess shorter time horizon and are thus accepted by target managements. Similarly, Kropf and Viswanathan (2004) have stated that such overpriced stocks of bidders are accepted by target management in the span of short time span making assumption of synergies. Such overvaluation and timing lead to merger activities.

There have been studies regarding the behavioral pattern of the decision making bodies with regards to merger activities. As per the empirical study done by Malmendier and Tate (2005) using a sample of Forbes 500 firms from 1980 to 1994, it was stated:

"We find that overconfident Chief Executive Officers (CEOs) are more likely to conduct mergers than rational CEO's at any point in time. The higher acquisitiveness of overconfident CEO's—even on average—suggests that overconfidence is an important determinant of merger activity. Moreover, the effect of overconfidence comes primarily from an increased likelihood of conducting diversifying acquisitions. Previous literature suggests that diversifying mergers are unlikely to create value in the acquiring firm. Thus it is consistent with our theory that overconfident managers are particularly likely to undertake them. Second, we find that the relationship between overconfidence and the likelihood of doing a merger is strongest when CEO's can avoid equity financing, i.e., in the least equity dependent firms. Overconfident CEO's strongly prefer cash or debt financed mergers to stock deals unless their firm appears to be overvalued by the market."

As per Nielsen and Bierrregaard (2010), biases may play a larger role than usually observed in the financial market as the risk of irrational behavior is larger in M&A transactions characterized by few bidders, low transparency and large spreads between negotiation prices. Heuristics and biasness such as herding behavior, anchoring, confirmation trap, framing effects, regret avoidance and escalation of commitment etc. have their own role in the M&A activities of the firm.

**Hubris:**

Hubris is an expression for M&A that attribute a tendency to overpay due to either excessive optimism about the value of an acquisition's potential synergy or the management's overconfidence in its ability to manage the acquisition (DePamphilis, 2008).

Hubris hypothesis states that managers sometimes believe that their own valuation of a target firm is superior to the market's valuation. Thus, the acquiring company tends to overpay for the target because of over-optimism in evaluating synergies. Competition among bidders also

is likely to result in the winner overpaying because of hubris, even if significant synergies are present (DePamphilis, 2009).
Hubris is guided by excessive optimism and overconfidence. Under excessive optimism, the chances of unfavorable outcomes are underestimated while favorable outcomes are overestimated. Overconfidence refers to the state where people see themselves better than others, and thus tend to make errors.
The value destroying M&A may arise when management base their M&A decision on intuitive judgment, and is determined to make some particular deals without undertaking a proper valuation. Excessive optimism and overconfidence can result in big losses and overconfident managers can induce mergers that are value destroying. Actually, it is shown that market reacts more negatively to the announced bids of overconfident managers (Malmendier and Tate, 2005).
Alternatively, managers are overoptimistic of the value of the target and overestimate the potential synergies. Another fact is that overconfident managers may see their firms as undervalued compared to the valuation of the less optimistic market, which makes the overconfident managers reluctant to issue equity to finance the acquisition (Malmendier and Tate, 2005).
Thus, behavioral theory highlights important determinants of merger and acquisition activities. The psychological comfort of the managers on running the larger business or obtaining greater return leads to merger and acquisition activities. Also related with the industry related behavior such as overvaluation of stocks, this theory states that high overvaluation (market to book ratio) is one of the essential factors of merger waves.

## 2.6 Resource dependence theory

Resource dependence theory is focused with power to control resource allocation as the key to organizational survival. Selznick (1949) has stated that organizations will try to manage their resource dependencies with a variety of tactics, such as cooptation of sources of constraint, in order to achieve greater autonomy and thus reduce uncertainty in the flow of needed resources from the environment. The basic concept of resource dependence theory is related with how the external resources of organizations affect the behavior of the organization.
A firm’s behavior is constrained in several ways by its limited access to resources owned or controlled by different constituencies in the environment (Laerence & Lorch, 1967; Pfeffer &

Salancik, 1978). “When faced with its critical resource dependencies, a firm can either adapt to its environmental constraints or try to proactively shape them engaging in cooperative or acquisitive strategies” (Vanhaverbeke et al., 2002). Mergers and acquisitions are one way for the firms to proactively manage their resource dependencies.

One prescriptive method to manage dependency and uncertainty is to incorporate it within organization’s boundary by the method of mergers and acquisitions. There are various empirical evidences supporting this theory. Pfeffer (1978) in a study of 854 US merger activities found that volume of economic transactions across two industries and proportion of acquisitions across same industries were positively related. Similarly, Burt (1980) found out that in order to manage inter-organizational constraints resulting from inter-industry transaction patterns, the organizations would opt for merger and acquisition. In one of the recent study, Xia (2010) has stated that resource dependencies are the essential factors contributing to cross-border acquisitions.

Inter-organizational interdependencies have been identified as a key driver of mergers and acquisitions (Meyer et al., 2009), as acquiring a resource supplier provides durable access to desired inputs, broadens an organization’s knowledge base, and facilitates joint strategy formation and implementation; although other options of inter-organizational arrangements are also available like alliance,(Dussauge et al., 2000) interlocks (Ellstrand et al., 2002), joint ventures (Pfeffer & Nowak, 1976) and the like.

## 2.7 Findings from the previous studies

The following table shows findings from the previous studies that shows the determinants and motives for deciding to go for merger and acquisition to take place:

| **Authors** | **Determinants that would lead to merger and acquisition (decision)** |
|---|---|
| Morris (2004) | To respond to the changing economic conditions in a bank's environment |
| Focarelli et all (2002) | To obtain higher income, to improve the quality and provide emphasis for diversification |
| Pasiouras and Zopounidis (2008), Morris (2004) | To grow, strengthen position and increase size |
| Focarelli et all (2002); Walter and Barney (1990); Gaughan (1999); Coyle (2000); Paulter (2001); Sherman and Hart (2006); Fontaine (2007); Miller (2008); William (2009) | To achieve efficiency through economies of scale |
| Trautwein (1990); Paulter (2001); Miller (2008) | To increase market power |
| William (2009) ; Blonigen and Taylor (2000); Ghoshal (1987); Bower (2002) | To obtain superior technology, new knowledge and enhance learning, to acquire research and development capability |
| Coyle (2000); Huang and Kleiner (2004) | To obtain growth in revenue |
| Sherman and Hart (2006) | To reduce competition |
| Walter and Barney (1990); Gaughan (1999); Bower (2002); Sherman and Hart (2006); McClure (2009) | To get into new markets as well as to innovate new products and services |
| Gaugham (1999); Coyle (2000); Bower (2002); Miller (2008 | To obtain opportunities through synergies |
| Pfeffer (1978), Noorderhaven (2002), Burt (1980), Xia (2010) | To manage resource dependency |

Table 1: List of factors leading to merger and acquisition decision

## 2.8 Merger and acquisition in the banking sector

Merger and acquisition in banking sector is not a new phenomenon now-a-days. Factors such as globalization, liberalization, internationalization of competition and technological developments have just intensified this tendency. Dymski (1999) stated that from 1981 to the that present period, an average of 1.7 banks have disappeared by merger each business day in United States of America. Morris (2004) has explained that in the United States, banks were actively involved in merger with financial institutions and banks over three decades. The banking industry of United States consisted of independent unit banks with small size which portrayed a crucial factor in merger and acquisition activities.

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). Another group found no evidence supporting profitability measures and the likelihood of a bank acquisition (Hannah and Rhoades 1987; Hadlock et al., 1999). The latter group found that acquirers were mostly the banks having big market shares and were larger in size, had good financial position, high profit rates while the target banks were small sized, badly managed and low capitalized. Hardlock et al. (1999) stated that if the ownership stake of bank managers is higher, there is less chances of the banks being acquired, thereby ignoring the earning side of the bank. In case of developing countries, banking consolidations are induced mostly as a part of regulatory or reform policy. Such consolidation through merger and acquisition form an important component of broader banking sector reforms, which result from deliberate regulatory policy designed to reform the banking sector and prevent banking crisis that may result in mass failures.

Many researches have been performed in various other countries regarding the merger and acquisition activity. The studies conducted by Pasiouras and Zopounidis (2008) in Greece showed that M&A in Greece banking industry were performed in order to grow, strengthen the position as well as increase the efficiency through economies of scale. 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. The study of Italian banks conducted by Focarelli et al. (2002) revealed that banks merge in order to increase their non-interest income, increase efficient use of capital and sell more services while acquisitions occur in order to increase the quality of loan portfolio of acquired banks; while making higher profitability the main purpose of both merger and acquisition. Pilloff (2004) studied about the banks in United States (US) and has found that gradual easing of geographic restriction on banks (deregulation of geographic limits) and advances in information technology as the major contributor factors for merger and acquisition in US 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. Other motives for mergers and acquisition include desire of CEO to gain more power, growth opportunities and improvements in efficiency (Humphrey & Vale, 2003) through economies of scale (Sufian, 2011).

## 2.9 Previous studies regarding relationship of theories with merger and acquisition in banking sector

There have been many studies regarding various factors that lead to the activity of merger and acquisition in banking sector. There are various factors affecting merger and acquisition activities and decisions that have been derived from the theories described above. However, is very hard to find previous quantitative analysis of such factors.

In the studies conducted by Smirnova (2014), he has drafted a model in which internal and external motives of merger and acquisitions in banking sector are explained. The table can be expressed as:

Internal motives:

- ❖ To increase shareholder's equity
- ❖ To increase research and development capability
- ❖ To increase number of clients
- ❖ To innovate products and services
- ❖ To strengthen position in market
- ❖ To obtain benefits from economies of scale
- ❖ To obtain better access to resources
- ❖ To increase efficiency

| |
|---|
| External motives<br>❖ Economic: To give response to changing market or economic conditions in bank’s environment<br>❖ Legal and political: to get support from government, to obtain tax benefits, getting forced by government<br>❖ Technological: to obtain superior technology and new knowledge<br>❖ Competitive: to achieve strategic advantages through synergies, to improve product and service quality and quantity |

Table 2: Motives of merger and acquisition as obtained from Smirnova (2014)

The convincing study of factors related to merger and acquisition based upon various theories is conducted by Novickytė and Pedroja (2015). In the framework suggested by Novickytė and Pedroja (2015), they have shown various factors based upon various theories that would lead to merger and acquisition in banking sector. With the banks going through various structural changes, lively discussion for such merger and acquisition activities have attracted the attention of various scholars. With respect to such factors, the models described by Novickytė and Pedroja (2015) are shown below:

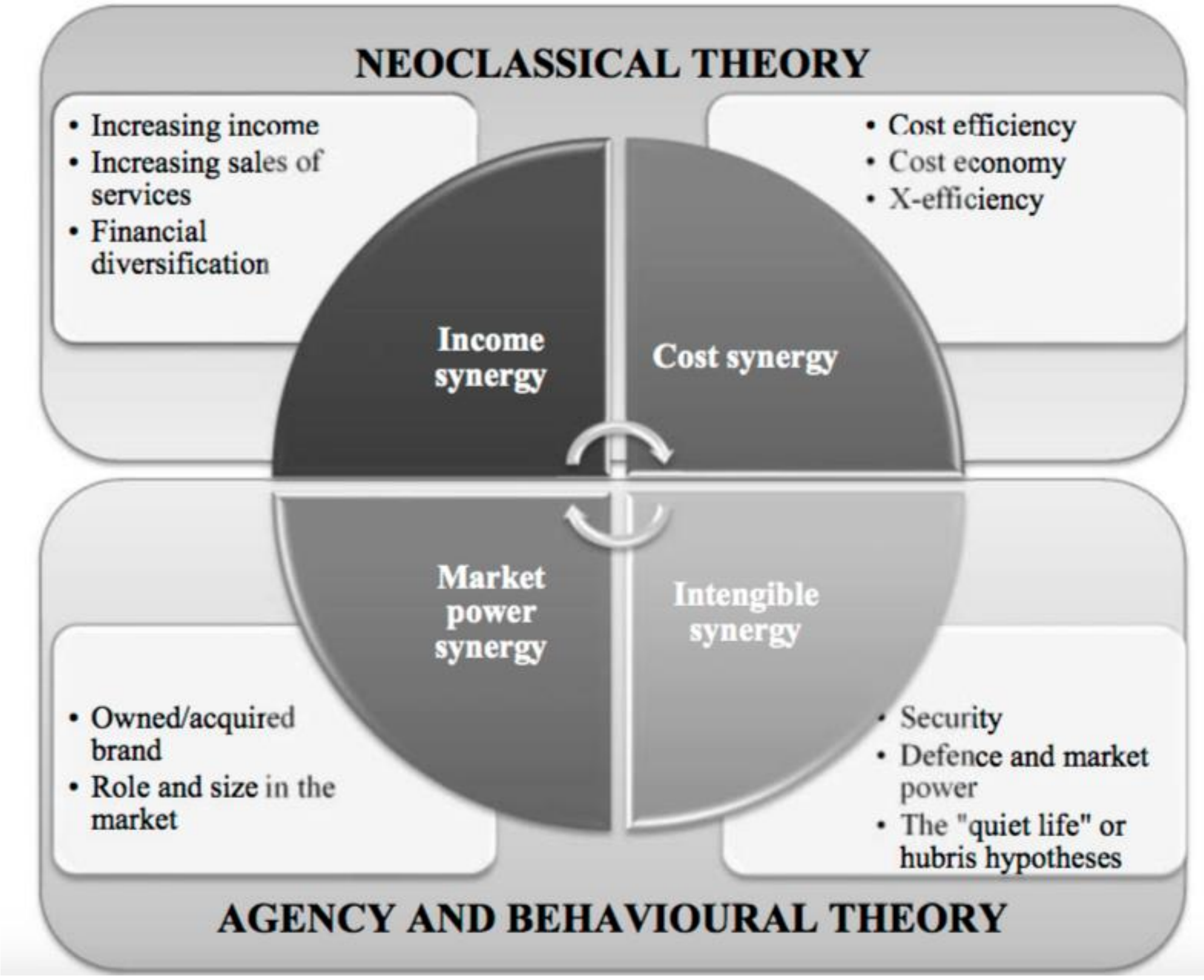



Figure 1: Factors affecting M&A in banking sector obtained from Novickytė and Predroja (2015)

As shown in the figure above, they have linked the factors obtained from various theories that would affect merger and acquisition in banking sector. Increasing income, increasing sales of services, diversification, cost efficiency and the like belong to neoclassical theories while brand, size of market, security, hubris and the like belong to agency and behavioral theories. The authors have shown basically four synergies: income synergy, cost synergy, market power synergy and intangible synergy; as the basic factors linked to classical, agency and behavioral theories that have the prominent role in the merger and acquisition activities in the banking sector. These are the possible factors because of which the banks would decide to go for merger and acquisition.

