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IMPACT OF MERGERS AND ACQUISITIONS ON THE PROFITABILITY AND STABILITY OF NEPALESE BANKS: A COMPARATIVE ANALYSIS

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Abstract: *Purpose:* This study evaluates the impact of mergers and acquisitions (M&As) on the performance of Nepalese banks, specifically focusing on the relationship between Return on Equity (ROE) and key financial determinants, including Earnings Per Share (EPS), Return on Investment (ROI), and the Price-to-Earnings (P/E) ratio. The aim is to assess how these variables influence the financial performance of banks following M&A activities.

Methods: A quantitative research design was employed, analyzing data from Prabhu Bank Limited and Kist Bank Limited over the period 2016/17 to 2022/23. The study utilized a purposive sampling technique, focusing on these banks due to their merger history. Secondary data collection was conducted, and multiple regression analysis was applied to determine the relationship between ROE and its determinants.

Findings: The results indicate a positive and significant correlation between EPS, ROI, and P/E ratio with ROE, emphasizing that effective management of these financial indicators contributes to enhanced bank performance post-merger. Specifically, the correlation values reveal that P/E ratio, EPS, and ROI are strongly associated with ROE, with coefficients of 0.85, 0.90, and 0.88, respectively. Regression analysis further confirms these findings, highlighting the significant impact of these variables on ROE. These results underscore the importance of strategic financial management, particularly in maintaining robust EPS, ROI, and P/E ratios, to boost the performance of Nepalese banks after mergers and acquisitions.

Conclusion: The study demonstrates that mergers and acquisitions contribute to better financial performance in Nepalese banks by improving key financial metrics.

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Understanding these relationships is crucial for policymakers, investors, and banking professionals as it provides insights that can guide decision-making during M&A processes, thereby enhancing shareholder value and market stability.

Novelty: This study provides a unique contribution to the limited empirical literature on M&As in Nepal's banking sector, offering valuable insights into financial performance metrics post-merger.

Keywords: Mergers, acquisitions, banking, Return on Equity, Return on Investment.

INTRODUCTION

Context

Mergers and acquisitions (M&As) have become a significant trend in the Nepalese banking sector, driven by the need to enhance financial performance and competitiveness. Regulatory bodies, particularly the Nepal Rastra Bank, have promoted consolidation among smaller banks to strengthen the financial system. This consolidation trend is primarily motivated by the desire to achieve economies of scale, diversify product offerings, and mitigate risks associated with market volatility (Bhandari & Pradhan, 2024). Understanding the impact of M&As on key financial indicators such as Return on Equity (ROE) is critical for various stakeholders, including investors, regulators, and banking management, as it directly affects bank performance and market stability. Research suggests that effective M&A strategies can lead to improved operational efficiency and market share, which in turn enhance ROE (Bhandari & Pradhan, 2024).

Issues/Focus of the Study

Despite the growing frequency of M&As in the Nepalese banking sector, there is a scarcity of empirical evidence examining their impact on key financial performance indicators, particularly ROE. The relationship between ROE and its determinants—Earnings Per Share (EPS), Return on Investment (ROI), and Price-to-Earnings (P/E) ratio—remains understudied in the Nepalese context. While international research indicates a positive correlation between these variables, localized studies are lacking. Bhandari & Pradhan, (2022) underscores the importance of understanding how external factors like economic stability and regulatory changes influence the financial performance of merged entities in Nepal. Addressing this gap, the study seeks to analyze how EPS, ROI, and P/E ratio impact ROE in Nepalese banks post-merger.

Purpose

The primary aim of this study is to evaluate the relationship between ROE and its financial determinants—EPS, ROI, and P/E ratio—in Nepalese banks following mergers and acquisitions.

By doing so, it seeks to provide insights that can inform banks' strategic decision-making processes during M&A activities, ultimately enhancing financial performance and shareholder value.

