## PERFORMANCE OF MERGED BANKS IN TANZANIA:  THE CASE OF ANC BANK LTD AND HBC BANK LTD.

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### ABSTRACT

*This paper assesses the impact of mergers on the performance of merged banks in Tanzania using the CAMEL model. The study found no compelling evidence to support the assertion that mergers improve banks' performance as the study had mixed results, both improvement and deterioration in some aspects. It was further observed that post-merger performance is greatly linked to the ability of the banks to strengthen the quality of assets. This is because deterioration in their quality affects both earnings and banks' capital. The study recommends that banks institute robust risk- management systems to improve their performance in the post-merger period as well to increase product innovation in order to prudently invest their excess liquidity to maximize returns.  At the industry level, the study confirmed that bank mergers are unavoidable due to the globalization in financial markets and increased competition in the market. It is thus recommended that policy makers/regulators in Tanzania examine the relevant policy matters necessary for the formulation of an appropriate platform and legal framework for bank mergers. As of now Tanzania's regulators have yet to put in place prudential guidelines and/or regulations on mergers, except for listed companies.*

**Key words:** Bank mergers, Performance, Financial sector reforms

### BACKGROUND AND OBJECTIVES

In response to the 1980s economic crisis, Tanzania embarked on extensive economic reforms that included the financial sector. The financial sector reforms aimed at building an efficient, deeper and robust financial system that would support private sector growth (Brownbridge and Gayi, 2000). An efficient financial sector is of significant importance to any economy because it ensures sustainable economic

growth (Beck, et al 2000). In its report the World Bank stated that, countries with well-developed financial systems tend to have better economic performance than to countries with weak financial systems (World Bank report, 1996).

In Tanzania, banking sector reform was the outcome of the Presidential Commission of Enquiry of 1990. One of the reforms *inter alia* was deregulation of the banking sector, the outcome of which was the influx of banks into the market, including foreign banks. Expected from the reforms was a more vibrant, effective and efficient banking system. However, the contrary is reported to have happened, as pointed out by IMF (2007) that

> "*Despite some indications of progress following recent extensive policy reforms, the current depth and efficiency of the financial system fall well short of what is needed to help support economic growth. Credit to the private sector remains very small and mostly short-term; interest rate spreads though declining are very high as well as accumulated extensive holdings of government paper and sizeable off-shore dollar placements.*"
> (IMF, 2003)

Irrespective of the reforms and increase in the number of banks, the banking sector in Tanzania has experienced bank failures, acquisitions and mergers. Failures included Delphis Bank (2003), Karadha Company Ltd (2000), First Adili (T) Bank Ltd (2000), Greenland Bank (T) Ltd (1999), Trust Bank (T) Ltd (1998), Tanzania Housing Bank (1995), and Meridian Biao Bank (T) Ltd (1995), while the latter involved Delphis Bank Ltd & Trust Bank Ltd, Stanbic (T) Ltd & Meridian Biao Bank Ltd, FBME & Delphis Bank Ltd, and African Banking Corporation Ltd & ULC Bank Ltd. The wave of bank failures, acquisitions and merger in Tanzania undermined the fundamental objective of the reforms namely enhancing banks' efficiency. On the bank mergers, several questions remain unanswered such as do mergers improve the performance of the merged banks? What effects do mergers have and what advantages do they offer to the banking sector? Concerning the value addition of mergers, one posits that;

> "*Bank mergers can have a long-lasting effect, for better or worse, on the structure and performance of a market; the preservation and enhancement of competitiveness in the banking system should be an important objective of any national policy in every market-based economy, hence a realistic appraisal is required of the likely competitive effects of a bank merger.*" (Austin, 2004, p.1.

Recently, bank mergers have attracted regulators' attention due to the potential risks or benefits to the participating banks, the banking sector and the economy at large (Austin, 2004). Biggar (2005) points out that controlling mergers is essential for maintaining financial sector stability. In its report, the G-10 task force (2001) states that the number of bank mergers rose rapidly in the 1990s due to the globalization of

financial markets, deregulation of the financial sector, improved information technology, the search for cost savings and revenue enhancement, and shareholders' pressure for an improvement in financial performance. Austin (2004) argues that in the emerging market, bank mergers took place to rescue banks in difficulty.

This paper examines the performance of merged banks in Tanzania, drawing experience from HBC and ANC (*names of the banks were changed and permission to publish findings obtained*). The next section of this article recapitulates the evolution of the banking sector in Tanzania. The third section contains a statement of the problem studied, followed by the research methodology adopted. The fourth section reviews the relevant literature. The study findings are presented and discussed in section five, and its implications are stated in the last section.

Prior to independence in 1961, the Tanzanian (then Tanganyika) banking sector was unregulated and dominated by branches of colonial banks. The modern banking system emerged in 1905 (Bank of Tanzania (BOT), 1999) following a German bank, the Deutsch-Ostafrikanische Bank, opening a branch in Tanganyika. German banks were later replaced by British banks following Germany's defeat in the first world war.

