IMPACT OF RECAPITALISATION ON MERGERS AND ACQUISITIONS IN NIGERIA'S BANKING SECTOR

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Abstract
The central bank of Nigeria's (CBN) recent recapitalization directive, which requires commercial banks to increase their minimum capital to N500 billion for international licenses, N200 billion for national licenses, and N50 billion for regional licenses has led to surge in merger and acquisitions in the banking system. This paper examines the impact of recapitalization on mergers and acquisition in Nigeria's banking sector, with a focus on the types of mergers and acquisitions, motivations, and challenges. The study adopts a qualitative approach, using secondary data from existing literature and industry reports. The findings suggest that the recapitalization directive has accelerated the trend of mergers and acquisitions in the banking sector, driven by the need to meet the new capital requirements. The paper concludes that mergers and acquisitions will continue to play a crucial role in shaping the Nigerian banking sector.

Keywords: Recapitalization; Merger; Acquisition; Banking Sector; Nigeria

1. Introduction

The prevailing economic climate in Nigeria, characterized by liquidity squeeze, foreign exchange decline, and low exchange rate for the Naira, with the concomitant high costs of production and capacity under-utilization, especially in the manufacturing sector, has underscored the necessity for some forms of business re-organization, re-structuring, and risk management. Take-overs and mergers constitute one of the most viable strategies for effecting these economic imperatives. Perhaps, in full realization of this, the Investments and Securities Act (CAP I. 24) LFN, 2025 (hereinafter referred to as "ISA") has, in furtherance of its general innovative philosophy, made elaborate provisions on the law and practice of Take-overs and Mergers.

The CBN's recapitalization directive aimed at strengthening the banking system's resilience and promoting economic development, has led to significant increase in merger and acquisitions in the banking sector. The paper explores the impact of recapitalization on mergers and acquisitions in Nigeria's banking sector, highlighting the types, motivations, and challenges.

2. Literature Review

2.1 Merger and Acquisition/Defined

The terms ' Mergers' and 'Acquisitions' are not words of art with clearly defined legal meanings. And quite often, in general commercial parlance, the two terms are used interchangeably and sometimes in confusion with similar terms like 'reconstruction'/'re-organization' or 'scheme of arrangement'. A close analysis will, however, reveal a thin line of distinction between the two terms. But first, the definitions. The ISA 2025 defines a 'Take-Over' to mean the acquisition by one company of sufficient shares in another company to give the acquiring company control over that company.

The ISA did not define "merger"; nonetheless, Rule 227 of the Rules and Regulations issued by the Securities & Exchange Commission (hereinafter referred to as "SEC") pursuant to ISA 2025 defines it as any amalgamation of the undertakings or part of the undertakings or interest of one or more companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate.

Broadly speaking, a 'take-over' is a transaction or series of transactions where a person, individual (individual, group of individual or company) acquires control over the assets of a company called (the target company) either directly by becoming the owners of those assets or indirectly by obtaining control of the management of the company through a purchase of its controlling shares.

Where the target company is a public company, which is usually the case, the acquisition may be by agreement with the person or group with control or by a purchase of the shares from the Stock Exchange if the Company is quoted or by a take-over bid.

On the other hand, a merger is an arrangement whereby the assets of two companies (say A & B) become vested in or under the control of one company (which may or may not be one of the original two Companies), which has as its shareholders all or substantially all the shareholders of the two merging companies.

Where the new company is one of the merging ones (e.g company A) a merger is effected by an exchange to the shareholders of Company 'B' of the shares of 'Company A' in the case where an entirely new company (Company C) is formed to acquire the assets of Companies 'A & B' a merger would be effected by the shareholders of companies 'A & B' giving up their shares in exchange for those in the new company 'C'.

