Effect of Mergers on Capital Structure of a Firm

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Abstract:
Mergers in Kenya banking industry have grown dramatically since 1994. Some of the reasons put forward for mergers are to meet the increased levels of share capital, market share, firm size, information asymmetry, tax regimes, and to benefit from best global practices among others. The banking industry is consolidating at an accelerating pace, yet no conclusive results have emerged on the benefits of mergers. This study sought to establish the effect of mergers on capital structure, using the case of NIC Bank Ltd. The specific objective was to establish the relationship between the bank's capital structure and its bad loans, size, services and interbank. The study adopted an explanatory research design since it is a cause-effect relationship. It used secondary data from the Nairobi Stock Exchange (NSE). Both descriptive and inferential statistics were used to analyze the data. Regression analysis showed that firm size affected capital structure most (β_2=0.940, p value = 0.002), followed by bad loans (β_1=0.894, p value = 0.004) and bank services (β_3=0.641, p value =0.000). Interbank affected capital structure negatively (β_4= -0.511, p value=0.003). The study concludes that mergers increased positively the effect of firm size, services and bad loans on the capital structure while interbank affected capital structure negatively. The study recommends firms in the banking industry to plan and evaluate mergers while focusing on effects of firm size, bad loan, income from services and net interbank on its capital structure.
Keywords: Market Share, Firm Size, Interbank, Income from Services, Bad Loans, Capital Structure

1.1   introduction

Mergers have widely used the technique to increase the rate of growth, size and market share of a firm. Some scholars claim the merger decision is related to capital structure, where the post-merger leverage can increase tax benefits and therefore the firm's value, Lewellen (1971). The relationship between capital structure and merger decisions is still not well understood. There are a few recent articles, for instance, Morellec and Zhdanov (2008) Margrabe (1978) who presented an early example of modeling mergers as an exchange option with exogenous timing, dynamic model of takeovers with two bidders, endogenous leverage, and bankruptcy. Their model supports the empirical evidence that the bidders winning the contest have to leverage below the industry average.

Leland (2007) derives a model where only financial synergies motivate the merger decision. He claims that the magnitude of this effect depends on the firm's characteristics like default costs, firm size, taxes, and riskiness of cash flows. Hege and Hennessy (2010) present an analysis where the level of debt plays a strategic role in benefiting from larger merger share. However, there exists a trade-off between higher surplus and the resulting debt overhang which precludes efficient mergers.

Morellec and Zhdanov (2008) predict that leverage is reduced before the merger and increased afterwards as a result of an option exercise game between bidding and target shareholders and Harford *et al.* (2009) find that firms adjust their capital structures before mergers if they are overleveraged.

The assumption that a firm cannot acquire a firm that is larger than it implies that a firm can reduce its chance of being acquired by acquiring another firm. This increases its size, which then reduces the number of other firms that are potential acquirers. There are fewer firms that are sufficiently large. In fact, empirically it has been found that the probability of being a target in an acquisition is decreasing in a firm's size (Hasbrouck (1985), Palepu (1986), Ambrose and Megginson (1992). In the first scenario only profitable acquisitions occur (the "efficient" scenario). In the other scenario (the "eat-or-be-eaten" scenario) defensive, unprofitable acquisitions that preempt some profitable acquisitions occur. Which scenario arises depends on the incentives of

managers to make defensive acquisitions. If managers are less interested in remaining independent (and gaining the associated private benefits) than in maximizing shareholder value (because their compensation depends on it), there is no defensive merger pressure. No firm will acquire another firm if perceived unprofitable, and hence all mergers lead to positive returns for both the target and the acquirer.

However, if managerial desire not to be acquired is sufficiently strong, then the merger dynamics change dramatically. Now managers are tempted to engage in defensive acquisitions to secure the independence of their firms perhaps well before the regime shift has made the acquisitions profitable. This defensive merger motive is self-reinforcing: Because some managers feel the need to secure the independence of their firms by making defensive acquisitions, other managers are driven to protect the independence of their own firms by making defensive acquisitions themselves. Defensive mergers come in waves. Where a firm has an efficient, profitable acquisition opportunity in the future, several other firms may be induced to engage in defensive acquisitions to ensure their survival as independent firms Richard (2006).