Banks and financial organizations require resources like insurances capital, reputation and the like in order to operate which could be controlled by actors like regulators, clients, other stakeholders and the like. In this regard, authors such as Hillman et al. (2009) have stated that managers will act to control resource provider's influence in order to minimize the uncertainty to obtain resources thereby making resource dependency theory carry a factor for merger and acquisition in banking sector.

All in all, most of the authors are of the view that the factors derived from neoclassical, agency, behavioral and resource dependency theory are related to the banking sectors too.

## 2.10 Determinants of merger and acquisition in the banking sector:

From the studies conducted by the various scholars, following are the representative determinants that will be used for hypotheses that can address the motives of merger and acquisition:

## Determinants from neoclassical theory:

Novickytė and Predroja (2015) have stated that synergy of income and costs are considered to be part of neoclassical theory, which explains the causes of mergers and acquisitions that are usually caused by economic disorders. With respect to banking sector, the following factors can be termed to be related to neoclassical theory:

1. **Emphasis on increasing income:**

Income, or gain can be increased by the process of merger and acquisition. In acquisition, this is possible through value creation. Sudarsanam (2003) has stated that "…in a horizontal merger, this (gain) is often referred to as the possibility to achieve economies of scale whereas such advantages in vertical and conglomerate mergers often are referred to as economies of scope." Simply the idea is that performance will increase by working together would lead them towards merger (Renaud, 2016). DePamphilla (2009) has stated that economies of scale and economies of scope can be obtained as a result of merger and acquisition.

2. **Emphasis on Increasing sales of services:**

Increasing sales of services would refer to the growth of companies. Mergers can lead the acquiring companies to increase their sales of services without having to do it by themselves. (Renaud, 2016). The companies which excel in one field (for e.g. consumer goods) can merge with the companies which excel in other field (for e.g. service goods) so that they can provide better service to the consumers. Reaching to more consumers through branches is possible by the help of mergers and acquisitions.

3. **Emphasis on Financial diversification:**

Diversification refers to a strategy of buying firms outside of a company's current primary lines of business. DePampihilla (2010) has stated that a company that merges to diversify may acquire another company in a seemingly unrelated industry in order to reduce the impact of a particular industry's performance on its profitability. Companies seeking to sharpen focus often merge with companies that have deeper market penetration in a key area of operations (Renaud, 2016). It also refers to financial synergy in which merger occurs between two companies in which one company have an excess capital but with less expansion possibilities and the other one with the larger growth opportunities but with less capital and together they can attain higher profits (Dilshad, 2013). Empirical studies state that investors do not benefit from unrelated diversification. Investors often perceive companies diversified in unrelated areas are riskier, because they are difficult for management to understand and management often fails to fully fund the most attractive investment opportunities (Morck et al., 1990). Moreover, it is difficult to understand how to value the various parts of highly diversified business. (Best and Hodges, 2004).

4. **Emphasis on Cost efficiency:**

Similar with the concept of income synergy, the companies decide to go for merger and acquisition if by working together they can reduce cost which they can do less by working individually. Essentially, a business will attempt to merge with another business that has complementary strengths and weaknesses (Renaud, 2016). Cost reductions can be achieved by the elimination of unnecessary managerial positions and closure of overlapping branches of banks (Dilshad, 2013). Economies of scale and scope imply that the cost will decrease with firm size, and thereby an increase in firm size will always be advantageous. Gugler et al. (2006) find that small firm mergers are motivated by this increase in efficiencies which are consistent with theory suggesting that the relative advantages will decrease as firms becomes larger.

## Determinants from agency theory:

Novickyte and Pedroja (2015) have stated that agency theory covers those determinants that are the main reasons for market power synergy. While considering the explanatory influences, motives or determinants of merger and acquisition decision in banking sector, following are the list of variables taken into consideration in agency theory:

5. **Emphasis on obtaining stronger position in market:**

As suggested by market power theory, firms merge to improve their monopoly power to set product prices at levels not sustainable in a more competitive market. Many merger and acquisition deals allow the acquirer to eliminate competition and gain larger market share in its product's market (Reaund, 2016). Merger and acquisitions increase the size and position of company in the market. So, in order to obtain high position and capture market size, the companies decide to go for merger and acquisition. However, may recent studies conclude that increased merger activity is much more likely to contribute to improved operating efficiency of the combined firms than to increased market power (DePamphillia, 2010).

6. **Emphasis on better branding:**

If the companies see chances of increasing their branding synergies through merger, then they decide to go for merger and acquisition. A key aspect of marketing due diligence is to study the transaction through the customers' eyes, a perspective that is critical to market facing business. Kumar and Blomqvuist (2004) have stated that acquiring companies need to ask:" What is the point of merger or acquisition if a substantial fraction of our customers desert us post-completion because the newly combined companies did not meet their expectations?" Part of the deal strategy must be to understand the lifetime value and needs of each company's customers, not only to determine an appropriate price for acquisition (Kumar, Blomqvist, 2004). Therefore, branding also plays an effective role in deciding to go for merger and acquisition.

## Determinants from behavioral theory:

Behavioral theory is more or less connected to the descriptive and normative aspects of the companies as well as people managing them. The determinants involved are:

7. **Using merger and acquisition as a means of security**

Here security would refer to confidence in the market to be successful. The two or more companies would decide to go for merger if they are sure that by working together, they would be successful. Security is considered to be a factor for merger for the company buying up because there will be involvement of better human as well as capital resources from the company being bought up in order to provide better services to the market thereby making the company successful. Similarly, the company being bought up can have better access to the market for providing its services to larger number of customers after the merger thereby making the company successful. Driven by the decision behavior of managers, if managers are confident that the company can perform better through merger an acquisition, then they would decide to go for it.

## Determinant from resource dependency theory:

The determinants from resource dependency theory related to banking sector are follows:

8. **Emphasis on maintenance of capital requirement (and Liquidity ratios):**

In the absence of timely and accurate central bank operations, large liquidity shortages may sometimes endanger the stability of the banking system (Carletti, et al., 2007). So, the central banks make certain rules regarding liquidity of the banks. Thus, in order to manage the liquidity risk, the banks may decide to go for merger and acquisition. The banks in Nepal have to maintain the liquidity ratio of at least 20 percent while the cash reserve ratio is at least five percent (Himalayan News Service, 2015). In 2015, the central bank of Nepal directed banks and financial institutions to NRs. 8 billion in two years which previously was only NRs. 2 billion. In order to manage the capital requirement, the banks can go for merger and acquisition. Banks not maintaining such ratio will be considered problematic and thus may go for merger and acquisition in order to maintain the ratio.

## Other determinants:

Other determinants are as follows:

9. **Fulfilling the requirements of Regulation from regulatory authorities**

Sometimes, the central bank of Nepal issues such regulations which would make merger and acquisition as the easiest way for the banks to fulfill the requirement. For instance, the capital adequacy ratio requirement as stated above, not allowing the family members to own more than one bank etc. are some of the restrictive regulations followed by Nepal Rastra Bank to make the banks undertake merger and acquisition decision.

# CHAPTER 3: MERGER AND ACQUISITION IN NEPALESE BANKING SECTOR

## 3.1 Introduction

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:

| S.No. | Before Merger | | | | After Merger |
|---|---|---|---|---|---|
| 1 | Machhapuchre Bank Ltd. | Standard Finance Ltd. | | | Machhapucchre Bank Ltd. |
| 2 | Global Bank Ltd. | IME Finance Ltd. | Lord Buddha Finance Ltd. | | Global IME Bank Ltd. |
| 3 | Pashupati Development Bank Ltd. | Uddhyam Bikash Bank | | | Axis Development Bank Ltd. |
| 4 | Butwal Finance Ltd. | Alok Everest Finance Ltd. | CMB Finance Ltd. | | Synergy Finance Ltd. |
| 5 | Annapurna Development Bank Ltd. | Surya Darshan Finance Ltd. | | | Supreme Development Bank Ltd. |
| 6 | Himchuli Development Bank Ltd. | Birgunj Finance Ltd. | | | H & B Development Bank Ltd. |
| 7 | Kasthmandap Development Bank Ltd. | Sikhar Finance Ltd. | | | Kasthmandap Development Bank Ltd. |
| 8 | Viber Bikash Bank Ltd. | Vajuratna Finance Ltd. | | | Vibor Bikas Bank Ltd. |
| 9 | Business Development Bank Ltd. | Universal Finance Ltd. | | | Business Universal Development Bank Ltd. |
| 10 | Nepal Industrial and Commercial Bank Ltd. | Bank of Asia Ltd. | | | NIC Asia Bank Ltd. |
| 11 | Diyalo Bikas Bank Ltd. | Professional Bikas Bank Ltd. | | | Professional Diyalo Bikas Bank Ltd. |
| 12 | Global IME Bank Ltd. | Social Development Bank Ltd. | Gulmi Bikas Bank Ltd. | | Global IME Bank Ltd. |
| 13 | Prabhu Finance Ltd. | Baibhav Finance Ltd. | Sambridhi Bikas Bank Ltd. | | Prabhu Bikas Bank Ltd. |
| 14 | Royal Merchant and Banking Finance Ltd. | Api Finance Ltd. | Rara Bikas Bank Ltd. | | Apex Development Bank Ltd. |

| | | | | | |
|---|---|---|---|---|---|
| 15 | Araniko Development Bank Ltd. | Surya Development Bank Ltd. | | | Araniko Development Bank Ltd. |
| 16 | Manakamana Development Bank Ltd. | Yeti Finance Ltd. | Valley Finance Ltd. | | Yes Development Bank Ltd. |
| 17 | Global IME Bank Ltd. | Commerce and Trust Bank Nepal Ltd. | | | Global IME Bank Ltd. |
| 18 | Civil Bank Ltd. | Axis Development Bank Ltd. | Civil Merchant Bittiya Sanstha Ltd. | | Civil Bank Ltd. |
| 19 | Reliable Finance Ltd. | Nepal Consumer Development Bank Ltd. | Subhalaxmi Finance Ltd. | | Reliable Development Bank Ltd. |
| 20 | Reliance Finance Ltd. | Lotus Investment Finance Ltd. | | | Reliance Lotus Finanace Ltd. |
| 21 | Imperial Finance Ltd. | Siddhartha Finance Ltd. | | | Siddhartha Finance Ltd. |
| 22 | Biratlaxmi Bikas Bank Ltd. | Chandbari Development Bank Ltd. | | | Biratlaxmi Bikas Bank Ltd. |
| 23 | Lumbini Bank Ltd. | Navadurga Finance Ltd. | | | Lumbini Bank Ltd. |
| 24 | Bageshwori Development Bank Ltd. | Shangrila Development Bank Ltd. | | | Shangrila Development Bank Ltd. |
| 25 | Kist Bank Ltd. | Prabhu Bikas Bank Ltd. | Gaurishankar Development Bank Ltd. | Zenith Finance Ltd. | Prabhu Bank Ltd. |
| 26 | Citizens Bank International Limited | Nepal Housing and Merchant Finance Ltd. | People's Finance Ltd. | | Citizens Bank International Limited |
| 27 | Triveni Bikas Bank Ltd. | Public Development Bank Ltd. | Bright Development Bank Ltd. | | Triveni Bikas Bank Ltd. |
| 28 | Bishwa Bikash Bank Ltd. | Fewa Finance Ltd. | | | Fewa Bikas Bank Ltd. |
| 29 | NDEP Development Bank Ltd. | Rising Development Bank Ltd. | | | Deva Bikas Bank Ltd. |
| 30 | Muktinath Bikas Bank Ltd. | Civil Development Bank Ltd. | | | Muktinath Bikas Bank Ltd. |
| 31 | Garima Bikas Bank Ltd. | Nilgiri Bikas Bank Ltd. | | | Garima Bikas Bank Ltd. |
| 32 | Sagarmatha Merchant Banking and Finance Ltd. | Patan Finance Ltd. | | | Sagarmatha Finance Ltd. |

Table 3: List of bank merger cases in Nepal until 2015, obtained from Nepal Clearing House (2015)

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.

## 3.2 Laws of merger in Nepalese banking sector

Nepal Rastra Bank, the central bank of Nepal, has stated various conditions on which it can direct the banking and financial institutions for immediate merger. The conditions, obtained from the website of Nepal Rastra Bank under the policies titled "Merger By laws, 2068 (Including First Amendment)" on 2016 are:

1. If the various banking and financial institution are owned by the same family, relatives or groups
2. If there is shortfall of capital, then the banking and financial institutions must go for merger (for this, the commercial banks are supposed to have capital adequacy ratio of 10 percent and development banks are supposed to have the capital adequacy ratio of 11 percent)
3. If the banking and financial institutions have been treated with reformatory punishment for three or more times
4. If the banking and financial institutions are unable to fulfillment their responsibility of payments because of systematic risks
5. If the banking and financial scenario has better results if two or more banks get merged
6. If there are chances of negative results in the financial situation of the country when the banks and financial institutions are allowed to perform in as-is basis

The provisions of merger bylaws obtained from New Business Age (2013) under the policies titled "Merger By laws, 2068 (Including First Amendment)" on 2016 are:

1. A, B, C, class financial institutions can merge with each other but the D class financial institutions can merge only with another same class financial institution.
2. Banking and Financial Institutions (BFI) that want to merge should delegate separate merger committees from their annual general meetings and sign a memorandum of understanding (MoU).
3. The due process including a MoU should be endorsed with an action plan before applying to the Nepal Rastra Bank for a Letter of Intent (LOI). The NRB should hold a meeting within 15 days of receiving the LOI application.
4. The NRB has a right to grant whether to approve the LOI or not after meeting discussion and detailed study of the concerned financial institution.
5. After receiving a LOI from the central bank a due diligence audit should be completed within six months.