Issue-based Limitations

Several limitations are inherent in this study. First, access to reliable financial data of recently merged Nepalese banks may pose a challenge, as accounting practices and financial reporting transparency vary (Bhandari, 2021). Second, the sample size of banks that have undergone mergers may be limited, affecting the generalizability of the findings (Choiriyah et al, 2021). Additionally, the study focuses on a specific timeframe post-merger, which may not capture the long-term effects on ROE. This temporal scope could limit the analysis of sustained financial performance and necessitates future longitudinal research.

REVIEW OF LITERATURE

Theory of Mergers

The theoretical foundation of this study is grounded in financial performance theories related to mergers and acquisitions (M&As). The synergy theory posits that mergers create value by generating cost efficiencies and enhancing revenue opportunities, which ultimately improve key financial metrics like Return on Equity (ROE). For instance, cost reductions through economies of scale and improved profit margins following a merger can lead to enhanced ROE (Gupta et al, 2021). Additionally, the resource-based view (RBV) suggests that acquiring valuable resources and capabilities through mergers can strengthen a firm's competitive advantage and financial performance. This theory emphasizes the strategic fit and integration of complementary resources as crucial to post-merger success (Barney, 1991).

Empirical Review

Previous research on the effects of M&As on bank performance has produced mixed findings. International studies by Evanoff et al. (2017) and Rhoades

(1998) demonstrated a positive correlation between Earnings Per Share (EPS), Return on Investment (ROI), and ROE, with strategic mergers resulting in stronger financial metrics over time. Evanoff et al. (2017) found that banks engaging in well-planned mergers showed notable improvements in financial performance in the years following the merger.

However, other studies have shown that the outcomes of mergers can vary based on factors such as market conditions and the size of the merging entities (Bhandari, 2021). In Nepal, empirical evidence regarding post-merger financial performance, particularly related to ROE, remains scarce. According to Adhikari (2023), post-merger performance analysis provides critical insights for stakeholders, as some Nepalese banks have demonstrated improved ROE following mergers, while others have faced challenges due to poor integration processes. This study aims to contribute to this field by analyzing the influence of EPS, ROI, and Price-to-Earnings (P/E) ratios on ROE in Nepalese banks after mergers, expanding the existing literature on M&A outcomes in a developing market.

Recent studies have highlighted evolving trends and impacts of M&As in emerging markets, providing insights into their implications for the banking sector. Paramashivaiah and Indushree

(2023) investigated the dynamics of M&As in Southeast Asia, identifying key strategic benefits and challenges faced by financial institutions in rapidly developing economies. Their analysis underscored that M&As, when aligned with sound financial strategies, enhance operational efficiency and shareholder value.

IDENTIFICATION AND RELATIONSHIP OF VARIABLES

Dependent Variable

Return on Equity (ROE): ROE is the key dependent variable and serves as a primary measure of financial performance. It reflects the bank's ability to generate profits from shareholders' equity and is a critical indicator of both management efficiency and institutional health (Adhikari, 2024).

Independent Variables

Earnings Per Share (EPS): EPS is a significant indicator of profitability, representing the amount of profit allocated to each outstanding share of a company's stock. It is expected to have a positive relationship with ROE, as higher profitability often translates to increased returns for shareholders (Bhandari & Pradhan, 2021).

Return on Investment (ROI): ROI measures the effectiveness of capital utilization, evaluating how well an investment generates profit. It is hypothesized that a higher ROI positively influences ROE by enhancing operational efficiency (Adhikari, 2024).

Price-to-Earnings (P/E) Ratio: The P/E ratio reflects market expectations about a firm's growth and profitability. It is expected to show a positive relationship with ROE, as higher investor confidence often correlates with better financial performance (Bhandari & Pradhan, 2024).

Cause and Effect of Variables

The anticipated cause-and-effect relationships in this study are based on prior research. EPS, ROI, and the P/E ratio are projected to have a positive impact on ROE, as profitability, efficient capital utilization, and favorable market sentiment are critical drivers of financial performance. Mergers that optimize these variables are expected to show significant improvements in ROE, supporting the hypothesis of positive correlations between these factors and post-merger financial success.

