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PERFORMANCE OF ISLAMIC BANKS PRIOR AND POST MERGERS AND ACQUISITIONS: CASE STUDY OF ALSALAM-BMI MERGER

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ABSTRACT

The aim of this study is to evaluate the efficiency of Islamic banks before and after mergers and acquisitions focus on BMI and Al Salam bank. The study adapted a quantitative, non-parametric method, in order to estimate the performance of AlSalam and BMI banks post and prior to merger between the periods of 2012-2015 using accounting ratios. The study found that the acquirer bank (Alsalam), increased its risk, and lowered its performance in terms of efficiency. On the other hand, BMI decreased its risk, and improved its performance

INTRODUCTION

The Business atmosphere has been transformed promptly because of on-going changes in the international environment. The advances in technology have changed the commercial transactions in present corporations to a global level. Each and every business has its vision of becoming a respectable organization; besides its vision to capitalize on market-share and development in the future. Hereafter the business establishments need to be sturdy for them to develop within the market [1].

The main aim of merger is to create a larger bank that had more assets. Assets in the banking industry are a strong force that increases the bank visibility through branches and the automated machines. According to Shaikh Khalid, the chairman of the acquired BMI bank merging was the wisest move for the bank considering the local market was saturated [2]. The only way the bank could compete better with local banks and explore more international markets was to merge with another bank. That way the consolidation would create a

financially stronger institution that would make stamp in both local and international market [3].

The great benefits accrued with M&A is what led to rise of the total banking assets in the United States in control of ten biggest commercial banks from 29% to 49% less than a decade ago [4]. However, this trend is a major concern to the small enterprises. It has been a subject of concern to the policy makers and regulators because with this high market concentration, it has made it difficult for the small businesses to get finance from these complex bank institutions. This usually happens when the consolidated banks decide to use their market power [4].

Usman and Obaidullah (2010) examined Pakistan banks by studying pre-and post-mergers and acquisitions economic performances with the help of accounting ratios and find out the need of new corporate opportunities for transforming technological atmosphere to boost their performance which is probably through M&A merger and acquisition [5].

The study by Ismail, Abdou and Annis (2011) from the Bahrain and Turkish banks discovered that M&A impacts negatively on their performance. Their research was cantered explicitly on accounting statistics and stock market prices. These are caused by a turbulent incorporation process which leads to challenges related to integrating various cultures for the workplace. Also, loss of productivity due to power management struggles. Extra expenditures that must be sustained to make purchases also contributes to the decrease in the stock value after M&A. Lastly, are accounting matters that deteriorates the annexation of the corporation's financial situation, including a reshuffling of goodwill and charges [6].

The study by Kalimeris (2010) also indicates that there are clear indication that banks which tend to go for mergers and acquisitions transactions did not perform well. The banks' liquidity was not value-added after M&A, and they deteriorated by the general banking industry scenario. According to the State Bank of Pakistan's financial analysis statement for the period 2006 to 2011, the leverage proportions are analyzed by way of mixed-trend; however, the outcome of the research indicated negative progress within the post-M&A period [7].

This paper will focus on BMI and Al Salam bank merger. The two banks merged at the end of the year 2013 with Alsalam bank acquiring BMI bank. The acquisition resulted to a merger between the bank's assets and liabilities [8]. During the merger the shareholders of BMI bank swapped each of their shares with 11 shares of Al Salam Bank. The effects of BMI bank and Al Salam Bank on the both market concentration and borrowers will be evaluated to see the merge disturbed the balance of financial industry in Bahrain. The paper will assess the effect of M&A carried out by BMI and Al Salam bank based on their performance before and after the merging processes.

METHODOLOGY

The financial ratios deducted from the financial statements of any company provide valuable information to aid in the analysis and decision-making process of the company. The financial ratios used in analyzing a company include liquidity ratios, financial leverage ratios and profitability ratios [9]. This study analyzes and estimates the efficiency of Islamic banks post and prior to M&A. Method of data collection and data analysis Data for the study was quantitatively retrieved from the annual reports of the studied banks.

