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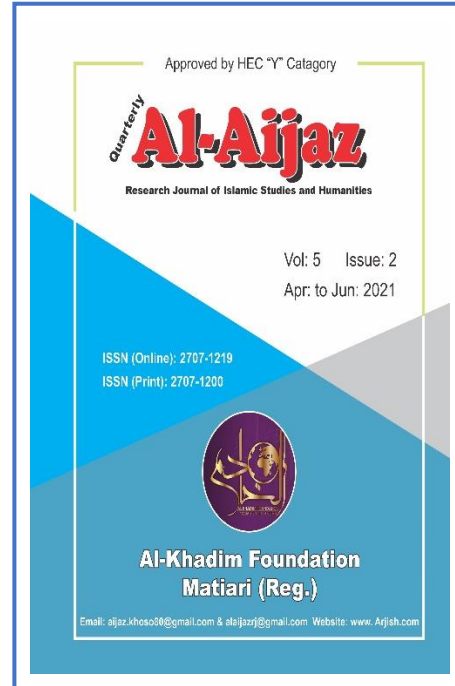
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TOPIC:

Merger and Acquisition Financial Performance Analysis of Conventional and Islamic Banks CASE OF KASB AND BANK ISLAMI

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Merger and Acquisition Financial Performance Analysis of Conventional and Islamic Banks CASE OF KASB AND BANK ISLAMI

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Abstract

Mergers Acquisitions (M&A) are known as the one of major useful practice and strategies for market development, market penetration, extension and growth of the firm. (M&A) strategies have commonly used and adopted in all over the world, these (M&A) practice also adopted in Pakistan by many firm, recently in telecommunication sector (M&A) adopted by Mobilink and Warid Telecom. This study purposes to evaluate and analysis the impact of (M&A) on Islamic banking if commercial bank merged with Islamic Bank by using the analysis of event study for the period of 2011 - 2017, In this paper Meezan bank limited data also analysis and Meezan bank limited result set as industry bench mark. Our findings indicate that merger of the company no relation or very week relation with Profitability.

Keywords: Ratio Analysis, leverage, liquidity, Mergers, Acquisitions, financial performance financial ratio analysis, capital adequacy ratio, profitability ratio, Conventional bank.

1. Introduction

1.1 Study Background

There are around 270 Islamic banks overall demonstrating that Islamic investment isn't limited to Islamic countries. As indicated by Kerr (2007), although the fast development of Islamic banks and investment, particularly in the recent decade, few studies observed on the performances of Islamic finance institutions (Zopounidis, 2017). There are five fundamental standards that separate Islamic banking system from conventional banking system (Beck, 2013). Riba is prohibited (interest rate is illegal in Shariah), another principle of islamic baking is gharar not allowed (High risk, gambling), financing of prohibited activates illegal in Islamic law, such as weapons, drugs, and different exercises that prohibited in Quran. One of the important principle of the Shariah, sharing profit and risk on capital invested. alcohol, and pork. Standards of high significance are the sharing of benefits and hazard between the contributor and the borrower and all exchanges must be upheld by the genuine exchange of a genuine resource. Similarly, investing in government securities with fixed and floating interest rate or coupon rate, inflation, time value of money and foreign dealing are also illegal in Shariah (Zopounidis, 2017).

The bank Islami started its functions on 07 April, 2006. The bank Islami has number of

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branches on across the country 213 branches in eighty (80) cities of Pakistan. On 11 May, 2015 KASB (Khadim Ali Shah Bukhari) bank merge with bank Islami and turn into part of Islami Bank. Currently bank Islami is the eleventh largest banking system which is include 317 branches. The services offered by the bank Islami is consumer banking retail banking, trade financing, investment banking and other related Islamic banking services. (Bank Islami).