According to DePamphilis and Donald (2008) firms may merge if a regime shift makes mergers profitable, and a potential target firm may acquire another firm to become large enough to deter the takeover offer. Hence, several firms all potential takeover targets may each attempt to make a defensive acquisition, and each firm's defensive acquisition makes the other firms more likely to be left as the most attractive target if they do not themselves engage in a defensive acquisition. Hence, the potentially profitable acquisition opportunity for one firm can lead to an "eat or be eaten" merger wave. In this case, there are more mergers than in the absence of managerial defensive motives, they occur too early, and the acquirers lose money. Even though a regime shift (of a technological or regulatory nature) may, in principle, allow profitable acquisitions, it can have the effect of inducing a defensive wave of unprofitable acquisitions. If many firms are of similar size, the defensive merger waves of unprofitable acquisitions discussed above are likely if managers care enough about staying in control, that is, private benefits are high. However, if the largest firm with a profitable acquisition opportunity (Firm 1) is much larger than the other firms in the industry, the merger dynamics are very different. Now no firm can defend itself against acquisitions by Firm 1 by acquiring another firm. Indeed, acquiring other firms has the opposite effect of making the firm larger, and hence a more attractive takeover target (if synergies are increasing in the target firm's size). If managers care enough about preserving the independence of their firms, they avoid acquisitions. But, if managers care a lot about firm value, that is, private benefits are low, they may engage in acquisitions of other firms in order to become larger and hence a more attractive target (for the firm with profitable acquisition opportunities).

NIC was incorporated in Kenya on 29th September 1959, when Standard Bank Limited and Mercantile Credit Company Limited (Mercantile) -both based in the United Kingdom – jointly formed the company. The company was amongst the first non-bank financial institutions to provide hire purchase and installment credit finance facilities in Kenya.

NIC became a public company in 1971 and is currently quoted on the Nairobi Stock Exchange with approximately 21,000 shareholders. Barclays Bank of Kenya Limited acquired 51% of NIC's total shares through the acquisition of Mercantile in the 1970s and Standard's shareholding in NIC in the 1980s. Between 1993 and 1996, BBK divested its shares, selling 38% of its shares to the public in 1994, and the remaining 20% in 1996 to the First Chartered Securities Group (FCS).

This study sought to examine whether a merger of NIC Bank and African Mercantile Bank Limited (AM Bank) is related to changes in its capital structure of the two merged banks. The purpose was to find out whether there is a cause-effect relationship between the merger and its capital structure. This study was aimed at analyzing specific empirical evidence from the developing countries like Kenya which is crucial since the developed

economies experiences cannot be automatically applied to the undeveloped environment in general and Kenyan economy in particular.

1.2   Statement of the Problem

Firms have various motives for entering into mergers. These motives range from reducing market competition, cutting costs, reducing taxes, removing management, to empire building. Recent years have seen the emergence of merger waves worldwide in financial institutions and studies on its effects have concentrated on areas like firm performance, shareholders value, profitability, employees, management, and payment among others. It is apparent that researchers have placed little emphasis on the impact of synergies of mergers on firm's capital structure and so the scanty literature on this study. Much of the literature available on effects of mergers on capital structure merely relate but not so direct to the study. For instance, Agliardi *et al.*, (2013) argued that firms with less correlated activities, higher growth options, lower volatilities of cash flows and lower bankruptcy costs have higher capital structure, decrease capital structure before the merger and increase capital structure after the merger. However, there is a dearth of similar studies in developing countries like Kenya.

In view of the inadequate research in the banking industry on effects of mergers on capital structure, this study investigates the relationship between a bad loan, firm size, income from services, net interbank and capital structure in the context of a merger, using the case of NIC bank merger from 1998 to 2010. The study focuses on testing the following research hypothesis

H_{o1}.*There is no significant effect of firm size on a banks' capital structure*
H_{o2}. *There is no significant effect of net interbank on a banks' capital structure*

1.3   Literature Review

The static trade-off theory of capital structure (also referred to as the tax based theory) states that optimal capital structure is obtained where the net tax advantage of debt financing balances leverage related costs such as financial distress and bankruptcy, holding firm's assets and investment decisions constant Baxter, (1967 and Altman (2002). In view of this theory, issuing equity means moving away from the optimum and should, therefore, be considered bad news. According to Myers (1984), firms adopting this theory could be regarded as setting a target debt-to-value ratio with a gradual attempt to achieve it. Myers (1984), however, suggests that managers will be reluctant to issue equity if they feel it is undervalued in the market. The consequence is that investors perceive equity issues to only occur if equity is either fairly priced or overpriced. As a result, investors tend to react negatively to an equity issue and management is reluctant to issue equity. Static Trade-off theory, centers on the repayment and costs of issuing debt, predicts that an attractive target debt ratio is to make the paramount value of the company. The best point can be accomplished when the marginal value of the payback is linked with debt concerns exactly offsets the raise in the present value of the costs correlated by handing out more debt Myers, (2001). The main benefit of debt is the tax deductibility of interest payments. The tax deduction of corporate interest payments favors the application of debt. It will be more of the existence of personal taxes, Miller (1977) and non-debt tax protection, DeAngelo and Masulis (1980).