6. The detailed evaluation comprising assets, liabilities and transactions of the concerned institutions should be submitted to the NRB

7. An agreement copy of the final decision regarding name, address and share ratio of concerned the BFIs should be submitted to the NRB.

8. An action plan of the concerned financial institution including date of operation after merger is completed should be submitted to the NRB.

## 3.3 Steps in merger process of Nepalese banks and financial Institutions:

The steps in the merger process of Nepalese banks and financial institutions are:

1. Formation of merger committee

There will be formation of the committee including the directors from all the BFIs that are subjected to merge.

2. Special Annual General Meeting

Here, the AGM will be held with the discussion of objectives and reasons to the shareholders. The decision will be taken into consideration only if majority of shareholders agree on it.

3. Memorandum of Understanding

It explains the future plans after merger backed up by at least two third of consensus and also is used as a tool for legal commitment. This is submitted to Nepal Rastra Bank for merger.

4. Application to Nepal Rastra Bank for merger

Application is submitted to Nepal Rastra Bank stating current positions of the companies and their future objectives after merger.

5. Due diligence report

Prepared by the independent third party audit firm, it explains the information regarding net worth, capital adequacy, liquidity condition, types of loans and the like of the companies

6. Final approval

The decision regarding merger is done by Nepal Rastra Bank based upon financial statements, memorandum of understanding, valuation of companies' asset and liabilities, location details and name of the companies about merge along with share valuation report, business plan after merger and the like.

## 3.4 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.

# CHAPTER: 4 HYPOTHESIS GENERATION AND CONCEPTUAL FRAMEWORK

## 4.1 Introduction

Deciding to opt for merger (and acquisition) have been like a trend in the economic climate of Nepal. However, decisions to go for merger and acquisition is one complex decision for the banks. While the merger and acquisition seem to be negative at first, it comes with the package of risk sharing as well as high performance and high market share. Bank analysts, economists, and business press usually characterize bank merger wave as inevitable, triggered by the larger banks´ need to gain economies of scale in their banking operation, and they frequently observe that it will eliminate excess capacity without hurting the customers. With the execution of merger and acquisition, there comes the advantage with regards to large scale operation, efficiency in performance, as well as up gradation of the teamwork within the bank. However, the risk related to poor culture fit, customer perception, risk sharing related problems etc. should be taken into consideration.

After going through various factors as discussed in the literature review, the various general and specific variables have been taken into consideration for hypotheses. These hypotheses are related to the banks that decide to acquire other banks or financial institutions, or decide to merge with them. Such hypotheses and variables are described below:

## 4.2 Dependent variable:

The decision to go for merger and acquisition is the dependent variable resulting from various other factors. The banks would decide to perform merger and acquisition activities if they consider various influencing factors in the form of independent variables. However, there is no previous studies regarding it and this variable is assumed by authors.

## 4.3 Independent variables and corresponding hypotheses:

The independent variables consist of various factors obtained as a part of general merger and acquisition scenario and specific banking scenario, which are described below:

1. **Emphasis on increasing income:**

In case of merger, for the companies that are buying up, the income would increase as they would be able to expand their activities after merger. For the companies that are being bought up, they dive into a bigger area because of merger with bigger company and thus, are able to increase their income by reducing duplication of efforts.

For acquisition, in case of friendly takeover, the acquirer wants to acquire the company if it sees the chance of increasing income by acquiring the target firm. The offeror wants to let itself be acquired if there are chances of income synergies from the process. In case of hostile takeover, the acquirer takes every steps possible to acquire the target firm even though the target company tries to oppose it; if the acquirer sees the income synergies. Literature of Coyle (2000) support this argument that the companies would decide to go for merger and acquisition if they want to increase the income. Accordingly, we propose:

H1: There is positive relationship between emphasis for increasing income and merger and acquisition decision.

2. **Emphasis on Increasing sales of services:**

The companies can expand their services by the help of merger and acquisition. They can expand their branches at various places by this activity. Increasing sales of services concern the company buying up because they do not need to pay extra for expansion of services. Similarly, it concerns the company being bought up because it can have access to various locations from the company that is buying it up. Thus, is case of both merger and friendly acquisition, the sale of services can increase. In case of hostile acquisition, the acquiring company sees this as beneficial rather than target company, as the target company tries to save itself from being acquired. Novickytė and Predroja (2015) have supported the argument that sales of services is the factor for banks to consider merger and acquisition decision. Thus, our second hypothesis is:

H2: There is positive relationship between emphasis on increasing sales of services and merger and acquisition decision.

3. **Emphasis on financial diversification:**

In case of merger, financial diversification concerns the company buying up because it can utilize its excess capital for expansion of services thereby leading to growth of the company. Similarly, financial diversification concerns the company being bought up because it can attain profit even with the use of less capital as the requirement will be fulfilled by the company buying it up.

Similar is the case of friendly and hostile acquisition in which the acquirer can use its excess capital by investing in the target company in order to create financial diversification. Morck

(1990) support the argument that financial diversification is one of the cause for banks to consider merger and acquisition decision. Thus, we propose:
H3: There is positive relationship between emphasis on financial diversification and merger and acquisition decision.

4. **Emphasis on cost efficiency:**

In the case of merger, cost efficiency concerns the company buying it up in a way that its duplication of costs can be minimized. Similarly, cost efficiency concerns the company being bought up in a way that it does not need to increase its capacity (which leads to increase in cost) in order to increase its sales.
In the case of both friendly and hostile acquisition, the acquirer can obtain larger capacity by minimal effort (which means lesser cost) by obtaining target company rather than establishing new one. Novickytė and Predroja (2015) argue that if banks want to achieve cost efficiency, they would go for merger and acquisition. Thus our fourth hypothesis is:

H4: There is positive relationship between emphasis on cost efficiency and merger activities.

5. **Emphasis on obtaining stronger position in market:**

In the case of merger, in case of company buying up, this factor is concerned as it can eliminate the competitors in the market. In case of company being bought up, it can obtain a better position in the market and increase its size by going for merger, thereby making it one of the considerable factors.
In case of friendly acquisition, the acquirer wants to obtain larger share in the market for which it wants to acquire the target company, and it gets the green signal from target company. In case of hostile acquisition, the acquirer will try every way possible to acquire the target company even though getting opposition from the target company. Smirnova (2014) also argue that in order to obtain strong position in market, the companies would prefer to make merger and acquisition decision. Accordingly, we propose:

H5: There is positive relationship emphasis on obtaining strong position in market and merger and acquisition decision.

6. **Emphasis on better branding:**

This factor particularly affects the company being bought up because branding requires investment of time and money and if the company wants to obtain brand with less hassles, then the merger with prestigious company can be the best solution. Also, the company buying it can see that it can obtain better position in market because of the increment of customers from the company being bought up by going through merger and acquisition.

In case of friendly acquisition, the acquirer is supposed to have better positioning in customers' mind when it goes for acquisition and it has support from the target company. In case of hostile acquisition, the acquirer does not have support from the target company to obtain better positioning. Novickytė and Predroja (2015) argue that branding is one of the factors affecting merger and acquisition decision. Therefore, our sixth hypothesis is:

H6: There is positive relationship between emphasis on better branding and merger activities

### 7. Using merger and acquisition as a means of security

Merger and acquisition is performed in order be secure from the competitors. In order to obtain competitive advantage as well as exploit unique selling points, going for subcontracting (providing certain job responsibility to parties outside organization) is not the long term solution. Such subcontract need not necessarily be related to technology but also to human capital, service methods etc. Therefore, one better way to obtain such competitive advantage is looking for merging or acquiring other companies so that in one hand the control can be maintained, and in the other hand competitive advantage can be obtained. Security is considered to be a factor for merger for the company buying up because there will be involvement of better human as well as capital resources from the company being bought up in order to provide better services to the market thereby making the company successful. Similarly, the company being bought up can have better access to the market for providing its services to larger number of customers after the merger thereby making the company successful. In case of friendly acquisition, the acquirer wants to acquire the target in order to minimize the competitor by taking it over so that in one hand the competitor is phased out and in the other hand, the company will be able to acquire the resources from the target company with full participation from target company. In case of hostile acquisition, this step is a bit harder as there is no support from the target company. William (2009), Ghoshal (1987) argue that security is one of the factors affecting merger and acquisition decision. Thus, our seventh hypothesis is:

H7: There is positive relationship between striving for Security and merger and acquisition activities.

8. **Fulfilling the requirements of regulation from regulatory authorities**

If the regulatory authorities provide a situation for which merger and acquisition can only be the solution, then the companies will follow it. For example, if the central bank makes a law that in order to remain in the status of commercial bank, there should be certain number of branches to be opened within a certain geographical area within given time frame. In such case, the companies can go through merger and acquisition in order to fulfill the criteria. This is an essential factor considered by both the company buying up and being bought up for merger or acquisition because merger or acquisition can be the easiest way to fulfill the requirement imposed by the central banks. Smirnova (2014) argue that decision to go for merger and acquisition result from obeying rules from authorities. Accordingly, we propose:

H8: There is positive relationship between fulfilling regulation requirement from regulatory authorities and merger and acquisition decision.

9. **Emphasis on maintaining capital requirement**

Liquidity management can be considered as a factor for merger by the company buying up because it requires to utilize the liquidity surplus as a result from the rules by the central bank and it is a factor for merger by the company being bought up because it may have to handle the liquidity crisis obtained from the rules imposed by the central bank. In case of friendly acquisition also, the banks may acquire other banks in order to maintain the liquidity ratio with the target banks allowing them to do it. In case of hostile acquisition, the target banks do not allow the acquirers to do so, but the plan succeed or fail depends upon other critical factors. This concept is adapted from Smirnova (2014) argue that companies would go for merger and acquisition to have better access to resources. Thus, our ninth hypothesis is:

H9: There is positive relationship between emphasis on maintaining capital requirement and merger and acquisition activities.

## 4.4 Conceptual framework:

As per the description shown in above lines, the framework of this paper is based upon finding out the relationship between the factors affecting merger and acquisition decision. The factors affecting the merger and acquisition decision are the ones that affect both party prior merger and acquisition execution. The framework is summed up in the following figure:

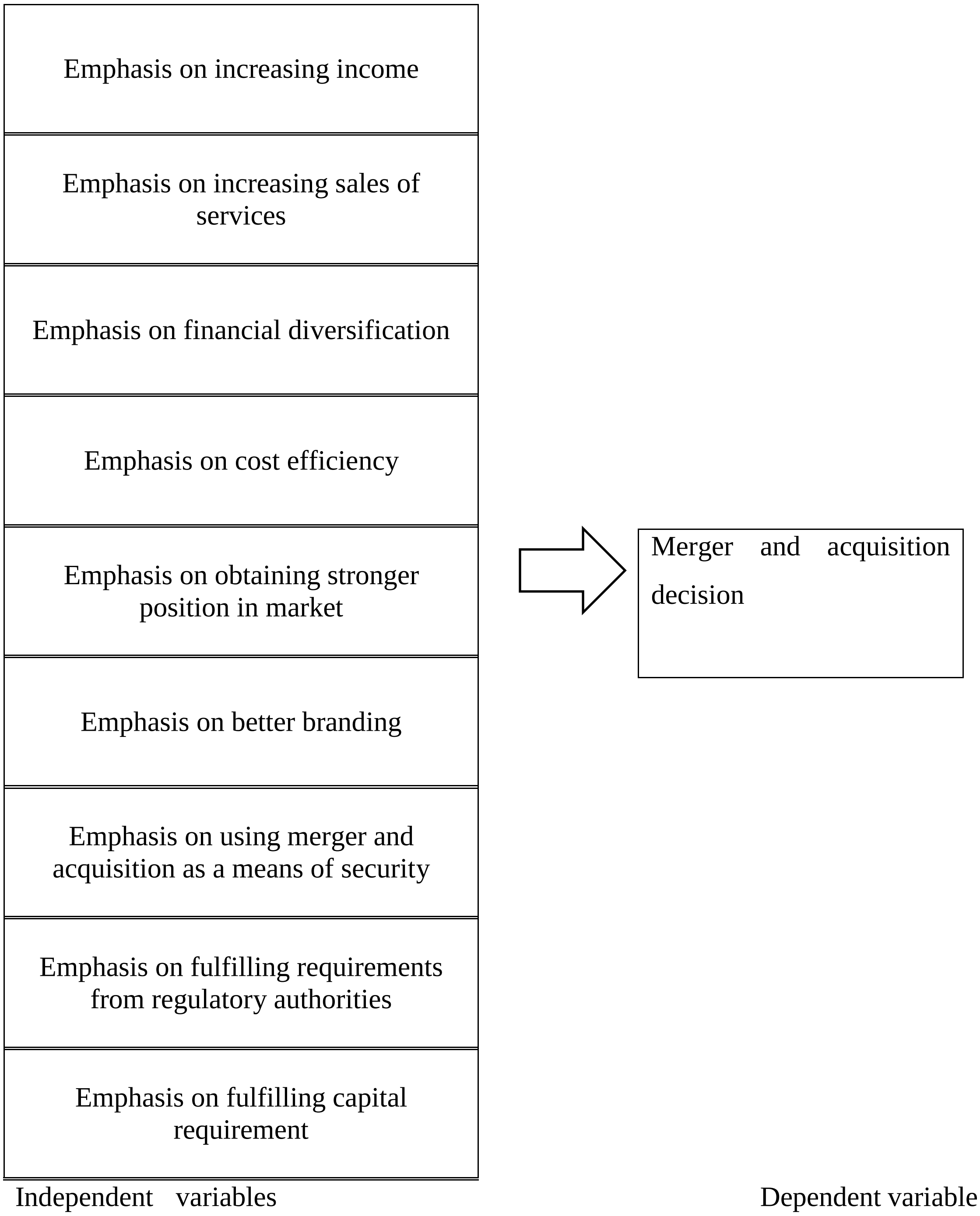



Figure 2: Conceptual framework showing the variables affecting merger and acquisition decision

As shown in the figure above, the various common factors leading to merger and acquisition activities are the dominant ones. The research will focus on whether these factors are relevant in the Nepalese banking and financial sector or not.

# CHAPTER 5: RESEARCH METHODOLOGY

This chapter deals with the methodologies used for research purpose as well as the detailed discussion about the procedures followed, methods and designs for the data collection for this research.

## 5.1 Data collection and empirical context

The process of thesis writing is considered to have started from defining the research questions, finding out of the variables involved, usage of various data collection methods and analysis of such data in order to obtain the conclusions/results.