Research Design

The research will adapt a quantitative, non-parametric method, in order to estimate the performance of AlSalam and BMI banks post and prior to merger between the periods of 2012-2015. The ratio analysis process for Al Salam and BMI bank will utilize the different categories of accounting ratios in order to analyze and interpret the trend noted pre-merger and post-merger. These ratios are categorized into three groups:

Liquidity Ratios

(Current Ratio, Cash Ratio, Net Working Capital to Current Liabilities)
Liquidity ratios, as the name implies, focuses on getting the most current liquidity level of a company by measuring the cash and cash equivalents to the prevailing current liabilities. Net working capital to current liabilities also provides the company with a measure of the liquidity levels as well as financial strength of the company on the short term [10].

Financial Leverage Ratios

(Total Debt Ratio, Debt/Equity, Equity Ratio)
Financial leverage ratios focus on the financial stability of a given company. It helps to monitor the ratio of the total debt of a company to the total capital; thus, providing basis to measure the total value owned by owners of the company, as well as value owned by debtors. This research will focus on 3 financial leverage ratios: Total Debt Ratio, Debt/Equity Ratio, and Equity Ratio. Total Debt Ratio is often considered as a mean of measuring risk. It quantifies how leveraged a company is by dividing its total debt to its total assets. On the other hand, Debt to Equity Ratio measures the financial stability of a company by providing details on the amount of debt over the equity owned by the owners of the company. Meaning, it shows the extent to which shareholders' equity can fulfil a company's obligations to creditors. Equity Ratio provides the percentage of the total capital of the company owned by the owners of the company. These ratios allow the company to understand and monitor the wealth of the shareholders as well as serve as a parameter to measure company performance on the basis of the potential investor. The measure of the financial leverage helps a potential investor understand what the business makes that belongs the investor or equity owner as well as the company financial exposure.

Profitability Ratios

(Return on Assets, Return on Equity)
Profitability ratios are meant to measure the profit levels of the company such as return on assets and return on equity. Return on assets measure the profitability of a company against the assets measuring the utilization of the company's assets to produce profits. The return on equity shows the ability of the owner's capital to generate profit.

RESULT AND DISCUSSION

ALSALAM BANK

Liquidity Ratios

Current Ratio: The current ratio is a commonly used liquidity ratio that measures a company's ability to pay its current liabilities with its current assets. Graph 1 shows how much the current ratio fluctuated. For year 2013, the ratio is 1.33. This means that Alsalam bank had BD1.33 in current assets for every BD1 of current liabilities. The ratio fluctuates in post-merger. It declines majorly in the first year, being at 1.20. It then goes up to 1.27 in 2015.

Cash ratio: The cash ratio is a mean to determine the company's ability to pay off its short-term debt. In this case, the merged assets of the two banks led to an increase in cash ratio, as it increased by .07 in 2014. Although it decreased to reach 0.12 in 2015, it is still higher than pre-merger cash ratio.

Net Working Capital to Current Liabilities:
The ratio decreases for Alsalam Bank post-merger. It goes from 0.33 in 2013 to 0.20 in 2014. It increases again in 2015 reaching 0.27.

Table 1. Liquidity Ratios Al Salam

Liquidity Ratios	***2015***	***2014***	***2013***	***2012***
Current Ratio	1.2797	1.2071	1.3331	1.3162
Cash Ratio	0.1197	0.1738	0.1055	0.0934
Net Working Capital to Current Liabilities	0.2797	0.2071	0.3331	0.3162