1.2 Research Gap

This research intentions and focus to analysis premerger and post-merger financial performance of selected firms. The aims of this paper is to evaluated and analyses impact and effect of merger and acquisition on financial position and overall performance of the merged banks in term of liquidity cash and other current assets, current liabilities, profitability, revenue, cost of sale, leverage long term liabilities, owner equity and capital management. In previews studies mostly researchers, such as (Salama & Hasen, 2015; Rehman & Ali, 2017; Shah & Khan,2017; Ombaka & Jagongo, 2018) focused on the performance of commercial bank. In this study, researcher investigates the performance of Islamic banks, if commercial banks merged with Islamic banks.

Many researchers (Ahmed, Nahrio, Parhyar, & Askaree, 2020; Asinakaopoulos & Athanasoglou, 2013; Vallascas & Hagendostt, 2011; kwoka & pollitt, 2010; Kumar, 2009; Badreldin & kalhoefer, 2009; Hassan & lowerence 2008; Odeck, 2008; Rezitis, 2008; Berger & Humphery, 1992; yeh & Hoshino, 2002) studied on the impact of merger and acquisition developed countries but still need of attention on this area especially in Pakistan (Arshad, 2012).

1.3 The Purpose/Goal

Throughout the most recent of years, mergers and acquisitions (M&A) have turned into a well-liked key decision for organizations around the world for the developments and extensions. Decisions of Merger and acquisitions significant impact on the company's short-and long term performance and success and it may be cause of bankruptcy (Bauer and Matzler, 2014; Lodorfos and Boateng, 2006). Merger and acquisition are the famous strategies for business extension in advanced countries. Nowadays, it is also expanding in developing and stable GDP countries (Ahmed et al., 2020). Economy of Pakistan is also evidence of such practice since last few years especially in the banking sector (Shah & khan, 2017). Merger and acquisition is the important management decision making activities. That is why, current market sensing is necessary.

This study report the (M&A) practical applications using financial ratio analysis typically performed by business for performance evolution.

Literature Review

Many studies and previous understanding of the comparative studies of conventional and Isamic banks reported that Islamic and conventional bank face many difficulties when they adopted merger and acquisition strategy (Bech, 2013). In comparison of conventional and Islamic banks during the period of financial crisis 2008, Dridi and Hasan (2010) examine that the financial crisis impact on Islamic banks had a no effect or lower negative effect on

profitably, but in 2009 high decline impact on Islamic banks performance as compared with conventional banking industry, many large Islamic banks also part of this study including Jordan, Turkey and Malaysian banks. The positive impact of study also reported that Islamic banks asset 100% increased during financial global crises as compared with conventional banks

Mostly two method are used for the measure the impact of merger on merged and acquired firm. One of them is operating performance analysis which measure pre-merger and post-merger analysis, and other one is share price analysis method which measure the effect of merger and also acquisition using share price value of targeted and acquirer firm (Kumar, 2009). In this paper authors used operating performance method to examine impact of merger and acquisition.

Research Methodology

In this research paper, the impact of pre and post Mergers and acquisition analysis and examine the financial and operational performance of the Bank Islami using the available financial information for the period 2011 to 2017, Mezzan bank limited performance set as industries benchmark performance.

Merged/Acquirer Company	Year	Targeted Company	Deal Value
Bank Islami	2011-2017	KASB Bank	19,508.616

The following framework is established for this study. It shows the relationship between the Merger transactions as independent variable and the operating performance as dependent variable. The dependent variable (financial performance) is measured by using financial ratios, grouped into three categories including profitability, liquidity, and leverage ratios. In this research study, we measure the impact of Merger and acquisition on bank Islamic we compare the performance of bank Islamic with Meezan Bank from the year 2011 to 2017, both bank working in same environment and shariah rules, so we suppose that extraordinary change in performance of Bank Islami can cause of merger and acquisition for measure the this change we analysis data from 2011 to 2013 as pre-merger performance and from 2015 to 2017 as post-merger performance, to overcome the external effect we skip the 2014 year data as the merger year, in the same we also analysis the Meezan bank data from 2011 to 2017. We also analysis the result of KASB bank last 3 years (2011-2013), this result shows the position KASB bank when KASB bank move to merger and acquisitions and Bank Islamic decide the acquire the KASB. Table 1 show the result of per-merger result of the KASB bank.