Immediately after independence, the government established several banks not only to compete with the foreign banks but also to meet the needs of indigenous Africans, who appeared to have been neglected by foreign banks (Lwiza and Nwankwo, 2002). Examples of such banks were the National Co-operative Bank (1962) and the Tanzania Bank of Commerce (1965). From 1967 to 1990s, following massive nationalization in 1967 and the government's ideology of socialism, all banks became state-owned. During this period, banks were essentially a quasi government financing machinery for state owned enterprises (Brownbridge and Gayi, 1998). By the mid 1980s the country was plagued by an unprecedented economic crisis, hitting the banking sector as well.
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To address the financial crisis, reform of the banking sector was unavoidable, and so the Presidential /Nyirabu Commission (1990), recommended various strategies and actions to achieve that purpose, culminating into the Banking and Financial Institutions Act, 1991. The reforms aimed at developing a competitive, well diversified, autonomous, solvent and sound banking system capable of supporting economic development (Rutihinda, 1993). Currently Tanzania's financial sector consists of one stock market, 34 banks, 157 Bureau de Change, 12 insurance companies, more than 6 pension funds and numerous microfinance institutions (BoT, 2007). Moreover, reforms made banking sector more competitive than in the pre-

reform era. This study however focuses on evaluating the performance of the merged banks in Tanzania.

One of the objectives of the reforms was to achieve banking sector efficiency that would support the country's economic development efforts through increased deposits mobilization and enhanced lending (Brownbridge and Gayi, 1998). It has been pointed out that before the reform:

> "*In Tanzania, the banking sector was inefficient, commercial banks had problems and some were technically insolvent. Banks had large volumes of non-performing loans, and unprofitable operations.*" *(Nyirabu Commission, 1990*)

The Commission recommended among others that the banking sector be liberalized, allowing both foreign and private banks to enter the market, which increased the number of banks from six in the 1980s to thirty-four by September 2007, ten of which were foreign banks. The reforms resulted in increased competition, changes and unexpected outcomes, namely deterioration in some banks' performance and failures. Consequently, some banks had to merge their operations to survive and improve their performance. There are three merged bank; namely HBC, ANC and KMC. Expected from the mergers were improved performance as result of economies of scale, enhanced assets quality and increased market share. The study sought to answer the question whether or not the mergers have improved the banks' performance, and whether the improvements (if any) can be attributed to the merger.

## Theoretical and Empirical Framework

### Bank Mergers: A Global Perspective

The number of bank mergers the recent past has been unprecedented in the history of the banking sector. Virtually no country has remained immune. In Germany for example, Koetter (2005) found that between 1991 and 2003, the number of banks declined due to mergers by 48.29%, from 4,177, to 2,160 respectively. Between 1980 and 2002, the number of banks in Malaysia, dropped by 41.06% from 14,000 to 8,252, respectively (Cenbank, 2005). In Africa, the number of Nigerian banks declined by 71.91%, from 89 to 25 banks between June 2004 and June 2006 (Cenbank, 2007) and in Kenya, more than 20 banks merged between 1994 and 2000 (Central Bank of Kenya 2007).

The debate on whether mergers improve banks' performance is inconclusive, although most recent studies seem to converge towards performance improvement. Spong and Shoenhair (1992) observed that banks' performance after a merger either had the same or slightly improved earnings due to improved cost control and asset quality. Berger

and Humphrey (1993*)* on the other hand found that mergers had no significant effect on banks' efficiency., as some mergers improves efficiency while others reduced it. Rhoades (1994*)* review of US bank mergers between 1980 and 1993 found that mergers do not yield any substantial benefits. The study by the Office of the Superintendent of Financial Institutions of Canada (1998) failed to conclude whether bank mergers increase or reduce banks' financial strength.

Walleghem and Willis (1998), focusing on small-sized bank mergers, found that in-market mergers improve both profitability and cost efficiency. Amel *et al* (2002) found that mergers involving small-sized banks are beneficial to the surviving banks through increased economies of scale. Likewise, Panetta (2002*)* and Wilmarth (2002) assert that mergers improve efficiency and profitability through increased economies of scale, and better assets management. Cornett, *et al* (2004) found significant operational improvements resulting from enhanced revenue and cost reduction after the merger, although they argue that the merger of large banks produces greater performance gains than the merger of small banks. Basu, *et al* (2004) observed that following mergers bank returns increased and the risk of insolvency was reduced.

Bank mergers in Tanzania date back to 1967 when all eleven commercial banks were nationalized and merged into one National Bank of Commerce (URT, 1967, Chijoriga, 1999). Prior to the financial sector reforms, mergers remained rare until 2000 when ANC emerged as the merger of two banks. Legislation governing mergers includes the Banking and Financial Institutions Act 2006, the Fair Competition Act, no 8 of 2003 and the Capital Market and Securities Act, 1994. However, bank mergers being a new phenomenon in Tanzania, the BOT is yet to put in place regulations and/or Prudential Guidelines to govern mergers.