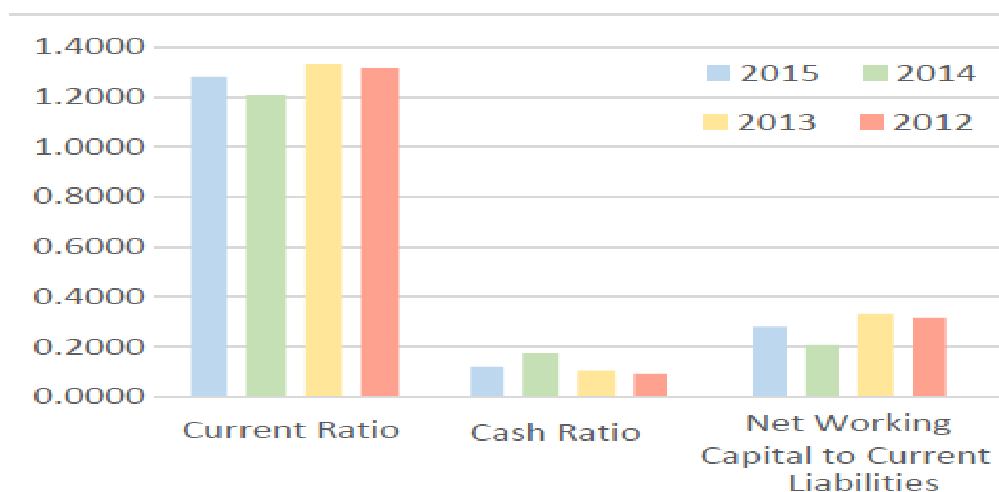

Figure 1. Liquidity Ratios Al Salam

Financial Leverage Ratios

Total Debt Ratio: Debt Ratio increased noticeably post-merger by 6.73%, which means that the banks have a lot of debt relative to their merged assets. Thus, becomes a bigger burden. However, it goes down to 76.9% in 2015, which is relatively close to their debt ratio pre-merger. Therefore, risk is reduced.

Debt to Equity Ratios: Debt/Equity ratio escalates to 501.7% post-merger; which means that for over 1 BD of Alsalam bank is owned by shareholder, the bank owes 5 BD to creditors. The second year after merger, debt ratio falls to 399.5%.

Equity Ratios: Pre-merger, in years 2012-2013, the equity ratio was at .22-.21 respectively. This implies that of every BD1 employed in the business, the contribution of shareholders is about .22. The first-year post-merger takes the equity ratio down by .5, making it .16. However, by 2015, equity ratio rises to .19.

Table 2. Financial Leverage Ratios Al Salam

Financial Leverage Ratios	*2015*	*2014*	*2013*	*2012*
Total Debt Ratio (TD/TA)	76.9%	81.7%	75.0%	76.0%
	399.54%	501.7%	347.0%	344.1%
Equity Ratio (TE/TA)	.19	.16	.21	0.22

