

# Acquisition and Performance of the Nigerian Banking Sector.

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## ABSTRACT

The dwindling performance of Nigerian banks has been attributed to low capital base, insolvency, and business distress among other factors. Banks now adopt acquisition as a strategy to improve their performance. This study assesses acquisition and performance of Nigerian banks using secondary data collected from NSE Fact-books between years 2011-2015. Independent t-test and correlation analysis were used to analyze the data. The results revealed that there was no significant difference between the pre and post-acquisition financial ratios of the sampled banks. The study recommended that management of banks' should be aware that not all acquisitions lead to improved performance.

(Key terms: banking sector, financial performance, acquisitions)

## INTRODUCTION

The level of global competition around the world has intensely increased through the hyper-competition across sectors in different parts of the world. Corporations are undertaking various strategies in efforts to improve financial performance. Financial performance is paramount to the success of any organization as it reflects the financial health of companies in the market and the performance as compared to other players in the industry (Mboroto, 2013).

Acquisitions are continuously being adopted for progressive company competitiveness in order to expand market share. Additionally, it is adopted to enable companies penetrate to new geographical markets, to support growth by capitalizing on economies of scale and to increase customer base, among other reasons (Kemal, 2011). Improving financial performance through acquisitions is mainly considered a management

strategy. Management considers acquisition as a method for reducing costs and expenses and maximize shareholders' value (Mboroto, 2013). The banking sector plays a germane role in the economic development of a nation. It is the prime mover of the economy as no economic activity will sail smoothly without adequate funds, the bulk of which is provided by the banking sector (Anderibom and Obute, 2015).

The Banking Sector Reform in Nigeria introduced in 2004 implemented by the government was aimed at establishing a reliable and efficient banking sector which has given the industry a new face of leaders and pacesetters after the exercise. Thus, acquisition as a consolidation tool has become a near permanent feature of Nigeria's financial lexicon after the 2005 consolidation exercise.

The performance of Nigerian banks before the reformation exercise in 2004 could be described as being characterized by low levels of capitalization, high regimes of insolvency, vulnerability to systemic financial crises, macro-economic instability, operational hardships, expansion bottlenecks as a result of heavy fixed and high operating costs, cases of insider abuse, loss of confidence by the customers and shareholders of the banks, and long customer queues in the banking halls (Obideyi, 2006).

The advantage envisaged from acquisition of banks in Nigeria after the consolidation exercise in 2004 is still a mirage after years of post-merger and acquisition experience because even after the series of mergers and acquisitions in 2005, another phase of surprising acquisitions in the industry sprung up in 2011. This phase of consolidation involved the acquisition of four banks (Intercontinental Bank, Oceanic Bank, Fin Bank and Equitorial Trust Bank) by Access Bank, Eco Bank, First City Monument Bank, and

Sterling Bank, respectively, as the only option against distress. In the light of the above it is therefore pertinent to assess acquisitions and performance of the Nigerian banking sector between years 2008-2015. The main objective of the study is to examine acquisition and performance of Nigerian banking sector. The specific objectives are to:

- i. determine whether or not there is significant difference between banks' pre and post-acquisition financial ratios; and
- ii. examine the relationship between financial ratios used to measure banks' performance.

The following hypotheses stated in null form are formulated to guide the study:

**Ho<sub>1</sub>:** There is no significant difference in the banks' pre and post-acquisition financial ratios.

**Ho<sub>2</sub>:** There is no significant relationship between financial ratios used to measure banks' performance.

## LITERATURE REVIEW

### The Concept of Acquisition

According to Anthony (2008), acquisition is the purchase of one organization by another. This can be hostile or friendly and the acquirer maintains control over the acquired firm. An acquisition, on the other hand, may be defined as the purchase or take-over of effective controlling interest in a company by another company which enables the later to control the assets and management of the former without any loss of identity for the two companies (Enyi, 2008).

In the opinion of Gunu (2009) acquisition refers to the purchase of a company that is completely absorbed as an operating subsidiary or division of the acquiring company. Akinsulire (2011) defines acquisition as involving the purchase of controlling shares in another company. Acquisition is the transfer of the control of a company from one group of shareholders to another (Broyles, 2003). Acquisitions can be friendly or hostile. Friendly acquisitions occur when the target firm expresses its agreement to be acquired, whereas hostile acquisitions don't have the same agreement from the target firm and the acquiring firm needs to actively purchase large stakes of the target

company in order to have a majority stake (Ahmed, John, and Ahmad, 2015).