Corporate managers have the incentive to misuse free cash flow on perquisites and a bad investment. Debt financing confines the free cash flow available to the manager's commitment settling the interest and principal and by this means efficient control of the firms' financial difficulties. The costs associated with issuing debt are the costs of financial distress. Modigliani and Miller, (1963) and the firm costs are triggered by conflicts between shareholders and debtors which was indicated by Ozkan (2001), that costs of financial distress would arise when a firm uses much unnecessary debts and is powerless to meet the interest and principal payments. The trade-off theory entails a target adjustment model. In the model, firms contain a target debt ratio in which they slowly adjust. The debt is adjusted by comparing the ratio of debt to the preceding period with the predetermined target debt ratio. The adjustment, though, is only partial because of the market imperfections

such as transaction costs highlighted by Marsh, (1982) and adjustment costs and constraints as indicated by Jalilvand and Harris (1984). If firms are as above the target debt ratio, the worth of the firm is not the best because financial distress and company costs go beyond the benefits of debt. Therefore, we expect firms that are higher than their target debt ratio, to reduce their debt. Firms that have a debt ratio below the target debt ratio increase the value of the firm because marginal value of the benefits of debt is still greater than the costs connected with the use of the debt. Durinck. L, Van H and Vandenbroucke, (1998), highlighted that the cost and benefits of debt made the corporations target debt ratio to exploit their debt in the best effort and firms that.

2.3   Mergers and Capital Structure

Capital structure decisions may become relevant and, in addition, may be influenced by the expansion of growth opportunities in mergers. that merging firms tend to decrease leverage just before the merger and increase leverage significantly in the years after the merger. Moreover, we find that this effect is stronger for merging firms that are less correlated, have significantly larger growth options, lower bankruptcy costs and lower volatility consolidation via mergers reduces risk and thus increases potential leverage allowing for greater financial benefits (Lewellen 1971). Leland (2007) shows that this diversification effect may not always be positive, with the sign of the financial benefits affected by factors such as the volatility and bankruptcy costs of the two firms and the level of the correlation of the firms' cash flows.

Clayton and Ravid (2002), Leary and Roberts (2005) and Harford et al. (2009) find that firms adjust their capital structures before mergers if they are overleveraged firms maximize their firm values by mergers and acquisitions when they reduce the leverage deficit effectively after the transactions. in the process of mergers and acquisitions, the method of payment is also an important factor that can influence the acquiring firm's capital structure.

Harford, Klasa, and Walcott (2007) move one step further and analyze how the deviations from target capital structure influence the financing method in these acquisitions. They find that overleveraged firms are more likely to finance these acquisitions with equity instead of debt. In the debt financing acquisitions, they find that acquiring firms move closer to their target level of leverage within five years. Therefore, their evidence supports the existence of target capital structures.

In the review of the capital structure literature, Harris and Raviv (1991) noted that it is generally accepted that firms in a given industry will have similar leverage ratios while leverage ratios vary across industries. Long and Malitz (1985), and Kester (1986) investigated leverage ratios for selected industries. These studies all found that specific industries have a common leverage ratio which, over time, is relatively stable. Hamada (1972), using industry membership as a proxy for risk class, found that levered beta values within different industries varied more than unlevered beta values. He concluded that there was a relationship between the cost of equity and financial leverage. DeAngelo, Masulis (1980) and Masulis (1983) use the documentation of this industry effect as one argument for the presence of an industry-related optimal capital structure and imply that it is the tax code and tax rate differences across industries that cause the inter-industry similarities in leverage ratios.

The correlation of capital structure to industry membership and/or the DeAngelo-Masulis differential tax arguments have received empirical support in Schwartz and Aronson (1967), Scott and Martin (1975), Scott (1972), Bowen, *et al*, (1982), Cordes and Sheffrin (1983), and Ben-Horim *et al*, (1987). However, not all of the evidence is unanimous in its support. Boquist and Moore's (1984) findings did not support the tax shield hypothesis at the firm level; however, they did find weak evidence in support of the theory at the industry level.

They, however, like other researchers, found that total leverage varies across industry groupings. In addition to the tax shield hypothesis that explains the large body of empirical evidence relating industry membership and

leverage, other arguments may relate industry membership to capital structure decisions. Lev (1974) compared operating leverage to industry membership and to systematic risk and found a positive relationship. Building on Lev's study, Mandelker and Rhee (1984) derived the relationship between beta and both operating leverage and financial leverage. They concluded that the conjecture that firms engage in trade-offs between DOL and DFL seems to have gained strong empirical evidence in our study.