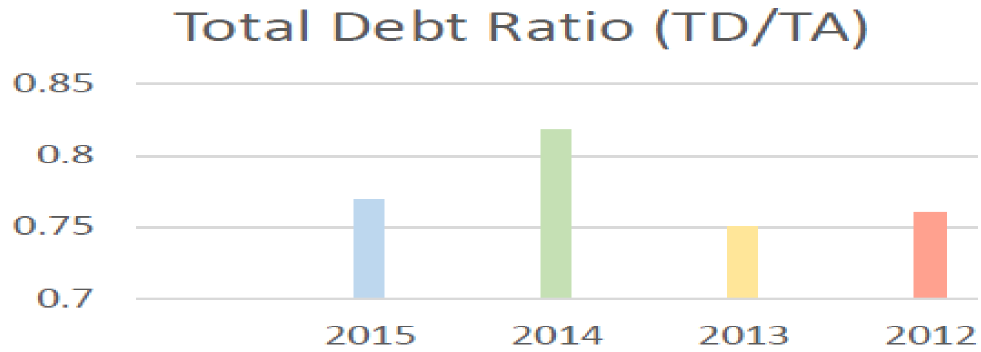

Figure 2. Total Debt Ratios Al Salam

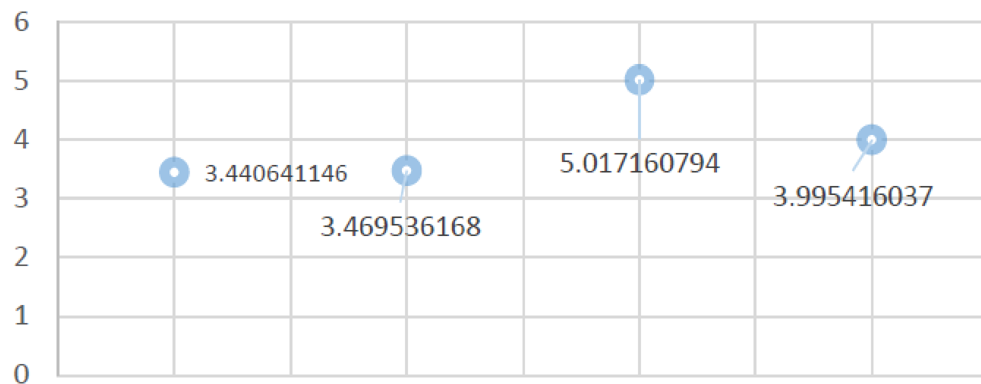

Figure 3. Debt to Equity Ratios Al Salam

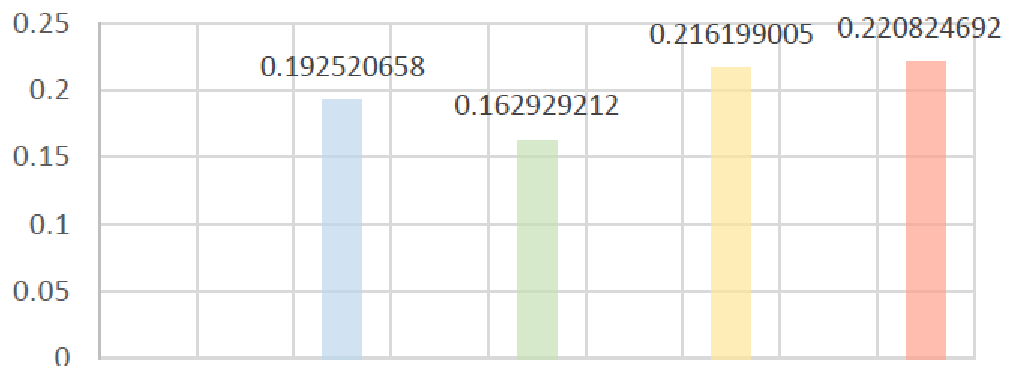

Figure 4. Equity Ratios Al Salam

Profitability Ratios

Return on Assets Ratio (ROA): Return on assets measures the amount of profit the company generates as a percentage of the value of its total assets. First year after the two banks merged, ROA fell from 1.22% to 1.04%. It took an even steeper fall in 2015, where it reached 0.58%.

Return on Equity (ROE): ROE is a measure of profitability that calculates how many BDs of profit the bank generates with each BD of shareholders' equity.

Al Salam Bank used to make BD0.05 for every BD1 f shareholders' equity. Post-merger it went up to BD0.057. The following year it decreased to BD0.033.