Nakamura (2005) asserts that an acquisition takes place when a company attains all or part of the target company's assets and the target remains as a legal entity after the transaction whereas in a share acquisition a company buys a certain share of stocks in the target company in order to influence the management of the target company. Therefore, acquisitions can be seen as the taking over of the controlling shareholding interest of another company.

### Types of Acquisition

Grinblatt, Sheridan, Mark, and Titman (2006) posit that investment bankers often find it useful to define three different categories of acquisition:

- Strategic acquisitions
- Financial acquisitions; and
- Conglomerate acquisitions

**a. Strategic Acquisitions:** Strategic acquisitions are ones that take place between two companies in the same line of business, which implies that the two companies are former competitors. It is important to be aware that not all strategic acquisitions are legal and therefore some have been blocked by antitrust regulators (Brealey, Richard, Myers, Stewart, Marcus, and Alan 2007). A strategic acquisition is one in which the acquiring company is able to gain operating synergies, which means that the two companies are more profitable combined than separate within operating areas (Grinblatt et al., 2006).

**b. Financial Acquisitions:** Financial acquisitions also known as vertical integration are marked by no operating synergies. Instead companies engage in financial acquisitions because the acquirer believes that the target company is undervalued relative to its assets. This concerns acquisition taking place either backwards (inputs and suppliers) or forwards (outputs and distributors) along the organizations' value systems, and in some ways overlap the current core competences. Reasons for vertical integration involve desire to make profits otherwise made by suppliers or possibilities to control quality and lower input costs. (Lynch, 2006).

**c. Conglomerate Acquisition:** Conglomerate acquisition has no clear potential for operating

synergies since the two companies operate in unrelated lines of business (Brealey et al., 2007 and Grinblatt et al., 2006). This type of acquisition is often motivated by financial synergies, which enables a company to lower cost of capital and thereby create value (Grinblatt et al., 2006). It concerns development beyond the organizations' current capabilities and value systems. Conglomerate also known as unrelated diversification lacks the potential benefits associated with economies of scope, and has an only goal to restructure and monitor performance (Lynch, 2006). There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market extensions (Mboroto, 2013).

### **Benefits of Acquisition**

At the level of individual companies, growth and increased market share are the main benefits for acquisition transactions. Other factors are diversification and better management (Gaughan, 2007).

**a. Growth:** One of the main factors affecting companies engaging in acquisition is growth. Enterprises can grow internally, through reinvestment of profits, or externally, through acquisitions (Nawrocki and Weilgus, 2011). Acquisition helps in maintaining or accelerating a company's growth, particularly when the internal growth is constrained due to the paucity of resources (Oloye and Osuma, 2015). By acquiring a company already operating in the given region or country the buyer acquires a market specific knowledge, does not need to conduct recruitment process or build own distribution network and the case of international expansion also bypasses the language barrier (Nawrocki and Weilgus, 2011).

**b. Diversification:** Diversification in terms of merger and acquisition is defined as an acquisition of a company operating in the industry not related to the buyer's core business. However, there are examples of diversified companies (e.g., General Electric (GE)), that have not only survived in the market as a conglomerate, but also turned out to be very successful. The key to GE's success in diversification was the strategy of buying the companies with highest or second highest market share in the given industry. The theoretical background of diversification is related

to the financial assets portfolio management according to which greater number of not correlated assets in a portfolio reduces its risk, analogically the risk of a company should decrease along with the acquisitions of firms operating in a various industries. (Nawrocki and Weilgus, 2011).

**c. Better Management:** Banks with poor management will lead to low or poor productivity. Therefore the need for merger with other banks or acquisitions by other banks who have the required technical know-how would be very important (Oloye and Osuma, 2015). Some of the mergers and acquisitions are driven by the belief of the buyer's management about their above-average skills and abilities to manage a target company better than the current management. If the company is indeed better managed after the merger, the value of the acquired business will increase. The motive of better management in M&A works best when small companies are acquired by larger entities (Nawrocki and Weilgus, 2011).

### **Theoretical Framework**

A number of theoretical approaches have been utilized to understand the influence of acquisition on performance of banks in the Nigerian Banking Sector. The study reviewed Efficiency and Bank Concentration Theories.

#### **Efficiency Theory**

The efficiency theory of Merger argues that firms engage in mergers and acquisition in order to reduce production costs, increase output, improved product quality, obtain new technologies, or provide entirely new products. Kama (2007) opined that acquisitions play an important role in improving banking and financial performance because acquisition is seen as a stimulant for efficiency. Efficiency theory also known as Value-increasing theory further argues that mergers and acquisition are the quickest, cheapest, or only way to attain these benefits (Farrel and Shapiro, 2001). The theory of efficiency further suggests that acquisition will only occur when they are expected to generate enough realizable synergies to make the deal beneficial to both parties and synergies would be more achievable if the companies involved are engaged in related lines of business.