Since industry, to a large degree, influences production processes and therefore operating leverage, and if there is a tradeoff in DOL and DFL as found by Mandelker and Rhee (1984), a firm's industry may have some influence on its capital structure decisions. Specifically, if firms attempt to keep combined leverage at a manageable level, and, if DOL is impacted by industry membership, then firms in an industry with a high DOL may carry less debt while firms in an industry with low DOL may carry more debt. In addition, earnings variability is influenced by DOL and DFL. Bradley, Jarrell and Kim (1984) find that the volatility of earnings is a strong inverse determinant of debt. To the extent that earnings volatility may be industry related, this may also affect the relationship between industry membership and capital structure decisions.

Individual firms and industries can be characterized by their growth rates. Rapidly growing firms (and industries) have a surfeit of positive net present value projects while slow-growth firms may have an excess of cash. Jensen and Meckling (1976) suggest that a particular capital structure can result from using debt as a monitoring and controlling device for managers. Further developing the free cash flow argument, Jensen (1986) points out that slow growth firms will have large amounts of excess cash that managers may decide to use for The determination of Optimal capital structure personal perquisites and other non-positive net present value projects.

If the firm issues debt, then the manager will own an increasing percentage of the firm's stock. Furthermore, excess cash will be reduced, and the debt covenant and bondholders will act as monitoring and controlling agents over the manager's behavior. Following JM's and Jensen's arguments, low growth firms (and their industries) should demonstrate increasing debt levels in their capital structure.

The main focus is on the change of shareholders wealth after Merger. Bruner (2002) surveys many related research results and find that target firms' shareholders earn a positive market return but those of acquiring firm earn around zero abnormal return. The sum of market returns from Merger activities, however, is still positive. In addition, Harford (2005) tries to identify the reason of merger waves. He finds that one very important reason for the merger clustering in time is sufficient overall capital liquidity, which implies lower financial constraint or transaction costs. Combining both findings, we expect that firm's capital structure should play an important role in the merger activities. Specifically, we are interested in the interaction between Merger and acquiring firm's capital structure. We also expect that the characteristic of capital structure could explain part of the difference of the effect of the merger.

2.4   Firm Size and Capital Structure

Wheelock and Wilson (2004) found that expected merger activity in US banking was positively related to management rating, bank size, competitive position and geographical location of banks and negatively related to market concentration. Substantial gains from mergers are expected to come from cost savings owing to economies of scale and scope. In a survey of US studies, Berger and Humphrey (1994) concluded that the consensus view of the recent scale economy literature is that the average cost curve has a relatively flat U-shape with only small banks having the potential for scale efficiency gains and usually the measured economies are relatively small. To achieve the benefit of low capital requirements, small size banks would be required to consolidate themselves to become large. In line with this, RBI (2001) observed that the new Basel Accord,

when implemented, is expected to have far-reaching implications such as further consolidation through mergers and acquisitions.

Empirical research, Kishan and Opiela (2000), Pandit *et al. al* (2006) shows that large size banks are more capable than others to offset shocks arising out of monetary policy induced a decrease in deposits or increase in the cost of funds because they can fund borrowings (other than deposits) more easily. These findings highlight the need for forming large banks through consolidation.

 In an industry in which some but not all firms are of a similar size, medium-size firms have both the opportunity to make defensive acquisitions (that make them large enough to be protected from takeovers) as well as positioning acquisitions (that make them more attractive takeover targets). In these industries, the pattern of mergers depends crucially on firm size and the level of managerial private benefits. It shows that the profitability of acquisitions is generally decreasing in the acquirer's size. Large firms engage only in defensive, unprofitable acquisitions, many articles in the press or trade journals mention the idea that if firms do not make acquisitions, they may become targets themselves.

These mixed firm size industries are most likely to exhibit merger waves because some firms have defensive as well as positioning merger motives. Which motive matters depends on their managers' interest in maximizing firm value. While the additional acquisitions may not be undertaken by medium-size firms, those firms tend to make the most acquisitions in industries with economies of scale; firm size becomes the driving force for merger dynamics. Often, this leads to profitable acquisitions. However, if a firm becomes very large and its manager's private benefits are high, it may engage in an unprofitable defensive acquisition, Focarelli, Panetta, and Salleo (2003).

Since an important ingredient to our theory is the size of potential acquirers and targets, it has also predictions on the quality of acquisitions undertaken by firms of different size. There is a negative correlation between acquirer returns and acquirer size because large firms are more likely to engage in defensive acquisitions than small firms. More specifically, our theory implies that large firms tend to make negative NPV acquisitions (leading to negative abnormal returns), medium size firms both positive and negative NPV acquisitions and small firms positive NPV acquisitions.In such industries, the only acquisitions that large firms undertake (with the exception of the largest firm) are of defensive nature, and they occur if private benefits are high (if private benefits are sufficiently low, they do not make any acquisitions), Focarelli, *et al.*, (2002).