Table 3. Profitability Ratios Al Salam

Ratios

Year	2015	2014	2013	2012
ROA (NI/TA)	0.58%	1.04%	1.22%	1.09%
ROE (NI/TE)	3.31%	5.71%	5.58%	4.95%

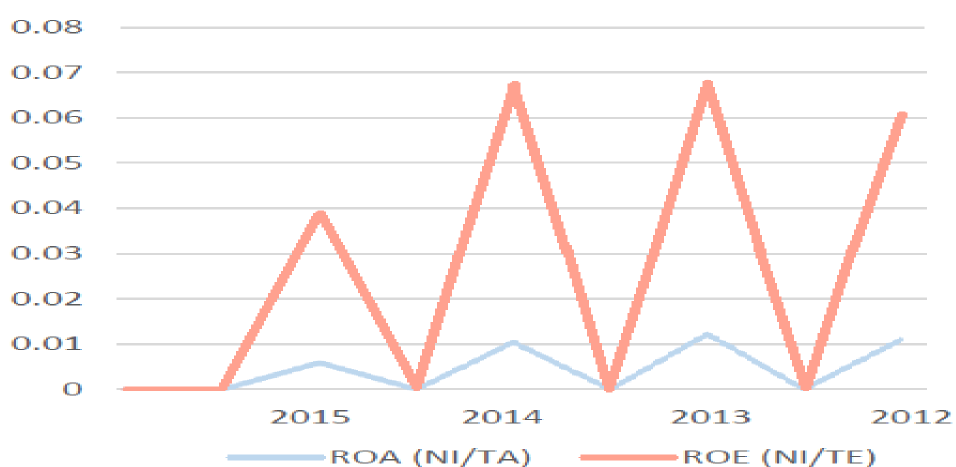

Figure 5. Profitability Ratios Al Salam

BMI BANK

Liquidity Ratios

Current Ratio: Pre-merger, the ratio was at 1.04. After the merger, the current ratio increases, and continues to do so for the two following years. Cash Ratio: The merged assets of the two banks led to an increase in cash ratio, reaching 0.18 in 2014. The following year, it spiked to 0.33.

Net Working Capital to Current Liabilities: The ratio increased greatly post-merger, going from 0.04 in 2013 to 0.24 in 2015.

Table 4. Liquidity Ratios BMI

RATIO/YEAR	2015	2014	2013	2012
CURRENT RATIO	1.2472	1.0980	1.0476	1.1036
QUICK RATIO	0.3357	0.1897	0.1106	0.0658
NET WORKING CAPITAL TO CURRENT LIABILITIES	0.2472	0.0980	0.0476	0.1036

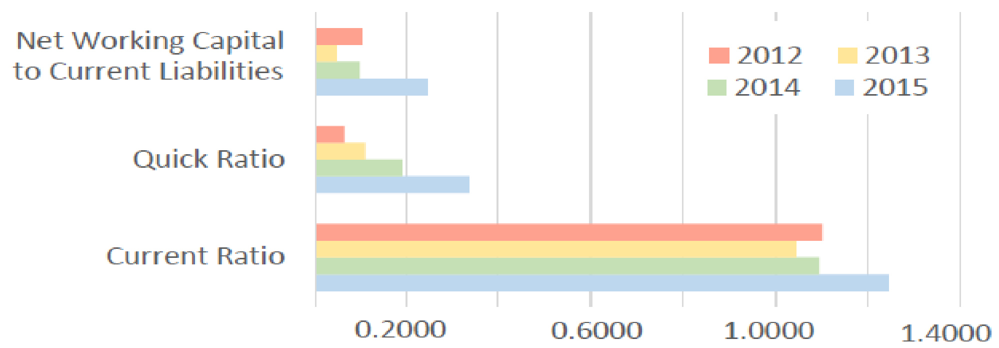

Figure 6. Liquidity Ratios BMI

Financial Leverage Ratios

Total Debt Ratio: Debt Ratio increased noticeably post-merger, reaching 90.3%. However, it goes down to 79.6% in 2015.

Debt to Equity Ratio: Debt/Equity ratio grows to 968.1% post-merger; which means that for over 1 BD of BMI bank is owned by shareholder, the bank owes 9.6 BD to creditors. This is a negative indicator suggesting that the banks may not be able to generate cash to satisfy its debt obligations. However, the second year after merger, debt ratio falls to 565.8%.

Equity Ratio: Pre-merger, in years 2012-2013, the equity ratio was at 11%. This implies that of every BD1 employed in the business, the contribution of shareholders is about .11. The first-year post-merger takes the equity ratio down by 2.3%, making it 9.3%. However, by 2015, equity ratio rises to 14.1%.