HYPOTHESES

H1: There is a positive relationship between Earnings Per Share (EPS) and Return on Equity (ROE) in Nepalese banks post-merger.

H2: Return on Investment (ROI) positively influences Return on Equity (ROE) in Nepalese banks following mergers.

H3: The Price-to-Earnings (P/E) ratio has a significant positive effect on Return on Equity (ROE) in the context of Nepalese banks after mergers.

RESEARCH GAPS

There is a lack of empirical research on the specific relationships between ROE and its determinants—EPS, ROI, and P/E ratio—in the Nepalese banking sector. This gap highlights the need for localized studies focusing on these variables, especially in a rapidly evolving financial landscape (Bhandari, 2021).

Few studies have analyzed the financial performance of banks post-merger, particularly in terms of the impact of EPS, ROI, and P/E ratio on ROE.

Existing literature tends to focus on general financial performance, leaving a gap in understanding the specific contributions of these variables to ROE (Adhikari, 2024).

Updated data and analysis are required following recent M&A activities in the Nepalese banking sector to provide relevant insights for policymakers and stakeholders. Given the dynamic nature of the banking landscape in Nepal, contemporary research is necessary to reflect current developments (Bhandari & Pradhan, 2024).

METHODOLOGY

Research Design

This study adopts a causal-comparative research design to evaluate the financial performance of two Nepalese banks—Prabhu Bank Limited (PCBL) and Kist Bank Limited (KBL)—before and after their merger. Secondary data from financial statements and regulatory filings from the fiscal years 2016/17 to 2022/23 are utilized. The dependent variable is Return on Equity (ROE), while the independent variables include Earnings Per Share (EPS), Price-to-Earnings (P/E) ratio, and Return on Investment (ROI). This structured framework helps identify significant correlations between these variables and improve understanding of the merger's impact on bank performance (Evanoff et al., 2009).

Population and Sample

The population for this study consists of all commercial banks in Nepal that have undergone mergers in recent years. However, the research narrows its focus to the merger between PCBL and KBL to enable an in-depth examination of their financial performance (Dwa& Shaha, 2018). The sample includes financial data from both banks for the periods immediately before and after the merger, specifically from 2016/17 to 2022/23. The sampling design incorporates three years of pre-merger data (2016/17 to 2018/19) and three years of post-merger data (2020/21 to 2022/23), ensuring a comprehensive reflection of the banks' operational states across these periods. This timeframe allows for a robust comparison of financial performance shifts that can be attributed to the merger (Bhattarai, 2021).

Measurement of Variables

The primary performance metric for this study is Return on Equity (ROE), representing the dependent variable. The independent variables include:

- Earnings Per Share (EPS): Reflecting profitability and a company's ability to generate earnings from each share of stock.
- Price-to-Earnings (P/E) ratio: Representing market expectations regarding future earnings growth and profitability.
- Return on Investment (ROI): Measuring the efficiency of capital used to generate profits.
- Nature and Sources of Data The study utilizes secondary data drawn from the annual financial statements of Prabhu Bank Limited and Kist Bank Limited, along with their regulatory filings. Data spanning the fiscal years from 2016/17 to 2022/23 provides both pre-merger and post-merger performance metrics.

Data Analysis Tools and Techniques A multiple linear regression model is employed to analyze the relationships between the dependent and independent variables. The regression equation is as follows:

$$ROE = \beta_0 + \beta_1(\text{ EPS}) + \beta_2(\text{ P/E Ratio }) + \beta_3(\text{ ROI }) + \beta$$

where ROE is the dependent variable, and EPS, P/E Ratio, and ROI are the independent variables. Each coefficient ($_1$, β_2 , β_3) represents the impact of the respective independent variable on ROE. The model is used to explore how financial ratios interact to impact overall bank performance (Iannotta, Nocera, & Sironi, 2007).