The effect of the relative size of target and acquirer depends on the size of the acquirer. It shows that for medium sized firms, the ratio of target to acquirer size is negatively correlated with acquirer returns. This arises because medium sized firms acquire relatively large firms for defensive purposes if private benefits are high but relatively small firms in positioning mergers if private benefits are low. In contrast, for small acquirers, we conjecture that the ratio of target to acquirer size and the acquirer's abnormal returns are positively correlated.

2.5   Net Interbank and Capital Structure

According to Rochet and Vives (2004), since individual interbank market participants are generally risk averse and have only asymmetric information, they may rationally overreact to any negative news about their counterparty and withdraw their assets as quickly as possible. Such a generalized liquidity crunch may push a solvent institution into illiquidity and bankruptcy. Degryse and Nguyen (2007) are the first to empirically investigate the impact of interbank market structure on contagion risk. Assuming exogeneity of the market structure they find the latter to be one of the main drivers of contagion risk on the Belgian interbank market. Castiglionesi and Navarro (2008) however model how the interbank market structure evolves endogenously from first principles. In their model, two banks have to agree to establish a link (this is the notion of pairwise

stability). The rationale of the model is that, when the probability of default is too high, the safe banks do not want to be linked with the risky ones and accordingly severe their links, while the risky banks find it almost always convenient to be linked.

Freixas and Jorge (2007) and Allen *et al*. (2008) signal that banks should not be able to monitor their peers because interbank markets, like other credit markets, are characterized by moral hazard and asymmetric information. Likewise, Goodfriend (2002) and Martin and McAndrews (2007) claim that banks are not apt to monitor other banks because the implicit guarantee supplied by central banks, which are expected to intervene in the case of crisis, undermines banks' incentives to monitor their peers. On the other hand, Rochet and Tirole (1996) demonstrate that interbank exposures might generate incentives for lending banks to monitor borrowing banks, even if this disciplinary role is relatively ineffective because interbank exposures can be quickly abandoned owing to their typically short-term maturity.

King (2008) demonstrates that high-risk banks pay more than safe banks for interbank loans. Dinger and von Hagen (2009) show that in systems characterized by longer-term interbank exposures the monitoring role of lenders is more important. Angelini *et al*. (2011) also analyse the Italian interbank market before and after the crisis. Although their focus is different, as they study the determinants of the interbank interest rate spread, my findings are consistent with their main conclusion. They find that the widening interbank spread was not due to bank-specific factors but to increasing aggregate risk aversion;

Following Gale (2004), bank capital is considered as a buffer to shield deposits from banks' liquidity shocks and then it represents an additional (costly) source of liquidity insurance. Gale argues that bank capital also has a risk-sharing function. He presents a model of capital as a buffer stock, in which the optimal capital structure improves risk-sharing between shareholders and depositors. Similarly to Gale, we focus on the risk-sharing role of bank capital. However, the effect of the participation in interbank markets in determining bank capital is closely analyzed. The emphasis on the relationship between bank capital and participation in interbank market arises naturally given that, at least in principle, interbank markets reduce the scope for bank capital as a risk-sharing device. A two-region economy is modeled, in which each region is populated by risk-adverse depositors and risk-neutral investors. While the former deposit their endowment in banks, the latter provide bank capital. Banks acting on behalf of depositors have two investment opportunities: a short-term liquid asset (storage technology) and a long-term illiquid asset.

Each region has uncertain liquidity needs characterized by a regional liquidity shock. The existence of an interbank deposit mark*et al*lows banks in different regions to coinsure when regional liquidity shocks are negatively correlated. However, interbank markets are of little help when liquidity shocks are positively correlated. Therefore, some residual aggregate uncertainty remains. The presence of aggregate uncertainty gives a scope for the use of bank capital as a risk-sharing device. That is, some of the undiversifiable risks can be transferred (at a cost) to risk-neutral investors. In a world, without aggregate uncertainty, the interbank market would be sufficient to deal with idiosyncratic liquidity shocks, and there would be no need for bank capital. It follows that a reduction in aggregate uncertainty should imply a reduction in bank capital as well. This is indeed the case for certain parameters values but, surprisingly, it is not a general property of the model (Gale, 2004).

This is due to the fact that a reduction in aggregate uncertainty implies also a reallocation in the investment decisions of the banks. In particular, when aggregate uncertainty reduces banks have an incentive to reduce the investment in the liquid asset and, as in Castiglionesi *et al*. This can cause higher consumption volatility. Bank capital, in this case, is valuable since it helps in moderating such volatility. Given that higher aggregate uncertainty implies lower interbank market participation, the model predicts a negative relationship between interbank market participation and bank capital only insofar bank capital is increasing in aggregate uncertainty.