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 analysis and the collection method of data was on 5 point Likert scale.

In order to collect the data, the whole banking scenario of Nepalese banking sector have been taken into consideration. Nepalese banking sector consists of banks of four types: commercial, development, financial institutions and micro finance development banks; each having their unique role in the banking service and development of Nepal which have been described in previous chapters. As stated, the number of banking and financial institutions witnessed a huge rise after the policies to encourage private sector participation in 1980. With the number increasing in high manner, the need to control for it was felt by Nepal Rastra Bank and thus, merger and acquisition Act was introduced in 2068 B.S. However, the factors affecting this scenario of merger and acquisition between and among banks have not been studied so far. The data collection here is done in such way that the views of experts working in various high level positions in Nepalese banking sector is taken in numerical form and is further analyzed to find out the significance of relationship among various factors with the decision to go for merger and acquisition.

**Population**

Population is referred to as a certain or specific group of individual units like a person, organization, family and the like; such group taken into consideration for definite study. For this thesis, the views of 200 people who are currently working in the position of either Member of Board of Directors or Senior management or owner/executive/corporate level were collected although it had been distributed to 250 informants. These people are the experts in their field and thus are able to provide information regarding the factors affecting merger and acquisition in Nepalese banking sector.

**Sampling frame**

The next step after defining the population is to find out the sampling frame. Sampling frame refers to the method of listing required elements in order to draw the actual sample. In the case of this thesis, the list of all banks of Nepal were considered.

**Sampling procedure**

For the purpose of data collection, non-probability sampling method was used. Convenience sampling method was used as the part of non-probability sampling method for its appropriateness in collecting the data. The sampling was done on non-probability sampling method because there was necessity of informants (experts on banking sector) rather than mere respondents. Under this method of data collection, those data that were obtained from the population who are voluntarily willing to participate; were studied. Also, there was no modification involved. For the purpose of collecting data, structured questionnaires were developed and the informants would choose from among the options available in the questionnaires in the structural manner.

**Sample size**

While determining the sample size, various factors needs to be taken into consideration such as time, money, methods and so on. Out of planned 250 responses, 200 responses were able to be collected and thus were taken as sample size for this research as it was found to be more convenient. The response rate was 80 percent. The sample size or the case should be of minimum 200 as suggested by MacCallum et al. (1999).

**Nature of instruments**

The structural questionnaires were divided into two parts:

- Part 1: It consisted of the background of respondents such as gender, bank category, name of bank, current job level, educational level and years of experience. The purpose was to find out whether they belong to minimum acceptable requirement for data collection or not.
- Part 2: It consisted of the list of 45 statements that would address 9 hypotheses with each hypothesis getting 5 statements on the form of 5 point Likert scale with 1 as the highest level of disagreement and 5 as the highest level of disagreement. Similarly, 5 statements addressing merger and acquisition decision as dependent variables was also defined here.

## 5.2 Data collection methods and tools:

The survey was carried out in major parts of Nepal from August 12$^{th}$ until September 27$^{th}$, 2016. The consent was taken voluntarily from the informants and only those informants who agreed, were provided with the questionnaire. The response on the questionnaire was taken face-to-face on most of the cases while some responses were also received from email. Mostly Nepalese language was the medium of communication while describing the questionnaire but the data was collected in English. 250 questionnaires had been distributed out of which 200 informants filled up the questionnaire. 163 responses were collected face-to-face while 37 were collected through email. The respondents were met in the office hour with most of the meetings prefixed through telephone. Most of the respondents filled up the questionnaire at the same time of meeting while few of them sent the filled up questionnaires in email later on. Such questionnaire sent later on as email were considered to be obtained as email and not face-to-face.

## 5.3 Measurement of variables

Likert scale was used to enter the responses in each sub variables (items) of the variables. The scale was divided as: 1-strongly disagree, 2-disagree, 3-neutral, 4-agree, 5-strongly agree. Some of the questions in the questionnaires had been transformed into negative ones in order for the respondents to respond effectively. They were later retransformed into positive ones. The variables used and their statements are as follows:

**Independent variables**

**Emphasis on increasing income**

1. Merger and acquisition may increase the net interest income (difference in revenue resulting from bank's assets and expenses associated with paying out its liabilities) of banks.
2. Merger and acquisition may increase the non-interest income (income resulting from deposits, fees, service charges, deposit slip fees etc.) of banks.
3. Economies of scale (providing more services at proportionate saving in costs) may not be obtained through merger and acquisition.
4. Multiple sources of income or economies of scope (providing two or more distinct services with less cost had they been done individually) can be introduced with the help of merger and acquisition.
5. Merger and acquisition helps to increase the customer activity (such as increase in opening bank accounts, banking transaction, use of safe deposits etc).

**Emphasis on service**

6. Opening of banks' branches would not be easier because of merger and acquisition.
7. In order to provide new services to customers, merger and acquisition is one of the easiest option.
8. Merger and acquisition is not an effective tool for executing the Expansion strategy (attempting to achieve high growth with comparison to previous achievement) of the banks.
9. Merger and acquisition makes it possible for the banks reach new customers easily together than they could have done alone.
10. Merger and acquisition is one of the effective tool to understand and apply the methods of providing more services to more customers.

**Emphasis on cost efficiency**

11. Merger and acquisition does not help to minimize the duplication of efforts.
12. Merger and acquisition is done in order to reduce the overall weakness of the merged/acquired banks.
13. Merger and acquisition does not make it possible to eliminate branch overlapping.
14. In order to reduce unnecessary managerial as well as operational positions, merger and acquisition among banks can be done.

15. In order to produce more without increasing the individual capacity of banks, merger and acquisition is performed.

**Emphasis on financial diversification**

16. In order to provide different types of products/services to the customers, merger and acquisition is done.
17. In order to achieve success in key area of operations, merger is done with banks having deeper market penetration i.e. banks whose services have high customer usage in market.
18. Merger and acquisition is not performed for the sake of managing the financial complexities (example: managing the non-performance of certain services),.
19. Merger and acquisition does not have any role in creating portfolio of banks' products/services.
20. In order to minimize the risk in the market, merger and acquisition is performed by banks as a part of related diversification (activities that are similar to the one currently offered).

**Emphasis on market positioning**

21. In order to obtain power to exclude rivals, banks go through merger and acquisition.
22. Merger and acquisition does not have any role to capture market share.
23. Merger and acquisition are not an effective tool for eliminating competition.
24. Merger and acquisition does not make it easier for companies to obtain better position by increasing its size.
25. Merger and acquisition helps the banks to achieve unique selling proposition (factor that distinguish product from that of competitors) by combining successful services from them before merger and acquisition.

**Emphasis on branding**

26. Merger and acquisition is done to increase the positioning of banks in the mind of the customers.
27. Merger and acquisition makes it possible to gain image of banks with less activities to be performed than had they done individually.
28. Merger and acquisition can not help to obtain branding of banks within short span of time.

29. Merger and acquisition helps to create the brand of banks with involvement of less cost than had it been done individually.
30. Merger and acquisition does not make it easy for the advertisement of banks to reach to the large number of consumers than had it been done alone.

**Emphasis on security**

31. Merger and acquisition does not have any role in  sharing the risks of the banks.
32. Technical, human resource as well as other significant capabilities can be utilized to higher potential by the help of merger and acquisition.
33. Merger and acquisition is not a significant tool to provide products/services to the consumers without having the banks to get exposed to some sort of loss of control (such as in sub-contracting).
34. In order to be secure from the competitors' strategies, merger and acquisition can be performed.
35. Merge and acquisition does not have any role to make banks secure from various environmental factors such as economical, political, socio-cultural as well as technological factors.

**Emphasis on regulation**

36. Merger and acquisition trend in Nepal did not arise because of the restriction regarding opening of branches (opening branch in Kathmandu is allowed only after two branches have been opened outside).
37. Providing short period of time (one year) to increase the paid-up capital by NRB (Nepal Rastra Bank) has led to merger and acquisition of banks.
38. As a part of plan to get the banking sector out from certain group of people only, NRB (Nepal Rastra Bank) has made regulation for merger and acquisition.
39. NRB (Nepal Rastra Bank) levied strict merger and acquisition policy because the number of banking and financial institutions were more than required by the economy of Nepal.
40. Merger and acquisition policy executed by NRB (Nepal Rastra Bank) has nothing to do with easing the monitoring activities of banks of Nepal.

**Emphasis on maintaining capital requirement**

41. The order from NRB (Nepal Rastra Bank) to fulfil capital requirement (NRs. 8 billion for commercial banks, 2.5 billion for development banks, 300-800 million for finance companies) has led to merger and acquisition.
42. The requirement to fulfil the liquidity ratio of at least 20 percent and cash reserve ratio of at least 5 percent has led to merger and acquisition among the banks.
43. It is easier for banks to go for merger and acquisition than to issue the shares (obtaining so much money to the banks in short period of time would be very hard).
44. Going for merger and acquisition does not make any difference for banks having trouble with capital requirement to meet the criteria.
45. Fulfilling capital requirement from issuing debentures will not have more burden for the banks than going for merger and acquisition.

**Dependent variable statements**

1. Merger and acquisition decision of bank is undertaken in order to be secure from competitors and provide better services.
2. Merger and acquisition decision of bank is undertaken to obtain synergy from banks' complementary skills and weaknesses.
3. Decision to go for merger and acquisition by bank is taken if the banks want to reduce various types of costs involved (can be related to investment or operational).
4. Merger and acquisition decision is undertaken if the banks want to increase capital with less hassle.
5. Banks decide to go for merger and acquisition if the banks want to diversify their services with less hassle.

## 5.4 Description of informants

Some of the basic descriptions of informants are as follows:

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | male | 133 | 66,5 | 66,5 | 66,5 |
| | female | 67 | 33,5 | 33,5 | 100,0 |
| | Total | 200 | 100,0 | 100,0 | |

Table 4: Gender information of informants

Out of the informants, 133 were male and 67 were female, thereby male holding 66.5 percent and female holding 33.5 percent of total response.

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Commercial | 40 | 20,0 | 20,0 | 20,0 |
| | Development | 58 | 29,0 | 29,0 | 49,0 |
| | Financial institution | 64 | 32,0 | 32,0 | 81,0 |
| | micro finance development bank | 38 | 19,0 | 19,0 | 100,0 |
| | Total | 200 | 100,0 | k100,0 | |

Table 5: Number of informants from banks of various categories

Among the response collected, 40 of them were from commercial banks, 58 from development banks, 64 from financial institutions and 38 from microfinance development banks. The development banks held highest number of response with 49 percent while response from commercial bank was least with 20 percent. However, the collections are in proportion with the number of banks under different categories.

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | owner/exe/c-level | 54 | 27,0 | 27,0 | 27,0 |
| | senior mgmt | 118 | 59,0 | 59,0 | 86,0 |
| | BoD member | 28 | 14,0 | 14,0 | 100,0 |
| | Total | 200 | 100,0 | 100,0 | |

Table 6: Job level of informants working at various banks

The obtained informant shows that 54 of informants are from owner/ executive/c-level, 118 from senior level and 28 from Board of Directors category. All of them belong to more of less the decision level of the banks to which they belong.

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | masters | 133 | 66,5 | 66,5 | 66,5 |
| | bachelors | 61 | 30,5 | 30,5 | 97,0 |
| | high school | 6 | 3,0 | 3,0 | 100,0 |
| | Total | 200 | 100,0 | 100,0 | |

Table 7: Education level of informants

Among the informants, 133 of them have Masters degree, 61 of them have Bachelors degree and 6 of them have passed high school.

| Descriptive Statistics | | | | |
|---|---|---|---|---|
| | N | Minimum | Maximum | Mean |
| yrs_served | 200 | 2 | 19 | 10.57 |
| Valid N (listwise) | 200 | | | |

Table 8: Descriptive information of years served in banking sector

As per the information obtained, the the minimum number of years served is 2 years while the maximum number is 19 years with 10.57 years as the average number of years served in the banking sector.

## 5.5 Reliability analysis of factors affecting merger and acquisition decision along with concept of Factor analysis

Reliability refers to the ability of questionnaire to make a constant measurement of data across various population at various periods of time. One of the best methods for measuring such reliability is Cronbach's alpha, the value of which falls into the range of 0-1 with measure towards 0 referring to the test becoming unreliable and the measure towards 1 referring to the test becoming reliable.

Factor analysis is used to analyze the correlation among the variables by the method of providing common dimensions, also known as factors. Factor analysis helps to remove unnecessary variables and find out the definite variables for further analysis. Based upon the Rotated Component Matrix obtained from Factor analysis, only those factors factors with value of factors above 0.5 are chosen.