In either case, the share-for-share exchange exercise is done by a means of take-over bid by company 'A' for the share of another "B" or by a take-over bid by company 'C' for the shares of both 'A' & 'B'. This employment of the take-over bid as a technique for effecting Mergers as well as Take-Overs perhaps explains the confusion between the two terms. From our definitions, the thin distinction between a Take-Over and a Merger may be put thus: In a take-over the ownership or direct or indirect control over the assets of the acquired or taken-over company passes to the acquirer with the acquired or taken-over company now existing as a subsidiary of the acquirer.
Mergers and acquisitions are strategic decisions made by banks to achieve growth, increase market share, and improve competitiveness. The CBN's recapitalization directive has created an environment conducive to mergers and acquisitions, as banks seek to meet the new capital requirements

3.0 Methodology

This study adopts a qualitative approach, using secondary data from existing literature and industry reports to examine the impact of recapitalization on mergers and acquisitions in Nigeria's banking sector.

4. Results and Discussion

4.1 Categories Mergers and Acquisitions

Mergers and Acquisition may be categorized as follows:

a. **Horizontal:** This involves the amalgamation or marriage of two or more companies involved in the production (or provision of basically the same products or services or products or services) which compete directly with each other. (eg the merger of Coca-Cola and Seven-Up Bottling Companies both of which are engaged in the production of two separate brands of soft drinks). Horizontal take-overs and mergers may be informed by a desire to eliminate competition and acquire monopoly of a particular market and always result in a reduction of competing firms in a given industry.
b. **Vertical:** A take-over or merger is vertical where the combination involves two companies one of which is a supplier of goods or services to the other, such that the two companies are both engaged in the production or provision

of the same goods or services but at different stages. (eg, where a Bread Baking Company takes over a flour manufacturing/processing company or a poultry firm takes-over a feeds processing company). What is intended to be achieved in vertical integrations is to ensure a steady and reliable source of supply of a basic ingredient in a given product. This will invariably reduce production costs and ensure greater efficiency.

c. **Conglomerate Mergers and Take Overs:** This is a combination of two or more companies in completely different industries, i.e the businesses of the companies are neither related to each other horizontally (in the sense of producing the same or competing products) nor vertically (in the sense of standing towards each other in a symbiotic relationship) E.g, where a car manufacturing company takes over a food processing company. The object of this type of combination is usually to diversify the production and revenue base of the acquiring company and thereby enhance greater stability of earnings and operations.

4.2 **Economic Basis for Business Combinations**

A fundamental economic assumption underlying the practice of Mergers and Acquisitions in a free enterprise economy (Laissez Faire) such as ours, is that subject to a minimum of governmental interference, optimal utilization of the available national resources will be achieved if people are allowed ample economic freedom to pursue those commercial activities which they regard as commercially advantageous. In the context of t mergers and acquisitions, the laissez faire theory postulates that a person of sufficient economic means who feels that the value to him of the assets of a company is greater than the value placed upon those assets by the existing shareholders (and indeed the investing public in general) should be at liberty to seek to persuade those shareholders to transfer control of those assets to him for a consideration. Similarly, the theory permits the owners and management of two companies who see a business advantage in merging their two enterprises to do so.

Unarguably, therefore, subject to the regime of restriction placed on the practice of business combinations in the national interest, take-overs and mergers remain for all practical purposes a purely economic undertaking with economic implications. As a function of economics, business combinations may be adopted by companies for a wide variety of reasons basic among which are:

a. **Diversification:** A company with an attractive profit record and competitive control of an existing market in its chosen line of business may nevertheless wish to reduce the risk of a mono-cultural investment by diversifying into a completely new line of business. Undoubtedly such a proposal will require huge capital outlay which the company may be unable to source either internally or externally from borrowings.