Akvein, Berger and Humphrey (1997) stated that economic literature distinguishes four types of efficiency: productive efficiency, transactional efficiency, allocative efficiency, and dynamic efficiency.

**Productive Efficiency:** Is the ability of firms to get the highest output from the least input given current technological constraints. Acquisition can influence productive efficiency through economics of scale, economics of scope and synergies.

**Transactional efficiency:** This recognizes that firms expend resources to protect the economic returns to their efforts and property right.

**Allocative efficiency:** This concerns the clearance of markets and the achievement of maximal consumer benefits given a particular production function.

**Dynamic efficiency:** This concerns the clearance of markets in a dynamic perspective through the improvement of existing products and processes and the development of new products.

Hence, if we observe an acquisition deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target. This is because the theory confirmed that acquisitions would occur only if it would produce an improved banking and financial performance.

### **Bank Concentration Theory**

This theory argues that economies of scale bring about bank merger and acquisition so that concentration will be based on bank efficiency (Demirguc-Kunt and Levine, 2000). Concentration refers to the degree of control of economic activity by large firms (Sathye 2002). According to Allen and Gale (2003), concentrated banking systems may also enhance profits and therefore lower bank fragility. Intensified competition in the financial markets, in which banks operate, has further encouraged consolidation (Oloye and Osuma, 2015).

Concentration theory of banks is related to the concept of economies of scale. Bank concentration theory is linked to the work of Demirguc-Kunt and Levine (2000) and that of Boyd and Runkle (1993). Increases in concentration levels could be due to considerable size enlargement of the dominant firms and/or

considerable size reduction of the non-dominant firms. Conversely, reduction in concentration levels could be due to considerable size reduction of the dominant firms and/or considerable size enlargement of the non-dominant firms. Demirguc-Kunt and Levine (2000) suggest that greater bank concentration enhances bank stability. They also view that larger banks can diversify better so that banking systems characterized by a few large banks will tend to be less fragile than banking systems with many small banks (Allen and Gale, 2003). Concentrated banking systems may also enhance profits and therefore lower bank fragility. High profits provide a buffer against adverse shocks and increase the franchise value of the bank.

Furthermore, a few large banks are easier to monitor than many small banks, so that corporate control of banks will be more effective and the risks of contagion would be less pronounced in a concentrated banking system (Beck, Demirguc-Kunt and Levine, 2003).

This theory clearly states that acquisition is of great importance in increasing profitability, market share of banks and a stimulant for improved growth. It is on this basis that this theory was adopted to serve as a framework for the study. The adoption of the theory stems from the fact that it addresses the main aim of the study.

### **Empirical Evidence**

Despite the widespread recognition attached to acquisitions, researchers have not come to conclusion as to how it really influences performance. There are different empirical findings from some studies carried out by researchers on the use of acquisitions to improve organizational performance. Some of these studies are discussed below:

Oloye and Osuma (2015) examined the impact of mergers and acquisition on commercial bank's performance in Nigeria. The study employed correlation and regression analysis. They used shareholders fund and profit after tax of the selected banks as proxies to measure the financial efficiency of the banks in both pre and post consolidation eras in Nigeria. Two banks were selected for this study using simple random sampling methods.

Data were collected from Journals, Nigerian stock exchange fact-book, text books, magazines, newspapers, companies' annual reports and internet sources. The research found out that merger and acquisition are effective means of ensuring the stability and profitability of the banking sector, the study also found out that shareholders fund contributed significantly to the profit after tax of the banks, and that corporate restructuring has affected the capital adequacy of commercial banks positively.

Adaramola and Oluwagbuyi (2014) employed the use of Enyi model and technique to investigate the synergistic effect of the recent mergers and acquisitions. It further confirmed the position of economic theory which cites synergy as one the many possible reasons why mergers might occur.

Using Enyi model and technique, the study analyzed the pre and post-merger financial statements of three (3) of the four (4) merger groups whose data were available between 2006 and 2012. The results of the study showed that of the three merger groups only one showed evidence of synergy in the growth of shareholders' funds while none of the groups achieved synergy in the growth of total assets. Thus, not all mergers and acquisitions in Nigeria result into true financial synergy.

Ahmed, John, and Ahmad (2015) examined the effect of mergers and acquisitions on profitability and Earnings per Share of selected deposit money banks in Nigeria. The sample size for this study is four (4) banks which consist of two old generation banks and two new generation banks. The old generation banks include United Bank for Africa and Union Bank while the new generation banks are Diamond Bank and Access Bank.