Chapter 04 Results and Discussions

4.1 KASB Bank Ratio Analysis from 2011 to 2013

Table 1

Ratio Name	2011	2012	2013	Average
Profitability Ratios analysis				

Return on Assets ratio	-3.3%	-1.2%	-2.31%	-2%
Return on Sales ratio	-52%	-16%	-32%	-33%
Gross Profit ratio	-11%	35%	43%	22%
	= -11%	= 35%	= 43%	
Return on shareholders' Equity ratio	-72%	-40%	-1.16%	-38%
	= -72%	= -40%	= -1.16%	= -38%
Liquidity Ratios analysis				
Current Ratio analysis	18.00	8.00	7.27	11.9
Cash Ratio	5.40	5.43	5.67	5.5
Net Working Capital	15198495	6188944	5460323	8949254
Leverage Ratios				
Debt Ratio	95%	97%	98%	97%
Equity Ratio	5%	3%	2%	3%
Debt-Equity Ratio	20	32	49	33.67

When bank Islamic decide to acquire the KASB bank, KASB bank profitably ratios not in good position, one of the major cause behind this acquisition. Table 1 profitability average result show that only gross profit is positive in position at 22%. 22% gross profit not enough to cover the all expenses of KASB bank. Furthermore, return on sale highly in negative position, assets of the KASB bank also not generate profitable income and shareholders bear the loss in three years 38% average per year. Year 2011 is dark year for KASB after 2011 KASB bank move toward positive and improve performance but not stable their position and targeted by Bank Islami. Leverage ratio result shows that KASB bank working under 97% debt financing, equity ratio decrease year by year and debt increased. These results show that's KASB bank does not continue their operation further without external help.

4.2 Bank Islami Ratios Analysis from 2011 to 2013

Table 2

Ratio Name	2011	2012	2013	Average
Profitability Ratios				
Gross Profit	47%	41%	39%	42%
Return on Sales	-3%	3%	3%	1%
Return on Assets	0.24%	0.24%	0.21%	0.23%
Return on	2.7%	3.28%	3%	3%

Liquidity Ratios

Current Ratio	0.6	5	3.66	3.09
Cash Ratio	2.93	1.75	1.44	2.03
Net Working Capital	8071514	11348064	8988646	9669408

Leverage Ratios

Debt Ratio	90%	92%	93%	92%
Equity Ratio	10%	8%	7%	13%
Debt-Equity Ratio	10	12	13%	11.67

4.3 Meezan Bank Ratios Analysis from 2011 to 2013*Table 3*

Ratio Name	2011	2012	2013	Average
Profitability Ratios				
Gross Profit	55%	58%	58%	57%
Return on Sales	15%	18%	17%	17%
Return on Assets	01%	01%	01%	01%
Return on Equity	19%	18%	18%	18%
Liquidity Ratios				
Current Ratio	10.55	8.18	12.75	10.49
Cash Ratio	10.00	7.97	12.02	10.00
Net Working Capital	110025211	154416556	176203309	146881692
Leverage Ratios				
Debt Ratio	93%	94%	94%	94%
Equity Ratio	07%	06%	06%	06%
Debt-Equity Ratio	13.55	15.57	16.43	15.19

4.4 Bank Islami Ratios Analysis from 2015 to 2017*Table 4*

Ratio Name	2015	2016	2017	Average
Profitability Ratios				
Gross Profit	43%	43%	49%	45%
Return on Sales	-2%	5%	0.72%	0.29%
Return on Assets	-0.11%	0.25%	0.72%	0.29%
Return on Equity	-1.75%	4%	11%	4.42%
Liquidity Ratios				

Current Ratio	10%	4.46%	1.79%	5.41%
Cash Ratio	1.91%	1.06%	0.63%	1.2%
Net Working Capital	45919114	24940007	15398388	288752503
Leverage Ratios				
Debt Ratio	94%	94%	93%	93%
Equity Ratio	6%	6%	7%	6.33%
Debt-Equity Ratio	14.5	13.5	14.8	14.26