Table 5. Financial Leverage Ratios BMI

RATIOS/YEARS	2015	2014	2013	2012
TOTAL DEBT RATIO (TD/TA)	79.6%	90.3%	88.3%	88.7%
DEBT/EQUITY	565.8%	968.1%	758.6%	782.9%
EQUITY RATIO (TE/TA)	14.1%	9.3%	11.6%	11.3%

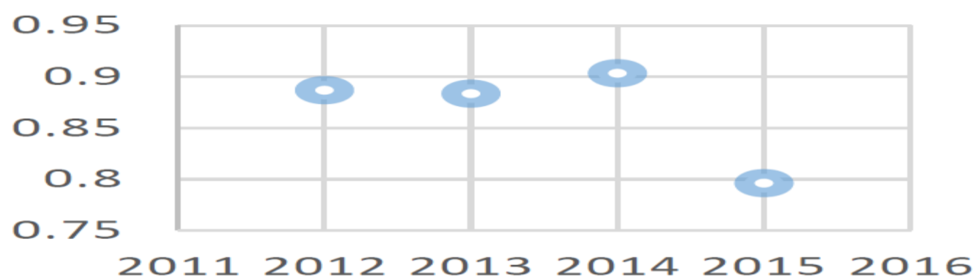

Figure 7. Total Debt Ratio BMI

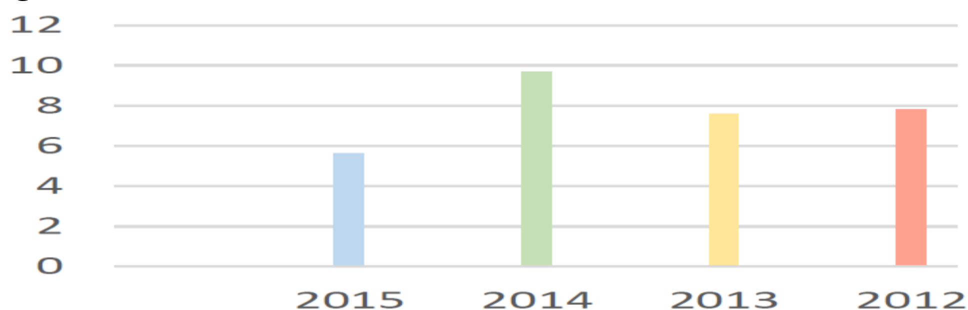

Figure 8. Debt/Equity Ratios BMI

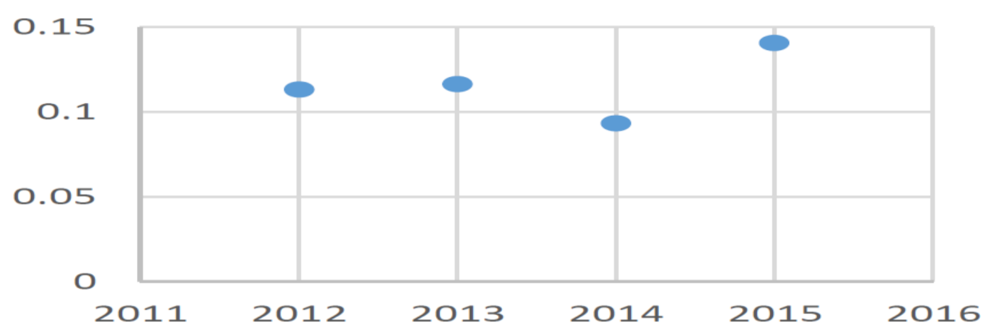

Figure 9. Equity Ratios BMI

Profitability Ratios

Return on Assets Ratio (ROA): First year after the two banks merged was a tough one for BMI, ROA fell -3.57%, indicating the existence of a problem. By 2015, ROA was higher than its pre-merger status, as it has increased to 1.33%.

Return on Equity (ROE): Much like ROA, ROE took a downward fall in 2014. The ratio was at -33.80%. This indicates that BMI is losing BD0.34 for every BD1 of shareholders' equity. However, it escalates to 11.74% the following year, generating BD0.11 for each BD of shareholder's equity.