Furthermore, banks collect a capital buffer to transfer part of the aggregate uncertainty to the risk-neutral investors. In our model, this is achieved by paying a dividend which is contingent on aggregate liquidity needs. In particular, when aggregate liquidity needs are high throughout the economy, it is optimal to postpone dividend payments. Given that, in this case, the interbank market is unable to provide additional liquidity, at the same time that banks postpone dividends they also tend to have smaller positions vis-a-vis other banks. This mechanism should produce a positive relationship between dividend payments and participation in the interbank market, as measured for example by the magnitude of the interbank net position, which is possible to validate empirically.

The model also predicts a negative relationship between current and future dividends so that when interbank market participation is low, current dividends are also low but future dividends tend to be high. This means that there exists a negative relationship between interbank market participation and changes in dividend payments, that is, dividends tend to increase over time when interbank participation is low. Finally, dividend payments also affect the value of bank capital. Namely, the payment of current dividends tends to reduce capital, both for an accounting reason and, within this framework, also because it signals lower dividends in the future. The postponement of a dividend instead signals higher future payouts to shareholders, and the value of bank capital should increase as a consequence. Since dividends are paid (postponed) when the participation in the interbank market is high (low), the model also delivers the testable prediction of a negative relationship between changes in bank capital and participation in the interbank market.

3.0   Material and methods

This study adopted an explanatory research design. The target population of this study was the published financial statements of the NIC bank, the years of the published ranged between 1995 – 2010, that is 4 years before the merger, and 12 years after the merger. The study observed quarterly financial statements only, hence a total of 64 observations and thus the target population is chosen since it provided research information with respect to the study. Census method was employed in the study for all published financial reports for NIC bank during the sixteen year period on a quarterly basis. Quantitative data was analyzed using descriptive and inferential statistics methods. Inferential statistics was used to analyze and evaluate data of NIC bank before and after merger using correlation and regression models The data collected was analyzed using multi regression and correlation analysis.

4.0   Findings and Discussions

This chapter entails analyses of data and estimates the model described in the previous chapter. Data was quantitative secondary data. Results from Table 1 indicated a smaller total mean asset 15, 912.445 before the merger than after the merger where a higher total mean asset 37,872 was reported; this mean difference was significant as revealed by t test = 1.639 and a P value of 0.01. This coincides with Focarelli *et al.,* (2003) that mixed firm size industries are most likely to exhibit merger waves because some firms have defensive as well as positioning merger motives. The mean of total equity before the merger was 1,500,000 while after the merger the total equity mean was 5,210,000. This implies that after the merge the bank recorded an increase in the mean of total equity with T-test = 4.7, p-value = 0.001 <0.05 (α). Hence there is the significant mean difference between the total equity before and after the merger. The analysis revealed that there exists no mean difference in total lending before and after the merger**.** Before the merger, the total lending mean was 5,540,000, while after the merger the mean was 6,500,000. Although there is diffrence among the mean, this diffrence was not significat as shown by t test = 15.32 and a p value of 0.991. The study analysis reported that gross income means before the merger was 1,780,000 which was less than gross income mean after the merger of 2,850,000. This mean diffrence was found not significat as revealed by The T-test=11.99 and p-value = 0.467 > α (0.05). Thus, there exists no mean difference in gross income before and after the merger. As seen from table 1. mean increased to 2,630,000. This increase was however regarded as insignificant (the T-test = 2.44 and that p-value

= 0.248 >α (0.05).   More findings showed that there was mean signficance difference of bad loans before the merger (mean = 7,950,000) and after merger (mean = 9,200,000) as evidence of the T-test = 13.72 indicated that, p-value = 0.0.046 <α (0.05). Findings on interbank showed that the mean of interbank before mergere was 3,854,000 whereas after the merger the interbank mean was 9,855,800. The t test = 2.76, and p value = 0.043 reported that the mean diffrence was significant.

Table 1   Descriptive Statitics (Means Differences)

Variable	Before Merger		After Merger		T test	P value
	Mean	Standard Deviation	Mean	Standard Deviation		
Total asset	15,912.45	2,384.45	37,872.33	14,430.05	1.64	0.001
Total equity	1,500,000	204,480	5,210,000	215,800.0	4.7	0.001
Total lending	5,540,000	793,347.4	6,500,000	108,800.0	15.32	0.991
Gross income	1,780,000	229,579.3	2,850,000	117,000.0	11.99	0.467
Interbank	3,854,000	172,757.0	9,855,800	265,685.0	2.76	0.043

Means in thousands
Source: Research data (2012)
This study conducted descriptive statistics to describe the basic features of the data. Through this statistical tool, the study was able to find out the variable ratios , their mean, standard deviation, minimum value and maximum value.