The table below illustrates the reliability analysis of the statements of the variable:

| S.no | Items | Nature | Highest Cronbach's alpha and variable name | Accepted/ Rejected |
|---|---|---|---|---|
| 1 | Merger and acquisition may increase the net interest income (difference in revenue resulting from bank's assets and expenses associated with paying out its liabilities) of banks. | Independent | Emphasis on increasing income<br><br>0.840 | rejected |
| 2 | Merger and acquisition may increase the non-interest income (income resulting from deposits, fees, service charges, deposit slip fees etc.) of banks. | Independent | | accepted |
| 3 | Economies of scale (providing more services at proportionate saving in costs) may not be obtained through merger and acquisition. | Independent | | accepted |
| 4 | Multiple sources of income or economies of scope (providing two or more distinct services with less cost had they been done individually) can be introduced with the help of merger and acquisition. | Independent | | accepted |
| 5 | Merger and acquisition helps to increase the customer activity (such as increase in opening bank accounts, banking transaction, use of safe deposits etc). | Independent | | rejected |
| 6 | Opening of banks' branches would not be easier because of merger and acquisition. | Independent | Emphasis on service<br>0.878 | accepted |
| 7 | In order to provide new services to customers, merger and acquisition is one of the easiest option. | Independent | | accepted |
| 8 | Merger and acquisition is not an effective tool for executing the Expansion strategy (attempting to achieve high growth with comparison to previous achievement) of the banks. | Independent | | accepted |
| 9 | Merger and acquisition makes it possible for the banks reach new customers easily together than they could have done alone. | Independent | | accepted |
| 10 | Merger and acquisition is one of the effective tool to understand and apply the methods of providing more services to more customers. | Independent | | accepted |
| 11 | Merger and acquisition does not help to minimize the duplication of efforts. | Independent | Emphasis on cost efficiency<br>0.763 | accepted |
| 12 | Merger and acquisition is done in order to reduce the overall weakness of the merged/acquired banks. | Independent | | accepted |
| 13 | Merger and acquisition does not make it possible to eliminate branch overlapping. | Independent | | accepted |
| 14 | In order to reduce unnecessary managerial as well as operational positions, merger and acquisition among banks can be done. | Independent | | accepted |
| 15 | In order to produce more without increasing the individual capacity of banks, merger and acquisition is performed. | Independent | | accepted |
| 16 | In order to provide different types of products/services to the customers, merger and acquisition is done. | Independent | | accepted |

| | | | | |
|---|---|---|---|---|
| 17 | In order to achieve success in key area of operations, merger is done with banks having deeper market penetration i.e. banks whose services have high customer usage in market . | Independent | Emphasis on financial diversification<br><br>0.613 | accepted |
| 18 | Merger and acquisition is not performed for the sake of managing the financial complexities (example: managing the non-performance of certain services),. | Independent | | accepted |
| 19 | Merger and acquisition does not have any role in creating portfolio of banks' products/services. | Independent | | accepted |
| 20 | In order to minimize the risk in the market, merger and acquisition is performed by banks as a part of related diversification (activities that are similar to the one currently offered). | Independent | | accepted |
| 21 | In order to obtain power to exclude rivals, banks go through merger and acquisition. | Independent | Emphasis on market positioning<br><br>0.681 | accepted |
| 22 | Merger and acquisition does not have any role to capture market share. | Independent | | accepted |
| 23 | Merger and acquisition are not an effective tool for eliminating competition. | Independent | | accepted |
| 24 | Merger and acquisition does not make it easier for companies to obtain better position by increasing its size. | Independent | | rejected |
| 25 | Merger and acquisition helps the banks to achieve unique selling proposition (factor that distinguish product from that of competitors) by combining successful services from them before merger and acquisition. | Independent | | accepted |
| 26 | Merger and acquisition is done to increase the positioning of banks in the mind of the customers. | Independent | Emphasis on branding 0.781 | accepted |
| 27 | Merger and acquisition makes it possible to gain image of banks with less activities to be performed than had they done individually. | Independent | | accepted |
| 28 | Merger and acquisition can not help to obtain branding of banks within short span of time. | Independent | | accepted |
| 29 | Merger and acquisition helps to create the brand of banks with involvement of less cost than had it been done individually. | Independent | | accepted |
| 30 | Merger and acquisition does not make it easy for the advertisement of banks to reach to the large number of consumers than had it been done alone. | Independent | | rejected |
| 31 | Merger and acquisition does not have any role in sharing the risks of the banks. | Independent | Emphasis on security<br><br>0.766 | accepted |
| 32 | Technical, human resource as well as other significant capabilities can be utilized to higher potential by the help of merger and acquisition. | Independent | | accepted |
| 33 | Merger and acquisition is not a significant ttool to provide products/services to the consumers without having the banks to get exposed to some sort of loss of control (such as in sub-contracting). | Independent | | accepted |
| 34 | In order to be secure from the competitors' strategies, merger and acquisition can be performed. | Independent | | accepted |
| 35 | Merge and acquisition does not have any role to make banks secure from various environmental factors such as economical, political, socio-cultural as well as technological factors. | Independent | | rejected |
| 36 | Merger and acquisition trend in Nepal did not arise because of the restriction regarding opening of branches (opening branch in Kathmandu is allowed only after two branches have been opened outside). | Independent | | Accepted |

| | | | | |
|---|---|---|---|---|
| 37 | Providing short period of time (one year) to increase the paid-up capital by NRB (Nepal Rastra Bank) has led to merger and acquisition of banks. | Independent | Emphasis on regulation<br><br>0.546 | Accepted |
| 38 | As a part of plan to get the banking sector out from certain group of people only, NRB (Nepal Rastra Bank) has made regulation for merger and acquisition. | Independent | | Accepted |
| 39 | NRB (Nepal Rastra Bank) levied strict merger and acquisition policy because the number of banking and financial institutions were more than required by the economy of Nepal. | Independent | | Accepted |
| 40 | Merger and acquisition policy executed by NRB (Nepal Rastra Bank) has nothing to do with easing the monitoring activities of banks of Nepal. | Independent | | Accepted |
| 41 | The order from NRB (Nepal Rastra Bank) to fulfil capital requirement (NRs. 8 billion for commercial banks, 2.5 billion for development banks, 300-800 million for finance companies) has led to merger and acquisition. | Independent | Emphasis on maintaining capital adquacy 0.77 | Accepted |
| 42 | The requirement to fulfil the liquidity ratio of at least 20 percent and cash reserve ratio of at least 5 percent has led to merger and acquisition among the banks. | Independent | | Accepted |
| 43 | It is easier for banks to go for merger and acquisition than to issue the shares (obtaining so much money to the banks in short period of time would be very hard). | Independent | | Accepted |
| 44 | Going for merger and acquisition does not make any difference for banks having trouble with capital requirement to meet the criteria. | Independent | | Accepted |
| 45 | Fulfilling capital requirement from issuing debentures will not have more burden for the banks than going for merger and acquisition. | Independent | | accepted |
| | | | | |
| 1 | Merger and acquisition decision of bank is undertaken in order to be secure from competitors and provide better services. | Dependent | Merger and acquisition 0.839 | Rejected |
| 2 | Merger and acquisition decision of bank is undertaken to obtain synergy from banks' complementary skills and weaknesses. | Dependent | | Accepted |
| 3 | Decision to go for merger and acquisition by bank is taken if the banks want to reduce various types of costs involved (can be related to investment or operational). | Dependent | | Accepted |
| 4 | Merger and acquisition decision is undertaken if the banks want to increase capital with less hassle. | Dependent | | Accepted |
| 5 | Banks decide to go for merger and acquisition if the banks want to diversify their services with less hassle. | Dependent | | accepted |

Table 9: Result from reliability analysis

The above table shows the reliability analysis of the dependent and independent variables based upon their items. Based upon the highest Cronbach's alpha for each statements, the items/ statements are either rejected or accepted for factor analysis. The highest alpha is based upon the deletion of rejected items. The value of Cronbach's alpha shown in the table above is after the rejected statements are deleted. Emphasis on fulfilling regulation requirement from regulatory authorities had the alpha of 0.546 only. However, it is considered for further analysis because it is supposed to be informative and not reflective.

## 5.6 KMO analysis of all independent variables and dependent variable

Kaiser-Meyer-Olkin, or KMO is the measure which shows whether the data is okay for further analysis or not based upon the value. Its value ranges up to 1. The values below 0.5 are rejected and above 0.5 are considered for further analysis After the rejection of various sub variables or items under the reliability analysis, the accepted sub variables or items are checked with their KMO value and factor loading. The table below illustrates it:

| Independent variable | Sub variable | Items | KMO | factor loading |
|---|---|---|---|---|
| Emphasis on increasing income | inc2 | Merger and acquisition may increase the non-interest income (income resulting from deposits, fees, service charges, deposit slip fees etc.) of banks. | | .841 |
| | inc3 | Economies of scale (providing more services at proportionate saving in costs) may not be obtained through merger and acquisition. | | .924 |
| | inc4 | Multiple sources of income or economies of scope (providing two or more distinct services with less cost had they been done individually) can be introduced with the help of merger and acquisition. | .670 | .851 |
| Emphasis on service | service1 | Opening of banks' branches would not be easier because of merger and acquisition. | .798 | .753 |
| | service2 | In order to provide new services to customers, merger and acquisition is one of the easiest option. | | .912 |
| | service3 | Merger and acquisition is not an effective tool for executing the Expansion strategy (attempting to achieve high growth with comparison to previous achievement) of the banks. | | .742 |
| | service4 | Merger and acquisition makes it possible for the banks reach new customers easily together than they could have done alone. | | .911 |
| | service5 | Merger and acquisition is one of the effective tool to understand and apply the methods of providing more services to more customers. | | .764 |
| Emphasis on cost efficiency | CostEff1 | Merger and acquisition does not help to minimize the duplication of efforts. | | .645 |
| | CostEff2 | Merger and acquisition is done in order to reduce the overall weakness of the merged/acquired banks. | | .695 |
| | CostEff3 | Merger and acquisition does not make it possible to eliminate branch overlapping. | | .762 |
| | CostEff4 | In order to reduce unnecessary managerial as well as operational positions, merger and acquisition among banks can be done. | | .777 |
| | CostEff5 | In order to produce more without increasing the individual capacity of banks, merger and acquisition is performed. | .714 | .725 |
| Emphasis on financial diversification | FinDiv1 | In order to provide different types of products/services to the customers, merger and acquisition is done. | | .597 |
| | FinDiv2 | In order to achieve success in key area of operations, merger is done with banks having deeper market penetration i.e. banks whose services have high customer usage in market . | | .787 |
| | FinDiv3 | Merger and acquisition is not performed for the sake of managing the financial complexities (example: managing the non-performance of certain services),. | | .763 |
| | FinDiv4 | Merger and acquisition does not have any role in creating portfolio of banks' products/services. | | .532 |
| | FinDiv5 | In order to minimize the risk in the market, merger and acquisition is performed by banks as a part of related diversification (activities that are similar to the one currently offered). | .548 | .433 |
| | MktPos1 | In order to obtain power to exclude rivals, banks go through merger and acquisition. | .663 | .766 |

| | | | | |
|---|---|---|---|---|
| Emphasis on market positioning | MktPos2 | Merger and acquisition does not have any role to capture market share. | | .803 |
| | MktPos3 | Merger and acquisition are not an effective tool for eliminating competition. | | .688 |
| | MktPos5 | Merger and acquisition helps the banks to achieve unique selling proposition (factor that distinguish product from that of competitors) by combining successful services from them before merger and acquisition. | | .607 |
| Emphasis on branding | Brand1 | Merger and acquisition is done to increase the positioning of banks in the mind of the customers. | | .767 |
| | Brand2 | Merger and acquisition makes it possible to gain image of banks with less activities to be performed than had they done individually. | | .734 |
| | Brand3 | Merger and acquisition can not help to obtain branding of banks within short span of time. | | .790 |
| | Brand4 | Merger and acquisition helps to create the brand of banks with involvement of less cost than had it been done individually. | .764 | .821 |
| Emphasis on security | Security1 | Merger and acquisition does not have any role in sharing the risks of the banks. | | .716 |
| | Security2 | Technical, human resource as well as other significant capabilities can be utilized to higher potential by the help of merger and acquisition. | | .797 |
| | Security3 | Merger and acquisition is not a significant ttool to provide products/services to the consumers without having the banks to get exposed to some sort of loss of control (such as in sub-contracting). | | .795 |
| | Security4 | In order to be secure from the competitors' strategies, merger and acquisition can be performed. | .773 | .756 |
| Emphasis on regulation | Regulation1 | Merger and acquisition trend in Nepal did not arise because of the restriction regarding opening of branches (opening branch in Kathmandu is allowed only after two branches have been opened outside). | | .510 |
| | Regulation2 | Providing short period of time (one year) to increase the paid-up capital by NRB (Nepal Rastra Bank) has led to merger and acquisition of banks. | | .783 |
| | Regulation3 | As a part of plan to get the banking sector out from certain group of people only, NRB (Nepal Rastra Bank) has made regulation for merger and acquisition. | | .562 |
| | Regulation4 | NRB (Nepal Rastra Bank) levied strict merger and acquisition policy because the number of banking and financial institutions were more than required by the economy of Nepal. | | .599 |
| | Regulation5 | Merger and acquisition policy executed by NRB (Nepal Rastra Bank) has nothing to do with easing the monitoring activities of banks of Nepal. | .535 | .498 |
| Emphasis on maintaining | CapitalReqm 1 | The order from NRB (Nepal Rastra Bank) to fulfil capital requirement (NRs. 8 billion for commercial banks, 2.5 billion for development banks, 300-800 million for finance companies) has led to merger and acquisition. | | .719 |
| | CapitalReqm 2 | The requirement to fulfil the liquidity ratio of at least 20 percent and cash reserve ratio of at least 5 percent has led to merger and acquisition among the banks. | | .669 |
| | CapitalReqm 3 | It is easier for banks to go for merger and acquisition than to issue the shares (obtaining so much money to the banks in short period of time would be very hard). | .816 | .757 |

| | | | | |
|---|---|---|---|---|
| capital adquacy | CapitalReqm 4 | Going for merger and acquisition does not make any difference for banks having trouble with capital requirement to meet the criteria. | | .739 |
| | CapitalReqm 5 | Fulfilling capital requirement from issuing debentures will not have more burden for the banks than going for merger and acquisition. | | .723 |
| | | | | |
| | **Dependent sub Variables** | **Items** | **KMO** | **factor loading** |
| Merger and acquisition | MA2 | Merger and acquisition decision of bank is undertaken to obtain synergy from banks' complementary skills and weaknesses. | | .835 |
| | MA3 | Decision to go for merger and acquisition by bank is taken if the banks want to reduce various types of costs involved (can be related to investment or operational). | | .806 |
| | MA4 | Merger and acquisition decision is undertaken if the banks want to increase capital with less hassle. | | .866 |
| | MA5 | Banks decide to go for merger and acquisition if the banks want to diversify their services with less hassle. | .751 | .774 |

Table 10: Result from KMO analysis

Thus, after the KMO analysis, following items were deleted as the factor loading was less than 0.5:

1. In order to minimize the risk in the market, merger and acquisition is performed by banks as a part of related diversification (activities that are similar to the one currently offered).
2. Merger and acquisition policy executed by NRB (Nepal Rastra Bank) has nothing to do with easing the monitoring activities of banks of Nepal.