Assumptions and Verification of Data Properties

Verifying the properties of data (linearity, normality, homoscedasticity, and multicollinearity) is crucial for ensuring the reliability of regression models. These assumptions are foundational for validating statistical analyses and making accurate inferences (Hair et al., 2010). Meeting these criteria ensures confidence in interpreting findings and drawing valid conclusions (Field, 2013).

Table 1: Summary Table of Assumptions and Parameters

Assumption	*Parameters*	*Interpretation Criteria*
Linearity	Pearson Correlation Coefficients, Scatter Plots	r values close to ±1 indicate strong relationships; scatter plots show linearity.
Normality	Descriptive Statistics (Mean, SD), Shapiro-Wilk Test, Q-Q Plots	Mean close to 0; non-significant p-values (>0.05); histograms show bell shape.
Homoscedasticity	Residual Analysis, Breusch-Pagan Test	Random scatter; non-significant p-values (>0.05); consistent standard deviation.
No Multicollinearity	Correlation Matrix, VIF, Tolerance Values	Values < ±0.8; VIF < 10, Tolerance > 0.1.

The assumptions of linearity, normality, homoscedasticity, and low multicollinearity are verified, ensuring the data's suitability for regression and hypothesis testing.

Hence, with the verification of the assumptions of linearity, normality, homoscedasticity, and no multicollinearity, the data is considered suitable for further analysis, such as regression or hypothesis testing. This ensures that the results are reliable and that any inferences made about the relationships between variables are valid (Hair et al., 2010; Field, 2013). Consequently, this approval allows for a deeper exploration of the dataset, leading to more accurate and meaningful conclusions.

Pre- and Post-Merger Comparison of Performance

Return on Equity (ROE)

Table 2: ROE Performance Comparison

Metrics	*PCBL(Pre-Merger)*	*PCBL(Post- merger)*	*KBL (Pre-Merger)*	*KBL (Post-Merger)*
Mean	12.33%	15.00%	12.08%	14.00%
S. D	0.88	1.00	0.38	0.50
Change	—	+2.67 (21.65%)	—	+1.92 (15.91%)

In the pre-merger period, the average Return on Equity (ROE) of **PCBL** (12.33%) was slightly higher than that of **KBL** (12.08%), indicating better overall performance prior to the merger. The variability in performance, as indicated by the standard deviation, was more pronounced in **PCBL**, whereas **KBL** displayed greater consistency. After the merger, both banks showed significant improvements in ROE, with **PCBL** experiencing a more substantial increase of 2.67% (21.65%) compared to **KBL**'s 1.92% (15.91%).

Price Earnings Ratio (P/E Ratio)

Table 3: P/E Ratio Performance Comparison

Metrics	*PCBL (Pre-Merger)*	*PCBL (Post-Merger)*	*KBL (Pre-Merger)*	*KBL (Post-Merger)*
Mean	10.00	12.00	9.00	10.50
S.D	0.75	0.80	0.50	0.55
Change	—	+2.00 (20%)	—	+1.50 (16.67%)

In the pre-merger phase, **PCBL** had a higher P/E ratio (10.00) compared to **KBL** (9.00), reflecting better market expectations. After the merger, both banks experienced improvements in their P/E ratios, with **PCBL** reaching 12.00, representing a notable increase of 2.00 (20%), while **KBL** increased to 10.50, reflecting a gain of 1.50 (16.67%).

Earnings per Share (EPS)

Table 4: EPS Performance Comparison

Metrics	*PCBL (Pre-Merger)*	*PCBL (Post-Merger)*	*KBL (Pre-Merger)*	*KBL (Post-Merger)*
Mean	3.00	4.50	2.50	3.50
S.D	0.40	0.60	0.30	0.35
Change	—	+1.50 (50%)	—	+1.00 (40%)

Prior to the merger, **PCBL** had a higher EPS (3.00) than **KBL** (2.50). Both banks showed significant post-merger increases in EPS, with **PCBL** experiencing a 1.50 (50%) increase, while **KBL** saw an increase of 1.00 (40%). This indicates the positive effects of the merger on profitability.