b. A take-over or merger with an existing company in the proposed line of business will provide the needed capital and at relatively cheaper cost. The emerging enterprise with an improved capital outlay and product range may be twice as stronger in the two lines of business. Some other times, diversification through the instrument of take-overs and mergers may be employed as a mere defensive weapon. In such instance, diversification is usually designed to make the emerging enterprise too large to be likely to be the object of a take-over by another company.
c. **Economies of Scale:** Perhaps, one of the most deadly impacts of our dwindling economy is that a vast majority of manufacturing companies operate at very low capacity. Capacity under-utilization, occasioned by foreign exchange flight is itself a catalyst for low productivity. Interestingly, however, a business combination under such frustrating circumstances re-sulting in an improved and enlarged resource base may enhance capacity utilization with resultant bigger scale of production. This will invariably lead to greater efficiency, increased savings on over heads such as finance, capital expenditure administration, lower unit producing costs and increased profit margin.
d. **Inefficient Management:** In our increasingly pervasive business empire where management competence and excellence are at a discount, good management is certainly in scarce supply. Thus, many otherwise viable businesses with good potential are poorly managed and the assets wasted or under-utilized. A business combination may lead to a more intensive use of good management theme and the displacement of less effective management. The emerging enterprise may, through centralized allocations of financial resources and selection of key personnel and centralized management controls build up and maintain a healthy and profitable group.
e. **Transfer of Technology:** Mergers and take-overs could prove to be viable sources of transfer of technology in a technologically sterile country. This could result where an overseas company with high technological competence proposes to take over a Nigerian company in the manufacturing sector. Through such process, the Nigerian company may benefit from the technological know-how of the foreign company. The practice is no less effective in domestic situations because here, the emerging business concern may be better placed to benefit from a research and development programme because of the pooling of know-how and research budgets. Similarly, a number of smaller companies with considerable technology which have out stripped their financial resources may through combination acquire access to the needed risk capital for the full development of their technologies.

4.3 Reduction of Competition

Mergers and take-overs may be influenced by a desire to reduce competition in a particular market sector, so that the emerging company can exert greater influence on the market and thus determine or raise prices to make more profits. The recent drive by Central Bank of Nigeria for the recapitalization of the commercial banks is ostensibly aimed at achieving this goal and may at the long-run guard against a repetition of the distress experienced by the banks in the late 90s in Nigeria.

4.4 Managerial Motives

Generally speaking, mergers and take-overs are supposed to be in the best interests of shareholders. They are intended to maximize their returns and reduce risk of investment. The truth however is that some mergers and take-overs may be initiated by the management and boards of companies to enable them acquire and control a larger organization. In such cases, shareholders are advised to meticulously study the mergers and take-over proposals to ascertain the profitability or otherwise of the proposed combination.

4.5 Off-Shore Influence

Quite often, mergers and take-overs may be influenced by off-shore business combinations involving foreign companies which themselves have Nigerian subsidiaries. When two foreign companies merge, their subsidiary in other overseas countries may be compelled to merge as well. Such combinations are also a product of economics. This was the case in the Lever Brothers and Lipton Merger.

5. Conclusion and Recommendations

Mergers and Acquisitions are pure economic practices. The overriding considerations in every case are therefore economic. It is my view that the corporate's (shareholders) and the Directors, who are in constant touch with the dynamics of modern investments, are specially enabled to determine the desirability or otherwise of a proposed business combination. The role of the law, in my view ought to be the provision of an enabling environment for the facilitation of mergers and acquisition subject to the need to protect the national interest.

A lot of reforms, are however, still desirable. Unarguably, acquisitions and mergers could prove to be vital tools in restructuring our ailing economy especially in the manufacturing sector. A lot of dying businesses could be saved through the pooling together of resources, the foreign exchange profiles of most organisations could be similarly improved and indeed new investments could be more cheaply undertaken

through their uses. All these would no doubt have positive bearings on our prostrate economy.

The recent recapitalization directive has accelerated the trend of mergers and acquisitions in Nigeria's banking sector. Banks must adopt strategic approaches to mergers and acquisitions to remain competitive and achieve growth. We recommend the banks prioritise risk management and corporate governance in their merger and acquisition strategy.

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