The statistical technique used to select the sample size was cluster and random sampling techniques. The study utilized secondary sources of data obtained from the banks' annual reports, Nigeria Stock Exchange (NSE) quarterly bulletin and Nigeria stock market guide. The data were organized using descriptive statistics. Analysis of pre- and post-merger data were carried out. Independent Sample t-test and Simple regression analysis were used to the hypotheses. Results revealed that there was a significant difference in profits between the periods as profits improved tremendously immediately after the mergers. It was also revealed that there was significant effect of global financial crisis on EPS. The study

recommends that bail-out funds should be provided to the banks in need as done to Union Bank, Plc. and others.

## **METHODOLOGY**

Quantitative research design was adopted for this study because the study involves the collection of numerical data of banks, then generalizing it to explain the performance of Nigerian Banking Sector after acquisition.

The targeted population for this study are the four banks involved in the acquisitions of 2011 and 2012 which include Intercontinental Bank, Oceanic Bank, Fin Bank and Equitorial Trust Bank which were acquired by Access Bank, Ecobank, First City Monument Bank, and Sterling Bank, respectively. A sample size of three banks was adopted due to availability. The sampling technique used in this research work is purposive sampling. Purposive sampling was used to select banks that were involved in acquisitions of 2011 and 2012 thereby selecting three banks of the four banks due to availability of data.

Secondary data was used for the study which was sourced from the Nigerian Stock Exchange Fact-book (2011-2015) and Annual Reports of sampled banks where data on financial ratios performance were extracted.

The analytical tools used are independent t-test and correlation analysis. Independent t-test was used to determine the change between financial ratios of pre and post-acquisition performance of selected banks and correlation analysis was adopted to determine the level of relationship between financial ratios used for the study.

The variables used as financial ratios to measure the financial performance of acquisitions in Nigerian banks include return on equity and return on asset.

### **Return on Assets**

This is defined as the earnings a bank generates from the investment of its assets. Profitability is primarily measured by return on assets. The return on asset is a functional indicator of a bank's profitability. It is a ratio calculated by dividing net income by total assets. Return on asset shows the profit earned per naira of assets

which reflects bank's management ability to utilize the bank's financial and real investment resources to generate profits. This is denoted by ROA.

### **Return on Equity**

This is referred to the earnings a bank generates from the investment of its shareholders' equity. Return on equity is what the shareholders took in return for their investment. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. Return on equity is the ratio of net income after taxes divided by total equity. It represents the rate of return earned on the funds invested in the company by its stakeholders. Return on equity reflects how effectively a firm's management uses its shareholders' funds. This is denoted by ROE.

## **DATA PRESENTATION AND ANALYSIS**

### **Hypothesis One**

To analyze the first hypothesis which states that there is no significant difference in the banks' pre and post-acquisition financial ratios; independent sampled t-test was used to test the difference.

Table 1 shows the differences in mean values, standard deviation and standard mean error for return on asset and return on equity among the banks before and after acquisition. From the table, the mean of return on asset and return on equity of the sampled banks showed a decreasing difference after acquisition. This implies that all the banks had a decrease in return on assets and return on equity after acquisition.

**Table 1: T-Test.**

Group Statistics					
FACTOR		N	Mean	Std. Deviation	Std. Error Mean
ROE1	PRE	3	.5100	.07211	.04163
	POST	3	.7900	.05000	.02887
ROA1	PRE	3	.1200	.02646	.01528
	POST	3	.1167	.01155	.00667
ROE2	PRE	3	1.0633	.51540	.29756
	POST	3	.9200	.64645	.37323
ROA2	PRE	3	1.2000	.43589	.25166
	POST	3	.9433	.67575	.39014
ROE3	PRE	3	1.4400	.45574	.26312
	POST	3	1.2733	.15695	.09062
ROA3	PRE	3	.1433	.06110	.03528
	POST	3	.1333	.00577	.00333

Source: SPSS Printout, 2016

Table 2 above shows the Levene variance test of the banks' variables. The table shows there is no significant difference between the banks pre and post-acquisition return on asset and return on equity using a significant level of 0.05.

The table also showed no significant difference between the banks' pre and post-acquisition return on asset using the t-test for equality of means of the variables. The banks' return on equity showed insignificant values which means that there is no significant difference between the banks' pre and post-acquisition return on equity. This implies that that there is no statistical This implies that there is no statistical difference between the banks' pre and post-acquisition return on equity where  $p < 0.05$ . The results above imply that all the banks had a significant decrease in return on asset after acquisition.