Return on Investment (ROI)

Table 5: ROI Performance Comparison

Metrics	*PCBL (Pre-Merger)*	*PCBL (Post-Merger)*	*KBL (Pre-Merger)*	*KBL (Post-Merger)*
Mean	15.00	18.00	14.00	16.50
(S.D)	1.00	1.20	0.90	0.95
Change	—	+3.00 (20%)	—	+2.50 (17.86%)

Before the merger, both banks had comparable average ROI performances, with **PCBL** at 15.00 and **KBL** at 14.00. After the merger, significant improvements were observed in ROI for both banks, indicating enhanced efficiency in utilizing investments, with **PCBL** showing a higher increase of 3.00 (20%) compared to **KBL**'s 2.50 (17.86%).

CORRELATION AND REGRESSION ANALYSIS OF ROE AND RELATED PERFORMANCE METRICS

Correlation Analysis

The correlation analysis provides insights into the relationships among the metrics and ROE, crucial for assessing how changes in these metrics may impact ROE before and after the merger.

Table 6: Correlation Matrix of ROE and Related Performance Metrics

Metrics	*ROE*	*P/E Ratio*	*EPS*	*ROI*
ROE	1.00			
P/E Ratio	0.85	1.00		
EPS	0.90	0.75	1.00	
ROI	0.88	0.82	0.80	1.00

The correlation matrix reveals strong positive correlations between ROE and all performance metrics: P/E Ratio (0.85), EPS (0.90), and ROI (0.88). This suggests that as these performance metrics improve, ROE also tends to rise, indicating a strong interrelationship among these variables.

Regression Analysis

To quantify the impact of performance metrics on ROE, regression analysis was conducted with ROE as the dependent variable and P/E Ratio, EPS, and ROI as independent variables. This analysis helps determine the extent to which these metrics predict ROE before and after the merger.

Table 7: Regression Results of ROE on Performance Metrics

Variables	*Coefficient*	*Standard Error*	*t-Statistic*	*p-value*
Constant	3.50	1.20	2.92	0.005
P/E Ratio	0.30	0.10	3.00	0.004
EPS	0.40	0.15	2.67	0.012
ROI	0.25	0.09	2.78	0.008

REGRESSION EQUATION

The regression equation derived from the above results is as follows:

$$ROE=3.50+0.30(P/E\ Ratio)+0.40(EPS)+0.25(ROI)$$

This equation is used to predict the ROE based on the values of the P/E Ratio, EPS, and ROI for both banks before and after the merger.

The equation represents a multiple regression model where Return on Equity (ROE) is the dependent variable, and the Price-to-Earnings (P/E) Ratio, Earnings Per Share (EPS), and Return on Investment (ROI) serve as independent variables.

The intercept of 3.50 indicates the baseline ROE when all other factors are zero, providing a reference point for evaluation. The coefficients suggest that increases in the P/E Ratio, EPS, and ROI are associated with increases in ROE by 0.30, 0.40, and 0.25 units, respectively.

This equation is significant for financial analysis, enabling investors to understand the key factors influencing ROE, thus aiding in investment decision-making. Additionally, companies can leverage this model to identify drivers of their ROE, which can inform strategic management and performance benchmarking. By analyzing the relationships encapsulated in this equation, stakeholders can gain predictive insights, making it a valuable tool for financial forecasting and strategic planning in assessing a company's performance and investment potential.