## 5.7 Factor analysis of selected independent and dependent variables

After the KMO of variables and items were measured, Principle Component Analysis was used as extraction method for various nine variables. Those having factor loading less than 0.5 were removed. The KMO of the statements when the accepted statements were run together was 0.679. Then, Varimax with Kaiser Normalization rotation method was used for finding out the Rotated Component Matrix of the independent sub variables belonging to respective variables. The following table is the Rotated component matrix of the independent variables:

| **Independent variables** | **independent sub variables** | **factor 1** | **factor 2** | **factor 3** | **factor 4** | **factor 5** | **factor 6** | **factor 7** | **factor 8** | **factor 9** |
|---|---|---|---|---|---|---|---|---|---|---|
| | | **Service** | **capital** | **cost efficiency** | **brand** | **security** | **income** | **market position** | **financial diversification** | **regulation** |
| increasing income | inc2 | | | | | | .824 | | | |
| | inc3 | | | | | | .909 | | | |
| | inc4 | | | | | | .837 | | | |
| service | service1 | .740 | | | | | | | | |
| | service2 | .886 | | | | | | | | |
| | service3 | .734 | | | | | | | | |
| | service4 | .891 | | | | | | | | |
| | service5 | .769 | | | | | | | | |
| cost efficiency | CostEff1 | | | .651 | | | | | | |
| | CostEff2 | | | .691 | | | | | | |
| | CostEff3 | | | .767 | | | | | | |
| | CostEff4 | | | .750 | | | | | | |
| | CostEff5 | | | .718 | | | | | | |
| financial diversification | FinDiv1 | | | | | | | | .583 | |
| | FinDiv2 | | | | | | | | .889 | |
| | FinDiv3 | | | | | | | | .770 | |
| market position | MktPos1 | | | | | | | .785 | | |
| | MktPos2 | | | | | | | .806 | | |
| | MktPos3 | | | | | | | .664 | | |
| | MktPos5 | | | | | | | .561 | | |
| brand | Brand1 | | | | .732 | | | | | |
| | Brand2 | | | | .765 | | | | | |
| | Brand3 | | | | .767 | | | | | |
| | Brand4 | | | | .802 | | | | | |
| security | Security1 | | | | | .713 | | | | |
| | Security2 | | | | | .783 | | | | |
| | Security3 | | | | | .771 | | | | |
| | Security4 | | | | | .761 | | | | |
| regulation | Regulation4 | | | | | | | | | .753 |
| | Regulation5 | | | | | | | | | .760 |
| capital | CapitalReqm1 | | .701 | | | | | | | |
| | CapitalReqm2 | | .655 | | | | | | | |
| | CapitalReqm3 | | .767 | | | | | | | |
| | CapitalReqm4 | | .740 | | | | | | | |
| | CapitalReqm5 | | .703 | | | | | | | |

Table 11: Rotated component matrix table

Thus, from the rotated factor matrix, following sub variables or items were not taken for further consideration:

1. Reg1: Merger and acquisition trend in Nepal did not arise because of the restriction regarding opening of branches (opening branch in Kathmandu is allowed only after two branches have been opened outside).
2. Reg2: Providing short period of time (one year) to increase the paid-up capital by NRB (Nepal Rastra Bank) has led to merger and acquisition of banks.
3. Reg4: NRB (Nepal Rastra Bank) levied strict merger and acquisition policy because the number of banking and financial institutions were more than required by the economy of Nepal.

## 5.8 Normalization of data

The rationale behind hypothesis testing relies on having something that is normally distributed (Field, 2009). So, it is very much important to test whether the data is normally distributed or not.

Skewness is used to measure the level of symmetry, that is, if the left and right sides of data set look symmetric or not when considered from center. Kurtosis is used to find out whether the data are light-tailed or heavy-tailed when compared to a normal distribution. Data sets with high kurtosis possess heavy outliers while data sets with low kurtosis lack outliers (Measures of Skewness and Kurtosis, retrieved 2016).

The value of skewness and kurtosis should lie between -2 and +2 for the data to be normally distributed (George & Mallery, 2010).

The following table shows the Skewness and Kurtosis of the average of variables after they were obtained from Reliability analysis and Factor analysis:

| Items | N | Minimum | Maximum | Mean | Std. Deviation | Skewness | Kurtosis |
|---|---|---|---|---|---|---|---|
| | Statistic | Statistic | Statistic | Statistic | Statistic | | |
| average of income factor selected from factor and reliability analysis | 200 | 1.00 | 5.00 | 3.7500 | .97927 | -1.094 | .306 |
| average of service factor selected from factor and reliability analysis | 200 | 1.20 | 5.00 | 3.5910 | .87404 | -.795 | -.104 |
| average of cost efficiency factor selected from factor and reliability analysis | 200 | 2.00 | 5.00 | 4.1330 | .60126 | -1.097 | 1.310 |
| average of financial diversification factor selected from factor and reliability analysis | 200 | 2.00 | 5.00 | 4.2417 | .57389 | -.891 | .787 |
| average of market position factor selected from factor and reliability analysis | 200 | 2.50 | 5.00 | 4.2563 | .54360 | -.684 | .239 |
| average of brand factor selected from factor and reliability analysis | 200 | 1.00 | 5.00 | 3.8988 | .69234 | -1.080 | 1.839 |
| average of security factor selected from factor and reliability analysis | 200 | 1.75 | 5.00 | 3.4975 | .75895 | -.247 | -.713 |
| average of regulation factor selected from factor and reliability analysis | 200 | 1.50 | 5.00 | 3.2725 | .75488 | -.317 | -.367 |
| average of capital factor selected from factor and reliability analysis | 200 | 1.80 | 4.80 | 3.4410 | .71321 | -.264 | -.641 |
| average of merger and acquisition decision as dependent factor selected from factor and reliability analysis | 200 | 1.00 | 5.00 | 3.9275 | .88049 | -1.229 | 1.038 |
| Valid N (listwise) | 200 | | | | | | |

Table 12: Mean, standard deviation , skewness and kurtosis of average of sub variables obtained after reliability and factor analysis

The above table shows that all the variables obtained after reliability and factor analysis have their skewness and kurtosis value fall with the range of -2 to +2. Thus, the data obtained has (approximate) normal distribution. Thus, the data is now set for further analysis which is shown in upcoming chapter.

# Chapter 6: Findings

This chapter illustrates the results of the study that were obtained after the data were analyzed. The analysis of the data was done with the help of SPSS software.

## 6.1 Correlation

Correlation is considered to be one of the important step in regression analysis. Correlation helps to calculate the strength of relationship between the variables. The measurement of correlation, denoted normally by R, shows the degree or extent of relationship among two various types of variables. The rage of correlation is from -1 to +1. The measure near to +1 signifies positive relationship which means that increment in one variable will lead to increment in another variable and the measure near to -1 signifies negative relationship which means that increment in one variable will lead to decrement in another variable.

For this research, Pearson Correlation method has been used to find out correlation among the variables. The following table depicts the relationship among the variables:

| | | emphasis on increasing income | emphasis on increasing service | emphasis on cost efficiency | emphasis on financial diversification | emphasis on better market positioning | emphasis on better branding | emphasis on better security | emphasis on fulfill regulations from regulatory authority | emphasis on fulfilling capital requirement | merger and acquisition decision |
|---|---|---|---|---|---|---|---|---|---|---|---|
| emphasis on increasing income | Pearson Correlation | 1 | | | | | | | | | |
| emphasis on increasing service | Pearson Correlation | -0,13 | 1 | | | | | | | | |
| emphasis on cost efficiency | Pearson Correlation | -0,073 | 0,024 | 1 | | | | | | | |
| emphasis on financial diversification | Pearson Correlation | 0,101 | -0,035 | -0,073 | 1 | | | | | | |
| emphasis on better market positioning | Pearson Correlation | -0,002 | 0,037 | 0,004 | 0,065 | 1 | | | | | |
| emphasis on better branding | Pearson Correlation | -0,05 | -.197** | -0,004 | -0,069 | -.144* | 1 | | | | |
| emphasis on better security | Pearson Correlation | -0,05 | -0,018 | 0,064 | 0,001 | -0,107 | 0,017 | 1 | | | |
| emphasis on fulfill regulations from regulatory authority | Pearson Correlation | 0,03 | -0,113 | -0,027 | 0,008 | -0,073 | 0,123 | 0,01 | 1 | | |
| emphasis on fulfilling capital requirement | Pearson Correlation | 0,086 | -0,092 | 0,116 | 0,003 | 0,016 | 0,003 | 0,055 | -0,094 | 1 | |
| merger and acquisition decision | Pearson Correlation | -0,045 | .470** | .158* | -0,063 | -0,002 | -.213** | 0,084 | -0,118 | .184** | 1 |
| **. Correlation is significant at the 0.01 level (2-tailed). | | | | | | | | | | | |
| *. Correlation is significant at the 0.05 level (2-tailed). | | | | | | | | | | | |

Table 13: Results from correlation analysis

As shown in the table above; emphasis in providing service, emphasis on better branding and emphasis on fulfilling capital requirement are correlated with merger and acquisition decision with 0.47, -0.213 and 0.184 respectively, with all of them significant at 0.01 level. Similarly, emphasis on cost efficiency is correlated with merger and acquisition decision with 0.158 significant at 0.05 level.

## 6.2 Regression analysis of the variables affecting merger and acquisition

Regression analysis focuses primarily on the use of linear models to predict changes in the value taken by one variable in the terms of changes in the values of a set of explanatory variables (Archdeacon,1994). Regression analysis is a way of predicting an outcome variable from one predictor variable or several predictor variables (Field, 2009). Our main aim is to find out whether the various independent variables as defined in the hypotheses have significant effect on the dependent variable or not. Thus. in order to find out the factors that have significant relationship with merger and acquisition, regression analysis was run. In order to make regression analysis, stepwise method was used because it is easier to find the variable that is most significant as this method removes those variables that are least significant. The entered predictors are deleted in subsequent steps if they no longer contribute appreciable unique predictive power to the regression when considered in combination with newly entered predictors (Thompson,1989). Thus, it is easier to find out the most significant variables with the help of stepwise method.

From the regression analysis, it was found that the independent variables (service with $\beta=0.456$ and $p<0.05$, capital with $\beta=0.257$ and $p<0.05$, cost efficiency with $\beta=0.174$ and $p<0.05$ and brand with $\beta=-1.151$ and $p<0.05$) have significant relationship with merger and acquisition.

The regression equation can be expressed as:

$$MA\_avg=\beta_0+\beta_1*income\_avg+\beta_2*service\_avg+\beta_3*costeff\_avg+\beta_4*financialdiversi\_avg+\beta_5*mktpos\_avg+\beta_6*brand\_avg+\beta_7*sercurity\_avg+\beta_8*regulation\_avg+\beta_9*capital\_avg$$

Thus, as per our model, it can be shown as:

$$MA\_avg=1.322-0.001*income\_avg+ 0.456*service\_avg+ 0.174*costeff\_avg - 0.047*financialdiversi\_avg-0.042*mktpos\_avg -0.151*brand\_avg+0.76*security\_avg- 0.029*regulation+ 0.257*capital\_avg$$

, where service_avg, capital_avg, costeff_avg and brand_avg are the significant variables. The meanings of all variables whose short forms were used above, are given below:

| **Short forms** | **Explanation** |
|---|---|
| Income_avg | average of income factor selected from factor and reliability analysis |
| Service_avg | average of service factor selected from factor and reliability analysis |
| Costeff_avg | average of cost efficiency factor selected from factor and reliability analysis |
| Financialdiversi_avg | average of financial diversification factor selected from factor and reliability analysis |
| Mktpos_avg | average of market position factor selected from factor and reliability analysis |
| Brand_avg | average of brand factor selected from factor and reliability analysis |
| Security_avg | average of security factor selected from factor and reliability analysis |
| Regulation_avg | average of regulation factor selected from factor and reliability analysis |
| Capital_avg | average of capital factor selected from factor and reliability analysis |
| MA_avg | average of merger and acquisition decision as dependent factor selected from factor and reliability analysis |

Table 14: Meaning of the variables expressed in short form

The following table shows the regression analysis among the independent variables with merger and acquisition:

| **Coefficients** | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Model** | | **Unstandardized Coefficients** | | **Standardized Coefficients** | **t** | **Sig.** | **95.0% Confidence Interval for B** | | **Correlations** | | | **Collinearity Statistics** | |
| | | B | Std. Error | Beta | | | Lower Bound | Upper Bound | Zero-order | Partial | Part | Tolerance | VIF |
| | (Constant) | 1.322 | 0.581 | | 2.274 | 0.024 | 0.175 | 2.469 | | | | | |
| | service_avg | 0.456 | 0.06 | 0.463 | 7.551 | 0.000 | 0.337 | 0.575 | 0.47 | 0.476 | 0.452 | 0.952 | 1.051 |
| | capital_avg | 0.257 | 0.073 | 0.213 | 3.52 | 0.001 | 0.113 | 0.401 | 0.184 | 0.244 | 0.211 | 0.977 | 1.023 |
| | costeff_avg | 0.174 | 0.086 | 0.122 | 2.018 | 0.045 | 0.004 | 0.344 | 0.158 | 0.143 | 0.121 | 0.985 | 1.015 |
| 4 | brand_avg | -0.151 | 0.076 | -0.122 | -1.996 | 0.047 | -0.301 | -0.002 | -0.213 | -0.142 | -0.119 | 0.961 | 1.041 |

a. Dependent variable: MA_avg

Table 15: Results of included variables from regression analysis under stepwise methods

The coefficient table illustrates that service_avg, capital_avg, costeff_avg and brand_avg have p-value less than 0.05 thereby rejecting the null hypothesis and stating that there is significant relationship between the stated variables with dependent variable. However, remaining variables do not show any significant relationship.

## 6.3 Test of hypothesis

**Hypothesis 1: There is positive relationship between emphasis for increasing income and merger and acquisition decision.**

To find out the influence of increasing income with merger and acquisition decision, regression analysis was run. This hypothesis is rejected as it can be seen in the coefficient table that $\beta=-0.001$ ($t=-0.11$, n.s.)

**Hypothesis 2: There is positive relationship between emphasis on increasing sales of services and merger and acquisition decision.**

To find out the influence of increasing sales of services with merger and acquisition decision, regression analysis was run. It can be seen from the table that $\beta=0.456$($t=7.551$, $p<0.01$). Thus, this hypothesis is supported stating that there is positive significant relationship between emphasis on increasing sales of services and merger and acquisition decision.

**Hypothesis 3: There is positive relationship between emphasis on financial diversification and merger and acquisition decision.**

To find out the influence of emphasis on financial diversification and merger and acquisition decision, regression analysis was run. It can be seen from the table that $\beta=0.47$($t=-0.786$, n.s.). Thus, this hypothesis is rejected.