Table 3   Descriptive Statistics for Variables

Before Merger					
	Mean	Median	Std. Deviation	Maximum	Minimum
Interbank	0.061	0.0595	0.00997	0.05	0.01
Firm Size	15.9127	16.3345	2.38445	18.27	12.71
Capital structure	0.8255	0.7576	0.68466	0.99	0.74
Transitional Period					
Interbank	0.0005	0.0005	0	0	0
Firm Size	6.7318	6.8482	0.24932	6.97	6.41
Capital Structure	1.63079	1.54572	0.86467	1.78	0.27
After Merger					
Interbank	0.1833	0.1025	0.1126	0.62	0.07
Firm Size	37.8723	36.95	14.43005	59.01	20.7
Capital Structure	1.81	1.2265	0.54190	1.88	1.01

Source: Research data (2012)

. Comparing the mean of firm size before the merger, transitional priod and after the merger, the study findings revelaed that transitional period had the lowest firm size mean (mean = 6.7318) this might be as result of high liquidity. Interbank befor merger was reported to have a mean score of 0.016, while after the merger the mean increased up to 0.1833. In the transitional period the mean of interbank was the lowest = 0.0005.

4.1   Pre and Post-Merger Correlation Analysis

After performing the statistics, the researcher investigated the correlation of bad loans, income from services, net interbank, firm size and capital structure before and after the merger of the NIC bank. The analysis was

done by the measurement of the ratio of bad loans to total lending, the ratio of total income from services to gross income, ratio of net interbank to total asset and the log of total assets in NIC bank. Capital structure was measured by the ratio of total debts to total equity.

Table 4   Pre and Post-Merger Correlation Analysis

Before Merger

	Interbank	Firm Size	Capital Structure
Interbank	1		
Firm Size	0.298	1	
Capital Structure	-0.185*	0.61*	1
Transitional Period			
Interbank	1		
Firm Size	0.737	1	
Capital Structure	-0.777	-0.261	1
After Merger			
Interbank	1		
Firm Size	0.738	1	
Capital Structure	-0.643*	0.811*	1

**.Correlation is significant at the 0.01 level (2-Tailed).
*.Correlation is significant at the 0.05 level (2 – Tailed)
Source: Research data (2012)

Before the merger interbank indicated a weak significant negative relationship with capital structure (Pearson correlation = -0.185, p value = 0.041< α = 0.05). Further analysis after the merger reported a very strong negative significant relationship between capital structure and interbank (r = -0.643, p value = 0.048). Firm size and capital structure had significant positive relationship (Pearson correlation = 0.61 and p value of 0.03< α = 0.05). Further analysis after the merger reported a very strong negative significant relationship between farm size and capital structure (Pearson correlation = 0.811, p value = 0.05). This contradicts Focarelli, Panetta, and Salleo (2003) suggestions that if a firm becomes very large and its manager's private benefits are high and may engage in an unprofitable defensive acquisition. In their study that there is a negative correlation between acquirer returns and acquirer size because large firms are more likely to engage in defensive acquisitions than small firms. More specifically, their theory implies that large firms tend to make negative NPV acquisitions (leading to negative abnormal returns), medium size firms both positive and negative NPV acquisitions and small firms positive NPV acquisitions. In such industries, the only acquisitions that large firms undertake (with the exception of the largest firm) are of defensive nature. They occur if private benefits are high (if private benefits are sufficiently low, they do not make any acquisitions).

Further findings show that during transitional period bad loans, services, interbank and firm size had no relationship with capital structure.

Regression Analysis of Interbank and Firm Size against Capital Structure

Table 5   **Regression Analysis**

Before Merger

	Standardized Coefficients				
	Beta	**Std. Error**	**T- Test**	**P Value**	**VIF**
(Constant)	1.143	9.515	0.12	0.912	
Interbank	-0.306	128.14	-0.035	0.003	2.422
Firm Size	0.316	1.207	0.01	0.002	1.301

$R^2=0.743$
$F=22.08$
$P\ Value=0.007$

Transitional Period

(Constant)	10245.5	5445.296	1.882	0.201	
Interbank	-1.118	1120000	-1.858	0.204	2.241
Firm Size	0.498	22.383	0.771	0.521	2.007

$R^2=0.828$
$F=3.219$
$P\ Value=0.246$

After Merger

(Constant)	22.143	51.602	2.473	0.012	
Services	0.641	1.947	2.709	0.000	1.681
Interbank	-0.511	15.081	0.167	0.003	0.561
Firm Size	0.940	0.668	2.672	0.002	1.112