Summary Table of Hypotheses Acceptance/Rejection

Hypothesis	*Status*	*Supporting Literature*	*Significance*
There is a strong positive correlation between ROE and P/E Ratio, EPS, and ROI.	Accepted	Brealey, Myers, & Allen (2017); Gupta (2021)	Indicates that improvements in performance metrics lead to increased ROE, emphasizing the interconnectedness of financial metrics in evaluating corporate performance.
P/E Ratio, EPS, and ROI significantly predict ROE.	Accepted	Chatterjee (1986); Feng & Wang (2017)	Validates the predictive ability of key financial metrics for ROE, enabling stakeholders to make informed investment decisions and assess company performance effectively.
The merger has led to improvements in the financial performance metrics of both banks.	Accepted	Haspeslagh & Jemison (1991)	Highlights the potential benefits of mergers in enhancing financial health and operational efficiency, reinforcing the importance of strategic mergers and acquisitions.

DISCUSSION

The findings from this study demonstrate that both Prime Commercial Bank Limited (PCBL) and Kumari Bank Limited (KBL) experienced significant improvements in key financial performance metrics following their merger. Specifically, the analysis of Return on Equity (ROE), Price-to-Earnings (P/E) ratio, Earnings per Share (EPS), and Return on Investment (ROI) reveals strong positive correlations between these variables. These results are consistent with prior research, which underscores the potential of mergers and acquisitions (M&A) to improve the financial health of institutions through enhanced operational efficiencies and greater market power (Brealey, Myers, & Allen, 2017; Haspeslagh & Jemison, 1991).

The post-merger increase in ROE is particularly noteworthy, suggesting that the merged bank was able to use its equity more efficiently to generate profits. The strong predictive relationship between EPS and ROE reinforces earlier studies that highlight the importance of profitability metrics in assessing the success of M&A activities (Gupta et al, 2021; Chatterjee, 1986). Additionally, the rise in the P/E ratio post-merger indicates improved market perceptions of the merged bank's future profitability, a common indicator of successful mergers that deliver value to shareholders (Feng & Wang, 2017).

Furthermore, the correlation analysis confirmed strong interrelationships among ROE and the other financial metrics, demonstrating that improvements in one area positively influence others. This interconnectedness emphasizes the need for a comprehensive post-merger performance management strategy, focusing particularly on enhancing EPS and ROI, which are critical for sustaining investor confidence and driving future growth.

CONCLUSION

The results of this study provide empirical evidence that the merger between PCBL and KBL significantly enhanced key financial performance metrics, including ROE, P/E ratio, EPS, and ROI. These improvements are indicative of a successful integration and demonstrate the potential of mergers to create value in the banking sector. The strong correlations and significant regression findings highlight the importance of focusing on financial metrics that drive overall performance.

The study's findings offer strategic insights for other banks considering mergers, emphasizing the importance of conducting thorough pre-merger evaluations and post-merger assessments. Such evaluations are crucial for identifying the best practices that maximize financial performance and enhance shareholder value.

IMPLICATIONS AND DIRECTIONS FOR FUTURE RESEARCH

The study's findings have several implications and suggest potential areas for future research:

Longitudinal Studies: Future research could conduct longitudinal studies to track the financial performance of merged banks over extended periods. This would provide deeper insights into the long-term effects of M&As, incorporating macroeconomic indicators to understand external influences on post-merger performance.

Sector-Specific Analysis: Expanding the analysis to include different sectors within the banking industry, such as comparing commercial banks and development banks, could help determine whether certain sectors are more conducive to successful mergers.

Qualitative Research: Incorporating qualitative methods like interviews with management and employees could yield valuable insights into the integration process post-merger. Understanding the human factors involved is essential for successful outcomes (Cartwright & Cooper, 1993).

Impact on Customer Satisfaction: Investigating how mergers affect customer satisfaction and loyalty would provide a more holistic view of the merger's impact. Future studies could explore customer perceptions of service quality and product offerings before and after the merger.

Cross-Country Comparisons: Conducting comparative studies across banking institutions in different countries would highlight best practices and strategies for successful mergers in varying regulatory and economic environments, allowing for broader insights into global M&A dynamics.

These implications offer valuable contributions to both academia and the banking sector, supporting future mergers and ensuring that they result in sustained financial and operational success.

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