**Hypothesis 4: There is positive relationship between emphasis on cost efficiency and merger and acquisition decision.**

To find out the influence of emphasis on cost efficiency and merger and acquisition decision, regression analysis was run. The coefficient table shows that $\beta=0.175$ ($t=2.018$, $p<0.05$). Thus, this hypothesis is accepted stating that there is positive significant relationship between emphasis on cost efficiency and merger decision.

**Hypothesis 5: There is positive relationship emphasis on obtaining strong position in market, and merger and acquisition decision.**

To find out the influence of emphasis on obtaining strong position in market and merger and acquisition decision, regression analysis was run. The table shows that $\beta=-0.42$ ($t=-0.689$, n.s.). Thus, this hypothesis is rejected.

**Hypothesis 6: There is positive relationship between emphasis on better branding and merger and acquisition decision.**

To find out the influence of emphasis on better branding and merger and acquisition decision, regression analysis was run. The coefficient table shows that $\beta = -0.151$, ($t=-1.996$, $p<0.05$). Thus, it was found that there is negative significant relationship between emphasis on better branding and merger and acquisition decision.

**Hypothesis 7: There is positive relationship between striving for security and merger and acquisition decision.**

To find out the influence of striving for security and merger and acquisition decision, regression analysis was run. The table shows that $\beta=0.076$ ($t=1.263$, n.s.). Thus, this hypothesis is rejected.

**Hypothesis 8: There is positive relationship between fulfilling regulation requirement from regulatory authorities and merger and acquisition decision.**

To find out the influence of regulation from regulatory authorities and merger and acquisition decision, regression analysis was run. The table shows that $\beta=-0.029$ ($t=-0.468$, n.s.). Thus, this hypothesis is rejected.

**Hypothesis 9: There is positive relationship between maintaining capital requirement and merger and acquisition decision.**

To find out the influence of maintaining capital requirement with merger and acquisition decision, regression analysis was run. The coefficient table shows that $\beta=0.257$ ($t=3.52$, $p<0.01$) Thus, this hypothesis is supported stating that there is positive significant relationship between maintaining capital requirement and merger and acquisition decision.

## 6.4 Discussion

The statistical results obtained illustrate that some independent variables such as providing effective service, fulfilling capital requirement, making cost effective and brand maintenance do have significant effect on merger and acquisition decision. The aim of this research is to find out the factors affecting merger and acquisition decision in Nepalese banking sector.

**Hypothesis 1: There is positive relationship between emphasis for increasing income and merger and acquisition decision.**

Merger and acquisition decision is supposed to be undertaken with a view to increase the income of the banks. Andrade et al. (2001), Harford (2004) etc. have supported this hypothesis. However, in Nepalese context, this hypothesis was rejected. Thus, in case of Nepalese banking sector, emphasis for increasing income has no strong relationship with merger and acquisition decision.

**Hypothesis 2: There is positive relationship between emphasis on increasing sales of services and merger and acquisition decision.**

Merger and acquisition decision is also done with the view of providing more services to the customers. This hypothesis was supported by Gaughan (1999). In case of Nepalese banking sector also, this hypothesis was supported thereby showing significant relationship between the two.

**Hypothesis 3: There is significant relationship between emphasis on financial diversification and merger and acquisition decision.**

Merger and acquisition decision was supposed to be carried out with a view to obtain financial diversification. Scholars like Focarelli et al. (2002) had support for this argument. However, in case of Nepalese banks, this hypothesis is not supported.

**Hypothesis 4: There is positive relationship between emphasis on cost efficiency and merger and acquisition decision.**

Merger and acquisition decision is undertaken to eliminate duplication of efforts which would eventually lead to decrease in cost. This hypothesis is supported by Gaughan (1999), William (2009) and others. In the context of Nepalese banking sector too, this hypothesis is supported thereby stating that there is significant relationship between emphasis on cost efficiency and merger activities.

**Hypothesis 5: There is positive relationship between emphasis on obtaining strong position in market and merger and acquisition decision.**

Merger and acquisition decision may be performed with a view to achieve strong position in the market. Scholars like Pasiouras and Zopounidis (2008), Morries (2004) supported this hypothesis. However, in the context of Nepalese banking sector, this hypothesis was not found relevant stating that banks would not go for merger with a view to obtain strong position in the market.

**Hypothesis 6: There is positive relationship between emphasis on better branding and merger and acquisition decision.**

This hypothesis indicates that banks see decision to go for merger and acquisition as a tool for enhancing their brand. Scholars like Noviktye and Predroja (2015) supported this hypothesis. One interesting fact found out from this survey was that branding had significant yet negative relationship with merger and acquisition activities. One reason could be that the people accept merger and acquisition as a treatment method rather than preventive method and thus have negative view of the banks after they go to merger and acquisition.

**Hypothesis 7: There is positive relationship between striving for security and merger and acquisition decision.**

In order to achieve confidence in market by strengthening the skills, deciding to go for merger and acquisition is supposed to be one safe method. This hypothesis has been supported by scholars like Noviktye and Predroja (2015), William (2009) etc. However, in the context of Nepalese banking sector, this hypothesis is not relevant thereby stating that there is no significant relationship between striving for security and merger and acquisition decision.

**Hypothesis 8: There is positive relationship between fulfilling regulation requirement from regulatory authorities and merger and acquisition decision.**

Sometimes, merger and acquisition decision are also forced from other parties such as government, central banks etc. Scholars like Smirnova (2014) have shown this as a form of external motive for merger and acquisition. However, in case of Nepalese banking sector, this hypothesis is not so much supported. Thus, in case of Nepalese banking sector, regulation from regulatory authorities do not have so much significant relationship with merger and acquisition decision.

**Hypothesis 9: There is positive relationship between maintaining capital requirement and merger and acquisition decision.**

Merger and acquisition decision are supposed to be carried out with a view of fulfilling various capital requirements. One better way of saying it will be in the form of resource dependency in which the banks decide to merge or acquire with those who can provide required capital for operation. The argument of resource dependency has been well defined by scholars like Pfeffer (1978), Noorderhaven (2002) and the like. In the case of Nepalese banking sector too, this hypothesis is accepted stating that there is significant relationship between maintaining capital requirement and merger and acquisition decision.

### 6.4.1 Model summary

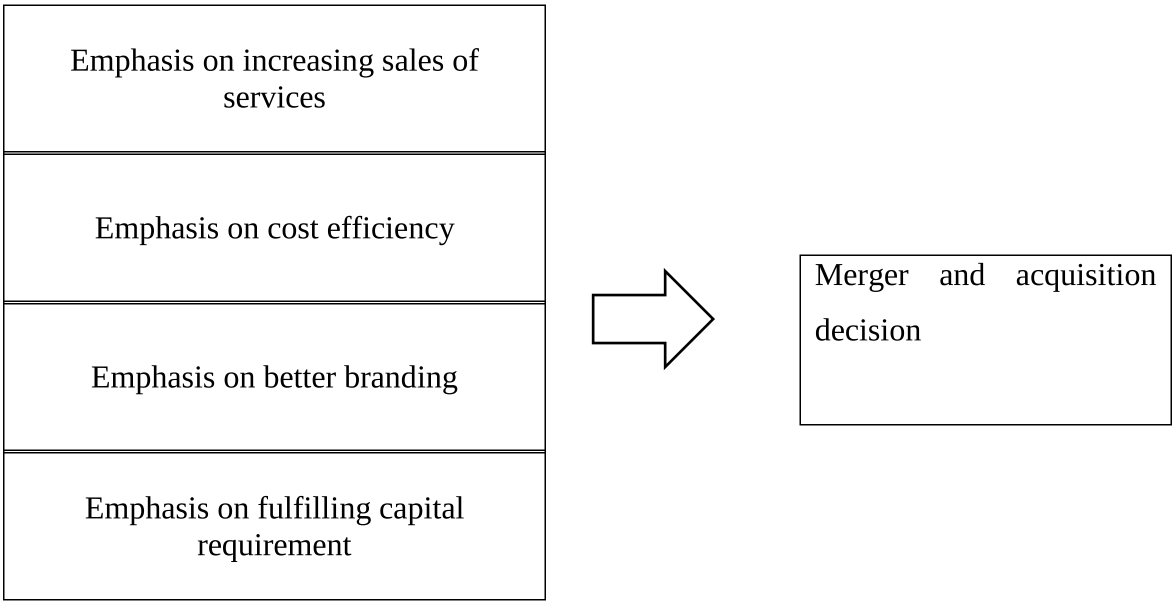
The following table shows the summary of whether the independent variables have effect on merger and acquisition decision or not in case of Nepalese banking sector:

| **Independent variables** | **Direct effect on Merger and acquisition decision** |
|---|---|
| Emphasis on increasing income | Not supported |
| Emphasis on increasing sales of services | Supported |
| Emphasis on financial diversification | Not supported |
| Emphasis on cost efficiency | Supported |
| Emphasis on obtaining stronger position in market | Not supported |
| Emphasis on better branding | Supported but negatively |
| Emphasis on achieving security | Not supported |
| Emphasis on fulfilling regulations from regulatory authorities | Not supported |
| Emphasis on fulfilling capital requirement | supported |

Table 16: Effect of factors on merger and acquisition decision in case of Nepalese banking sector or not in case of Nepalese banking sector

### 6.4.2 Revised conceptual framework

The following table is the revised conceptual framework obtained after the testing of the hypothesis using regression analysis:




Independent variables Dependent variable

Figure 3: Revised conceptual framework

The above figure indicates that emphasis on increasing sales of services, emphasis on cost efficiency, emphasis on better branding and emphasis on fulfilling capital requirement have significant relationship with deciding to go for merger and acquisition in the context on Nepal. This figure is supported by the following table:

| **Independent variable** | **Coefficient** | **T-value** |
|---|---|---|
| Emphasis on better service | 0.456 | 7.551 |
| Emphasis on fulfilling capital requirement | .257 | 3.520 |
| Emphasis on cost efficiency | 0.174 | 2.018 |
| Emphasis on branding | -0.151 | -1.996 |
| **Constant** | 1.322 | 2.274 |
| **$R^2$** | 0.302 | |
| **Adjusted $R^2$** | 0.288 | |
| **F change** | 3.986 | |
| **Maximum VIF** | 1.051 | |

Table 17: Results of significant variables after regression analysis

The above table is the summary of coefficients and T-value of the independent variables significant in context of Nepal along with the values of $R^2$, Adjusted $R^2$, F change and Maximum VIF. The complete model including all variables is provided in Appendix 3.

# CHAPTER 7: CONCLUSION

## 7.1 Introduction

This chapter is concerned with concluding the findings, research implications as well as the limitations of the study.

The main purpose of making this research 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, Novickytė 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 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.

For the purpose of this research, previous literatures have been observed so far in order to create a concrete base for identifying the factors leading to merger and acquisition and thus, its decision. Based upon the factors, hypotheses have been created. The testing of the hypotheses has been done and the findings have been presented as well as discussion of the hypotheses based on the findings have been done. From the testing of hypotheses, it has been found the factors such as emphasis on providing service, emphasis on cost efficiency, emphasis on better branding and emphasis on fulfilling capital requirement are correlated with deciding to go for merger and acquisition in case of Nepalese banking sector. However, factors such as emphasis on increasing income, emphasis on financial diversification, emphasis on obtaining stronger position in market, emphasis on achieving security and emphasis on fulfilling regulations from regulatory authorities; do not have any significant effect leading to merger and acquisition decision in case of Nepalese banking sector. In case of emphasis on better branding, the relationship was found to be negatively correlated. The reason for it might be because merger and acquisition is not accepted as normal activity in Nepalese context and is carried out only in case of problematic situations.

To encapsulate, this research carried the objective of finding out the factors affecting merger and acquisition decision in Nepalese banking sector. 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.

## 7.2 Contribution of the study

For banking sector:

This research is new in case of banking sector of Nepal with the focus on factors leading to deciding to go for merger and acquisition. As all the category of the banks have been taken into consideration for purpose of conducting research, it will provide basis for the banks to whether consider merger and acquisition or not.

For other sectors:

The study of significant factors affecting merger and acquisition decision can also be used as guideline for the firms engaged in various other sectors of Nepal. Merger and acquisition for other sectors in relatively new in Nepal and thus they can use this research as a basis for considering merger and acquisition.

For policymakers:

For those authorities that are responsible for making plans and policies, this research provides information regarding the possible scenario under which the banks would go for merger and acquisition. Thus, it they intend to increase merger and acquisition activities, they can positively influence the factors and vice versa.

## 7.3 Limitations of the study

This research is also not free from limitations. Such kind of limitations can be minimized in case the similar research is done in future. In this research, the opinion of experts working in all four sectors of Nepalese banks is taken into consideration. Therefore, this research is generalized in nature. In future, if the research is done separately in four categories of bank, then it can include opinions more number of informants and the findings can be analyzed separately and compared later on. Another limitation of this study is that this research the quantitative aspect of the opinions of the experts is taken into consideration. If the qualitative methods are taken in consideration in the future, then there can be other debatable findings. Similarly, the measurement of merger and acquisition decision as dependent variable have not been done in previous studies. Thus, the operationalization of this dependent variable may be the subject of criticism as it is too close to independent variables.

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# APPENDICES

## Appendix 1: Reflective note

Participation of private and foreign sector is very much necessary for the development of banking sector in any country especially in those countries that are still in the developing phase. Private and foreign sector brings competition and with competition comes the concept of quality and care. Prior to privatization in Nepal(pre-1980s), there were very few banks in Nepal who were not as effective as they should have been in both providing service to the existing customers as well as exploring new customers. With the introduction of liberalization policy by Nepal Rastra Bank in 1980s, it paved an easy way for the private sector as well as foreign sector to enter the banking sector of Nepal. As there was possibility of exploring large number of customers in Nepal, many banks were established in Nepal to exploit the opportunity. With the number of banks becoming more than required, various issues began to emerge and thus the regulatory authority Nepal Rastra Bank introduced Merger Act and Acquisition Act on 2011 and 2014 respectively. Based upon the Merger Act, 68 banks out of 248 have gone through merger in case of Nepal and the practise is still going on. This research was carried out with a view of finding out the significant factors that would lead to merger and acquisition decision in Nepalese banking sector. Nine different factors were assumed for this research. They 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 from regulatory authorities and emphasis on fulfilling capital requirement. These factors were taken from previous studies done by various scholars and based on four popular theories: neoclassical, agency, behavioral and resource dependency. The views of experts working in banking sector were taken into consideration and thus it was found that among these nine, only four of them were found to be significant which are: emphasis on providing service, emphasis on cost efficiency, emphasis on better branding and emphasis on fulfilling capital requirement; among which emphasis on better branding was found to be negatively significant.