Table 6. Profitability Ratios BMI

RATIO/YEAR	2015	2014	2013	2012
ROA (NI/TA)	1.33%	-3.57%	0.45%	0.07%
ROE (NI/TE)	11.74%	-33.80%	3.91%	0.58%

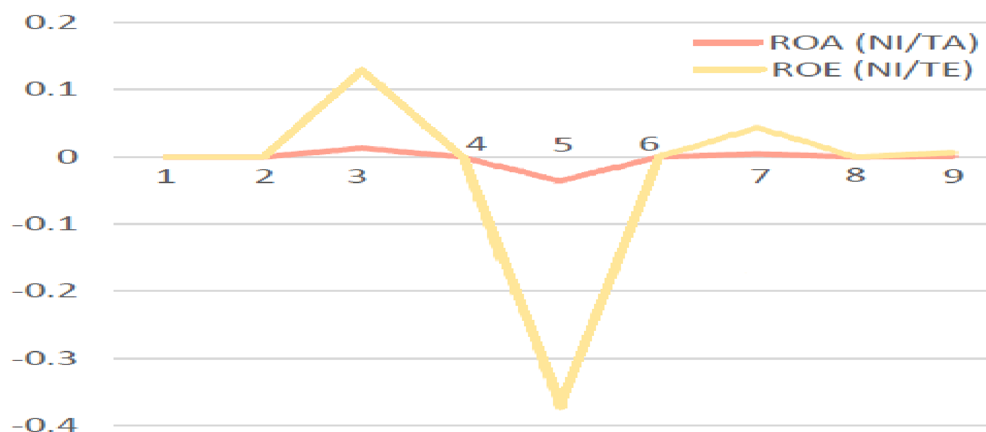

Figure 10. Profitability Ratios BMI

After assessing the effect of Alsalam/BMI merger based on their performance before and after consolidation processes, the analysis took an unexpected turn, as it showed an improvement in one bank, and a decline in the performance of the other.

The liquidity ratios are important in order to determine how easily a company can fund its debt. As a higher liquidity ratio, whether current, cash, or NWC ratio, the more likely you are able to settle your debts. For Alsalam Bank, there was a common pattern for liquidity, financial leverage, and profitability ratios. The ratios were all negatively affected during the first-year post-merger. However, they restore a normal ratio close or better than the pre-merger ratios. Overall, for Alsalam Bank, all liquidity ratios showed a slight, or no improvements, except for the current ratio. The current ratio for Alsalam bank falls in post-merger, which raises a red flag when considering their ability to pay off their current liabilities with their current assets. On the other hand, BMI bank showed a major improvement in terms of liquidity. Due to the merge of assets, all liquidity ratios increased. Therefore, it required to improve the bank's ability to pay off its short-term debt.

When analyzing Financial Leverage Ratios, the first thing noticed is the increase in Total Debt Ratio for Alsalam bank. Meaning, the banks have a lot of debt relative to their merged assets. Thus, carrying a bigger burden, and increasing risk. The same goes to Debt/Equity ratio; it escalated post-merger and continued to be above its pre-merger levels. In general, a high debt-to-equity ratio indicates that the bank may not be able to generate enough cash to satisfy its debt obligations. The Equity Ratio for Alsalam Bank was negatively affected by the merger as well. A low equity ratio indicates a higher risk for credititors. Alsalam Equity ratio decreased post-merger. Though it increased the second year after merger, it remains lower than its pre-merger ratio. The first year after merger was relatively tough for BMI Bank in terms of financial leverage. Total Debt and Debt/Equity ratio escalated majority during the first year. However, it showed an improvement in performance during the second year; the ratios were better than their pre-merger status. Considering this improvement, the merger reduced the risk for BMI'S shareholders and credititors, and improved the bank's long-term solvency position.

In terms a profitability, ROA and ROE ratios showed a falling for Alsalam Bank. Hence, there a problem in generating profit. Not only is that, these ratios a mean to measure efficiency. That being the case, the performance of Alsalam bank has decreased in terms of efficiency. For BMI, similar to financial leverage ratios, profitability took steep fall the first year. The second year showed an improvement, even more than its pre-merger performance.

CONCLUSION

Based on the obtained result, the performance of Alsalam bank did not improve after the merger. Being the acquirer, it suffered the bigger part of burden, therefor decreasing its efficiency, and increasing risk. Alternatively, BMI showed an incredible improvement, as their post-merger ratio shows an increase in efficiency, and a decrease in risk.

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