4.5 Meezan Bank Ratios Analysis from 2011 to 2013

Table 5

Ratio Name	2015	2016	2017	Average
Profitability Ratios				
Gross Profit	55%	58%	58%	57%
Return on Sales	15%	18%	17%	17%
Return on Assets	1%	1%	1%	1%
Return on Equity	19%	18%	18%	18%
Liquidity Ratios				
Current Ratio	14.98	7.96	7.00	9.98
Cash Ratio	5.98	4.53	3.83	4.78
Net Working Capital	282075194	286193165	287938065	285402141
Leverage Ratios				
Debt Ratio	95%	95%	96%	95%
Equity Ratio	5%	5%	4%	5%
Debt-Equity Ratio	19.19	20.58	21.28	20.35

4.6 Pre and Post performance of Bank Islami Ratios analysis

Table 6

Ratio Name	Pre	Post	*ΔBI	*ΔMB
Profitability Ratios				
Gross Profit	42%	45%	3%	8%
Return on Sales	1%	2.9%	1.9%	-5%
Return on Assets	23%	29%	6%	-1%
Return on Stockholders' Equity	3%	4.42%	1.42%	-10%

Liquidity Ratios

Current Ratio	3.09%	5.41%	2.32%	-0.51
Cash Ratio	2.03%	1.2%	-0.83%	-5.22
Net Working Capital	9669408	288752503	279083095	138520449

Leverage Ratios

Debt Ratio	92%	93%	1%	2%
Equity Ratio	13%	6.33%	-6.67%	-2%
Debt-Equity Ratio	11.67%	14.26%	2.59	5.17

* Δ BI change in performance of Bank Islamic

* Δ MB Change in performance of Meezan Bank

Table 6 shows the pre and post-performance of the Bank Islami and also show the performance of Meezan bank, table 6 result show that probability ratio increased after merger, gross profit increase from 42% to 45% change in performance of gross profit after merger only 3%, at the same time industry performance increased 8% this result show no positive effect of merger and acquisition. Return on sale increase from 1% to 2.9% with increase of 1.9% at same time industries performance too much low, after merger increase in return of sale of bank Islami can be effect of merger and acquisition, return on sale show positive effect of merger and acquisition. Return on asset of bank Islamic increased from 23% to 29% at same time industry performance decreased. Return on shareholder equity increase from 3% to 4,42% with increase of 1.42% at same time industries performance too much low, after merger increase in return of shareholder equity of bank Islami can be effect of merger and acquisition, return on shareholder equity show positive effect of merger and acquisition. Overall profitability ratio increased as we compare with industry ratios, but no extraordinary effect of merger and acquisition seen.

Liquidity ratios show the financial position of current assets over the current liability we suppose that increase in current assets over the current liability show good current health and wealth of company. Current ratios of bank Islamic increase increased from 3.09 to 5.42%. at the same time change in industries performance decreased. Cash ratio decreased in Bank Islamic and in industry. Net working capital amount increased in both sides. After merger bank Islamic own high debt ratio. Overall leverage ratio increased, change in leverage ratio can be recognized as merger and acquisitions effect. It is observed that comprehensive analysis result show no major effect on Bank Islamic performance. However, that debt on bank Islami increased after merger and acquisitions, profitability and liquidity ratios little bit increased.

RECOMMENDATIONS AND CONCLUSION

This study aims to evaluate the impact and effect of Merger on the operating performances of Bank Islamic in Pakistan during the period of 08 from 2011 to 2017. The pre-merger and acquisition and post-merger and acquisition financial performances are measured and analysis, degree of change in financial and operating performance is tested. Liquidity, Profitability, and Leverage ratios analyses used for to compare the pre-merger and acquisition and post-merger and acquisition financial performances of the Bank Islami. Results show that the profitability ratios, increase and liquidity and Leverage ratios decrease. In this study only one case of merger and acquisition analysis for better results merger cases can be increased. In this study we set only one Meezan bank as benchmark of industry for more accurate result more than one banks can set for benchmark.

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