**Globalization**

Merger and acquisition in Nepal is inspired from the activities in global arena. In the global scenario, in both banking and non-banking sector there have been cases of merger and acquisition. Being closer to India where merger and acquisition policies were guided by the Finance Act 1999, the trend started in Nepal. One notable thing is that deciding to go for merger and acquisition does not result from internal issues only; there are various external issues that would lead to merger and acquisition decision such as responding to economic changes, obeying rules and regulations, responding to competition, and the like. In order to sort out the challenges brought out by various uncertainties in the banking sector environment, many banks would decide to opt for merger and acquisition as the suitable strategy to tackle with such external issues. However, there are also various company failures which arose because of merger and acquisition execution. The studies by various scholars have proved that there is consistent failure of 30-50 percent with regards to merger and acquisition in global scenario which provides an effective debate for the authorities at strategic level to always make the careful analysis before taking the decision of merger and acquisition.

**Innovation**

Merger and acquisition is carried out with the view of enhancing innovation. Technology transfer, new product innovation as well as providing service in innovative manner is possible through the help of merger and acquisition. With the possibility of cross border merger and acquisition in the banking sector, various innovative ideas from abroad is possible after merger and acquisition. The customers have become sophisticated with various changes in technology and banks being the customer-driven sector, need to bring out the innovative ideas to maintain and extend the customer base. However, importing such innovated ideas is a very hard job and this can be made a lot easier by the banks going for merger and acquisition. In Nepal also, various banking technologies (for example banking software), services (for example remittance services) are being able to be provided to large customer base after the banks have gone through merger and acquisition.

**Responsibility**

Merger and acquisition activities are one of the leading activities shaping the banking sector of the countries and thus have their impact on the economic sector of the country. Merger and acquisition decisions are sometimes taken as per need of the parties and sometimes directed by the authorities in order to regulate the banking sector. With rising number of banks, there arises the chances of banks practising unethical methods in order to get the customers or eliminate the competitors. One of the best way to retain customers while reacting to the completion would be deciding to go for merger and acquisition. However, while deciding to go for merger and acquisition, various other factors should be taken into consideration so that the chances of being failure could be reduced to minimum.

## Appendix 2: Survey questionnaire

### A survey on finding out the factors causing merger and acquisition in Nepalese banking sector

Note: The given information is for research purpose only and will not be disclosed to anybody.

### Part 1

1. What is your gender?
   a. Male …………
   b. Female ……..….

2. What is the name of your bank or banking institution?

……………………………………………………………………………………………

3. Which category best describes your bank?
   a. Commercial (A class) ………
   b. Development (B class) ………
   c. Financial institutions (C class) ………
   d. Micro finance development (D class) ………

4. Which of the following describes your current job level?
   a. Owner/ executive/c-level …………….
   b. Senior management ……………
   c. Member of Board of Directors……….

5. What is your highest education level?
   a. Masters ……………….
   b. Bachelors ………………
   c. Intermediate (High school) ………………

6. How long have you been serving in banking/financial sector?

   ……………………………………

## Part 2

Please read each question carefully and select your level of agreement for the following statement. And tick (√) mark the appropriate number from 1 to 5. Each testimonial is measured by 5- point Likert scale: 1= Strongly disagree; 2=Disagree; 3=Neutral; 4= Agree; 5=Strongly agree.

| **S.no** | **Factors affecting merger and acquisition in Nepalese banking sector** | **Level of agreement** | | | | |
|---|---|---|---|---|---|---|
| | | **1** | **2** | **3** | **4** | **5** |
| | **Emphasis on increasing income** | | | | | |
| 1 | Merger and acquisition may increase the net interest income (difference in revenue resulting from bank's assets and expenses associated with paying out its liabilities) of banks. | | | | | |
| 2 | Merger and acquisition may increase the non-interest income (income resulting from deposits, fees, service charges, deposit slip fees etc.) of banks. | | | | | |
| 3 | Economies of scale (providing more services at proportionate saving in costs) may not be obtained through merger and acquisition. | | | | | |
| 4 | Multiple sources of income or economies of scope (providing two or more distinct services with less cost had they been done individually) can be introduced with the help of merger and acquisition. | | | | | |
| 5 | Merger and acquisition helps to increase the customer activity (such as increase in opening bank accounts, banking transaction, use of safe deposits etc). | | | | | |
| | | | | | | |
| | **Emphasis on increasing sales of services** | | | | | |
| 6 | Opening of banks' branches would not be easier because of merger and acquisition. | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 7 | In order to provide new services to customers, merger and acquisition is one of the easiest option. | | | | | |
| 8 | Merger and acquisition is not an effective tool for executing the Expansion strategy (attempting to achieve high growth with comparison to previous achievement) of the banks. | | | | | |
| 9 | Merger and acquisition makes it possible for the banks reach new customers easily together than they could have done alone. | | | | | |
| 10 | Merger and acquisition is one of the effective tool to understand and apply the methods of providing more services to more customers. | | | | | |
| | | | | | | |
| | **Emphasis on cost efficiency** | | | | | |
| 11 | Merger and acquisition does not help to minimize the duplication of efforts. | | | | | |
| 12 | Merger and acquisition is done in order to reduce the overall weakness of the merged/acquired banks. | | | | | |
| 13 | Merger and acquisition does not make it possible to eliminate branch overlapping. | | | | | |
| 14 | In order to reduce unnecessary managerial as well as operational positions, merger and acquisition among banks can be done. | | | | | |
| 15 | In order to produce more without increasing the individual capacity of banks, merger and acquisition is performed. | | | | | |
| | | | | | | |
| | **Emphasis on financial diversification (allocation of capital to reduce exposure to any one particular asset/risk)** | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 16 | In order to provide different types of products/services to the customers, merger and acquisition is done. | | | | | |
| 17 | In order to achieve success in key area of operations, merger is done with banks having deeper market penetration i.e. banks whose services have high customer usage in market . | | | | | |
| 18 | Merger and acquisition is not performed for the sake of managing the financial complexities (example: managing the non-performance of certain services),. | | | | | |
| 19 | Merger and acquisition does not have any role in creating portfolio of banks' products/services. | | | | | |
| 20 | In order to minimize the risk in the market, merger and acquisition is performed by banks as a part of related diversification (activities that are similar to the one currently offered). | | | | | |
| | | | | | | |
| | **Emphasis on obtaining stronger position in market** | | | | | |
| 21 | In order to obtain power to exclude rivals, banks go through merger and acquisition. | | | | | |
| 22 | Merger and acquisition does not have any role to capture market share. | | | | | |
| 23 | Merger and acquisition are not an effective tool for eliminating competition. | | | | | |
| 24 | Merger and acquisition does not make it easier for companies to obtain better position by increasing its size. | | | | | |
| 25 | Merger and acquisition helps the banks to achieve unique selling proposition (factor that distinguish product from that of competitors) by combining | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | successful services from them before merger and acquisition. | | | | | |
| | | | | | | |
| | **Emphasis on better branding** | | | | | |
| 26 | Merger and acquisition is done to increase the positioning of banks in the mind of the customers. | | | | | |
| 27 | Merger and acquisition makes it possible to gain image of banks with less activities to be performed than had they done individually. | | | | | |
| 28 | Merger and acquisition can not help to obtain branding of banks within short span of time. | | | | | |
| 29 | Merger and acquisition helps to create the brand of banks with involvement of less cost than had it been done individually. | | | | | |
| 30 | Merger and acquisition does not make it easy for the advertisement of banks to reach to the large number of consumers than had it been done alone. | | | | | |
| | | | | | | |
| | **Using merger and acquisition as as means of security** | | | | | |
| 31 | Merger and acquisition does not have any role in sharing the risks of the banks. | | | | | |
| 32 | Technical, human resource as well as other significant capabilities can be utilized to higher potential by the help of merger and acquisition. | | | | | |
| 33 | Merger and acquisition is not a significant ttool to provide products/services to the consumers without having the banks to get exposed to some sort of loss of control (such as in sub-contracting). | | | | | |
| 34 | In order to be secure from the competitors' strategies, merger and acquisition can be performed. | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 35 | Merge and acquisition does not have any role to make banks secure from various environmental factors such as economical, political, socio-cultural as well as technological factors. | | | | | |
| | | | | | | |
| | **Fulfilling the requirements of regulations from regulatory authorities** | | | | | |
| 36 | Merger and acquisition trend in Nepal did not arise because of the restriction regarding opening of branches (opening branch in Kathmandu is allowed only after two branches have been opened outside). | | | | | |
| 37 | Providing short period of time (one year) to increase the paid-up capital by NRB (Nepal Rastra Bank) has led to merger and acquisition of banks. | | | | | |
| 38 | As a part of plan to get the banking sector out from certain group of people only, NRB (Nepal Rastra Bank) has made regulation for merger and acquisition. | | | | | |
| 39 | NRB (Nepal Rastra Bank) levied strict merger and acquisition policy because the number of banking and financial institutions were more than required by the economy of Nepal. | | | | | |
| 40 | Merger and acquisition policy executed by NRB (Nepal Rastra Bank) has nothing to do with easing the monitoring activities of banks of Nepal. | | | | | |
| | | | | | | |
| | **Emphasis on maintaining capital requirement** | | | | | |
| 41 | The order from NRB (Nepal Rastra Bank) to fulfil capital requirement (NRs. 8 billion for commercial banks, 2.5 billion for development banks, 300-800 million for finance companies) has led to merger and acquisition. | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 42 | The requirement to fulfil the liquidity ratio of at least 20 percent and cash reserve ratio of at least 5 percent has led to merger and acquisition among the banks. | | | | | |
| 43 | It is easier for banks to go for merger and acquisition than to issue the shares (obtaining so much money to the banks in short period of time would be very hard). | | | | | |
| 44 | Going for merger and acquisition does not make any difference for banks having trouble with capital requirement to meet the criteria. | | | | | |
| 45 | Fulfilling capital requirement from issuing debentures will not have more burden for the banks than going for merger and acquisition. | | | | | |

| **S.no** | **Merger and acquisition as dependent factor** | **Level of agreement** | | | | |
|---|---|---|---|---|---|---|
| | | **1** | **2** | **3** | **4** | **5** |
| 1 | Merger and acquisition decision of bank is undertaken in order to be secure from competitors and provide better services. | | | | | |
| 2 | Merger and acquisition decision of bank is undertaken to obtain synergy from banks' complementary skills and weaknesses. | | | | | |
| 3 | Decision to go for merger and acquisition by bank is taken if the banks want to reduce various types of costs involved (can be related to investment or operational). | | | | | |
| 4 | Merger and acquisition decision is undertaken if the banks want to increase capital with less hassle. | | | | | |
| 5 | Banks decide to go for merger and acquisition if the banks want to diversify their services with less hassle. | | | | | |

## Appendix 3: Model Summary[e]

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | | Durbin-Watson |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | R Square Change | F Change | df1 | df2 | Sig. F Change | |
| 1 | .470[a] | .221 | .217 | .76127 | .221 | 56.255 | 1 | 198 | .000 | |
| 2 | .523[b] | .273 | .266 | .73719 | .052 | 14.145 | 1 | 197 | .000 | |
| 3 | .537[c] | .288 | .277 | .73166 | .014 | 3.987 | 1 | 196 | .047 | |
| 4 | .550[d] | .302 | .288 | .72615 | .014 | 3.986 | 1 | 195 | .047 | 1.259 |

a. Predictors: (Constant), service_avg

b. Predictors: (Constant), service_avg, capital_avg

c. Predictors: (Constant), service_avg, capital_avg, costeff_avg

d. Predictors: (Constant), service_avg, capital_avg, costeff_avg, brand_avg

e. Dependent Variable: MA_avg

## Appendix 4: Excluded variables

| Model | | Beta In | t | Sig. | Partial Correlation | Collinearity Statistics | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Tolerance | VIF | Minimum Tolerance |
| 4 | income_avg | -.001[e] | -.011 | .992 | -.001 | .966 | 1.036 | .935 |
| | financialdiversi_avg | -.047[e] | -.786 | .433 | -.056 | .988 | 1.013 | .949 |
| | mktpos_avg | -.042[e] | -.689 | .492 | -.049 | .979 | 1.022 | .942 |
| | security_avg | .076[e] | 1.263 | .208 | .090 | .993 | 1.007 | .951 |
| | regulation_avg | -.029[e] | -.468 | .641 | -.034 | .966 | 1.035 | .942 |

e. Predictors in the Model: (Constant), service_avg, capital_avg, costeff_avg, brand_avg

## Appendix 5: ANOVA table

| ANOVA[a] | | | | | | |
|---|---|---|---|---|---|---|
| Model | | Sum of Squares | df | Mean Square | F | Sig. |
| 1 | Regression | 32.602 | 1 | 32.602 | 56.255 | .000[b] |
| | Residual | 114.747 | 198 | .580 | | |
| | Total | 147.349 | 199 | | | |
| 2 | Regression | 40.289 | 2 | 20.144 | 37.068 | .000[c] |
| | Residual | 107.060 | 197 | .543 | | |
| | Total | 147.349 | 199 | | | |
| 3 | Regression | 42.423 | 3 | 14.141 | 26.416 | .000[d] |
| | Residual | 104.925 | 196 | .535 | | |
| | Total | 147.349 | 199 | | | |
| 4 | Regression | 44.525 | 4 | 11.131 | 21.110 | .000[e] |
| | Residual | 102.823 | 195 | .527 | | |
| | Total | 147.349 | 199 | | | |

a. Dependent Variable: MA_avg

b. Predictors: (Constant), service_avg

c. Predictors: (Constant), service_avg, capital_avg

d. Predictors: (Constant), service_avg, capital_avg, costeff_avg

e. Predictors: (Constant), service_avg, capital_avg, costeff_avg, brand_avg