Based on this finding, we accept the null hypotheses and reject the alternative hypothesis that there is significant difference in the banks' pre and post-acquisition financial ratios. This result is consistent with the findings of the study of Adaramola and Oluwagbuyi (2014) that found that there was no significant difference between banks' pre and post-acquisition assets.

**Table 2: Independent T-Test.**

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
ROE1	Equal variances assumed	.679	.456	-5.527	4	.005	-.28000	.05066	-.42066	-.13934
	Equal variances not assumed			-5.527	3.562	.007	-.28000	.05066	-.42775	-.13225
ROA1	Equal variances assumed	3.226	.147	.200	4	.851	.00333	.01667	-.04294	.04961
	Equal variances not assumed			.200	2.735	.855	.00333	.01667	-.05273	.05940
ROE2	Equal variances assumed	.385	.569	.300	4	.779	.14333	.47733	-1.18195	1.46862
	Equal variances not assumed			.300	3.811	.780	.14333	.47733	-1.20829	1.49496
ROA2	Equal variances assumed	.894	.398	.553	4	.610	.25667	.46427	-1.03235	1.54568
	Equal variances not assumed			.553	3.419	.614	.25667	.46427	-1.12356	1.63689
ROE3	Equal variances assumed	5.028	.088	.599	4	.582	.16667	.27829	-.60599	.93932
	Equal variances not assumed			.599	2.468	.600	.16667	.27829	-.83746	1.17079
ROA3	Equal variances assumed	6.201	.067	.282	4	.792	.01000	.03543	-.08838	.10838
	Equal variances not assumed			.282	2.036	.804	.01000	.03543	-.13992	.15992

Source: SPSS Printout, 2016

**Hypothesis Two**

To analyze the second hypothesis which states that there is no significant relationship between the financial ratios used to measure banks' performance, correlation analysis was used to ascertain if relationship exist between the identified financial indicators of sampled banks.

**Table 5: ROE and ROA Correlations.**

Correlations					
		ROE	ROA		
Spearman's rho	ROE	Correlation Coefficient	1.000	.351	
		Sig. (2-tailed)	.	.119	
		N	21	21	
ROA	ROE	Correlation Coefficient	.351	1.000	
		Sig. (2-tailed)	.119	.	
		N	21	21	

Source: SPSS Printout, 2016

**Table 4: Correlation Matrix.**

Descriptive Statistics			
	Mean	Std. Deviation	N
ROE	1.0386	.45437	21
ROA	.4648	.56508	21

Source: SPSS Printout, 2016

The result in Table 5 above shows a result of 0.351 which implies that that there is no significant positive correlation between the banks' return on equity and return on asset. The result indicates no significant positive correlation between the financial ratios using a significant level of 0.05.

Based on this finding, we accept the null hypotheses and reject the alternative hypothesis that there is no significant relationship between financial ratios used to measure banks' performance. This result is in agreement with the finding of work of Adegboyega and Oluwagbuyi (2014) which discovered that there was no significant relationship between the variables used to measure banks' performance.

## CONCLUSION

In this study, efforts were made to evaluate acquisitions and its performance in the Nigerian Banking Sector. More specifically, the relationship between the financial ratios used to measure performance of banks was determined.

The study revealed that there was no significant difference between pre- and post-acquisition financial ratios of banks' used for the study. The use of independent sampled t-test showed that the banks' return on asset did not increase after acquisition. It also showed that only Access Bank return on equity had a significant increase after acquisition while other banks had no significant increase. Also, the use of correlation analysis was to determine the relationship between the financial ratios used to measure the banks' performance which showed that there was no significant relationship between return on asset and return on equity of banks'.

Based on the findings of this work, the acquisition of Oceanic Bank and Equitorial Trust Bank by Ecobank and Sterling Bank, respectively, failed to produce a significant increase in its return on asset and return on equity expected from such business combination while the acquisition of Intercontinental Bank by Access Bank produced a significant increase in its return on equity but did not produce a significant increase in its return on assets like other banks.

## RECOMMENDATIONS

From the above conclusion, the following recommendations were made:

- i. Management of banks' should be aware that not all acquisitions result into improved performance and should not jump into any acquiring opportunity that offers itself. It has to be planned and well executed to realize

increased performance among other reasons for acquisition because what makes a sound bank is how effective and efficient the management of the bank deploys its available resources.

- ii. Banks that intend to acquire other banks should be conscious of target banks so as not to acquire banks in distress as they would only posit more negative financial performance ratios after the exercise. Acquiring a firm in such grave conditions as shown in virtually all the performance ratios is resultant to acquisition of liability/loss.
- iii. Strategic integrated acquisition programs of financial products should be put in place so as to help improve banks' financial positioning in terms of assets and equity.

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