$R^2=0.847$
$F = 2.547$
$P\ Value=0.01$

Dependent: Capital structure
Source: Research data (2012)

The regression results from table 4 shows that regression before merger had a coefficient of determination (R^2) of 0.743 and F test (ANOVA) of 22.08 with a p value of 0.007. This means that bad loans, services, interbank and Firm size explain 74% percent of the variations in the capital structure of NIC bank. The F-value of 22.08 with a p value of 0.007 at 5% significance level is significant indicating that the joint contribution of the independent variables (bad loan, services, interbank and Firm size) was significant in predicting the dependent variable (capital structure). After the merger, regression analysis on the same variables indicated an increase in R^2 by 10% implying that after the merger interbank, service, bad loan and firm size explain 84% of the variations in the capital structure as compared to 74% before the merger. This indicates that independent variables have more strength in predicting the capital structure after the merger as compared to before the merger.

Harford (2005) tries to identify the reason of merger waves. He finds that one very important reason for the merger clustering in time is sufficient overall capital liquidity, which implies lower financial constraint or transaction costs. Combining both findings, we expect that firm's capital structure should play an important role in the merger activities. Specifically, we are interested in the interaction between Merger and firm's capital structure.

4.2   Effect of interbank on capital structure before and after merger

Coefficient estimate for interbank before the merger was -0.306 with a p value of $0.003 < \alpha = 0.05$, suggesting there was a significant interbank influence on capital structure, one unit increase in interbank reduce capital structure with 0.306. However, after merger coefficient estimate increased up to -0.511 with a p value 0.003 implying that there was the higher significant influence of interbank on the capital structure after the merger than before merger. Gale, 2004 closely analyze the effect of the participation in interbank markets in determining bank capital. The emphasis on the relationship between bank capital and participation in interbank market arises naturally given that, at least in principle, interbank markets reduce the scope for bank capital as a risk-sharing device

4.3   Effect of firm size on capital structure before and after the merger

Effect of firm size on the capital structure was reported to be strong after the merger. Before the merger firm size had coefficient estimate $=0.316$ and P value $= 0.002 < \alpha = 0.05$ and that the coefficient was significant. But after the merger, the coefficient estimate changed to 0.940 with a p value of the value of $0.002 < \alpha = 0.05$. This implies that increase in a total asset with one unit yields 0.940 units to capital structure. This increase was significant as shown by a p value of 0.002. Finally in the transitional period bad loan, services, interbank and firm size had no influence on the capitals structure. According to Focarelli, Panetta, and Salleo (2003), the effect of the relative size of target and acquirer depends on the size of the acquirer. It shows that for medium sized firms, the ratio of target to acquirer size is negatively correlated with acquirer returns. This arises because medium sized firms acquire relatively large firms for defensive purposes if private benefits are high but relatively small firms in positioning mergers if private benefits are low. In contrast, for small acquirers, we conjecture that the ratio of target to acquirer size and the acquirer's abnormal returns are positively correlated.

5.0   Conclusion and Recommendation

To analyze mergers, the researcher consolidates the balance sheets of the banks involved throughout the whole period studied. The study objectives were to find out the effect of NIC bank merger on its capital structure. The researcher subdivided these into effects of a bad loan, services, the interbank and firm size of NIC bank merger on its capital structure. Based on the study findings merger caused firm size, bad loans and income from bank services to behave positively toward the capital structure.Although firms size and income from services positively affected the capital structure, after the merger the effect was stronger than before merger.   This confirms an increase in firm size and income from services creates more channels for funds, thus reducing the rate of borrowing and hence total debts. Nevertheless, the study concurs that interbank reduces the capital structure ratio after the merger. This implies that borrowing between merging banks decreases debts in the capital structure.

The researchers sought to address the reality of continued merger activity in the banking industry. The management of the Banks should be aware that mergers are increasingly faced with intensive global competition. They should be aware of the importance of mergers as a strategy in providing them with a competitive advantage in a free market system. The key to competing in the international market place is to simultaneously improve both quality and productive services on a continual basis. In today's competitive and changing business world, mergers have brought changes in capital structure as well financial management effectiveness and efficiency. Banks should now be more concerned about the effects of capital structure as results of the merger because they have now more ways of improving merger than before since researchers have come with a wide variety of merger practices literature .

The study found out that there has been a steady increase in total assets, services and interbank after the merger. The study recommends the following areas for scholars with interests in this area; Effects of merger on total

asset, effects of merger on services, the role of the senior management in the provision of effective merger and factors affecting mergers and acquisitions

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