## Driving Force behind Bank Mergers

The debate on the driving force behind bank mergers has remained unresolved. Delong (2001), for example, posits that bank mergers have been precipitated by changes in technology, laws and regulations. Brealey, *et al* (2006) and Wayne (1999) provide that mergers aim at eliminating market inefficiency by replacing poor management with a better one. Mansfield (1992) asserts that mergers aim at creating firms' supremacy in the industry. Focarelli *et al* (1999) argue that bank mergers seeks to improve returns through improved lending policies. Elana *et al* (2002) counter the positive arguments in that bank mergers can be unbeneficial to the stability of the financial sector as it can diminish competition in market. Truett and Truett (2004) and Quartery (2001) underscore the negative effects by arguing that, if not properly monitored, mergers can create a monopoly. Our study focused on assessing the performance of merged banks in Tanzania.

**Performance Evaluation Techniques**

Two techniques are advocated in the literature for evaluating the performance of merged banks, operating and event study approaches. The operating approach compares a firm's financial performance between pre and post-merger periods using its financial statements. The event study approach entails observing price reaction of the stock during and after the merger. The operating approach is the only one relevant to this study as our banks are unlisted and it is also the one most widely used (Koetter, 2005, Cornett et al, 2004). Wood (2005) stresses that with ratios, financial statements can be easily interpreted and applied usefully to satisfy the needs of the reader.

As explained earlier, the study will use the CAMEL model to assess performance, as all CAMEL components except for "M=Management quality" can be determined using ratios. C=Capital adequacy component measures the ability of the bank to absorb unforeseeable losses, thus signaling the extent to which the bank is solvent. Four capital adequacy ratios were used in the study namely, total capital to total risk weighted assets (TRWA), off balance sheet items (OBSE), total capital to total assets, core capital to TRWA &OBSE and growth in shareholders' funds.

Asset quality ratios measure the quality of bank assets and earnings capability. Four ratios are used to analyze assets quality, namely, earnings assets to total assets; gross loans to total assets; non performing loans (NPLs) to gross loans and total provision to gross loans. The rationale for this is that interest on loans are the major source of income for banks and the level of NPLs affects banks' earning capability.

Earnings analysis provides evidence as to how effectively and efficiently banks' operations have been managed. Four ratios are used in the study; return on assets (ROA) and return on equity (ROE), which measure the efficient use of banks' assets and returns to shareholders, and the ratio of non-interest income to gross income as well as net interest income to earnings assets, which measure the extent to which banks depend on income from their non-core banking business and the level of efficiency of earnings assets to generate income.

Liquidity analysis measures banks' ability to meet their maturing obligations, as the higher the ratios, the more the liquid a firm is. Excessive liquidity holding is undesirable because of the low yield from most liquid assets. Four ratios were used, that is ratio of liquid assets to total assets, liquid assets to demand liabilities, liquid assets to total liabilities and gross loans to total deposits.

The quality of management is instrumental in the success of corporate governance and organizations. Without strong management banks are more likely to fail (Lingren, 1996).The quality of management is measured by the way banks manage their business affairs, by the quality of the Board and the oversight of senior management, the adequacy and effectiveness of the internal audit, and internal control functions, the adequacy of policies and procedures and risk management systems, banks' compliance with laws and regulations and banks overall performance. Another qualitative performance indicator considered was banks' market share.

## METHODOLOGY

The study assessed the impact of repetition merger on banks' performance in Tanzania, involving two banks, namely, HBC and ANC. The choice of HBC and ANC was prompted by the fact that, prior to financial sector reforms, they were the first true bank mergers to take place in Tanzania. ANC Bank Ltd was established in 2000 following a merger between two financing houses and incorporated by the BoT in the 1990s, becoming fully operational in 2002. The merged bank changed from being a financing house to a commercial bank and commenced operations with an authorized and paid up share capital of TZS 10 billion and TZS 1.75 billion respectively. The HBC Bank Ltd was established in 2004 following a merger between Bank H Ltd and Building Finance Ltd (BFL). HBC commenced its operation with a paid up share capital of TZS 9.58 billion. Both banks operate from Dar es Salaam and have no up-country branches. A third bank merger took place in 2000 when KMC Bank (T) Ltd and KMC Finance Ltd were fused to become KMC Bank (T) Ltd. KMC was excluded because its merger was mere fusion of a subsidiary into a parent company.

The study used the CAMEL model, which is an acronym for C-Capital adequacy, A-Assets quality, M-Management, E-Earnings and L-Liquidity, in the assessment. The model is based on an analysis of the financial statement and is widely used by regulators and the BoT for assessing banks' performance (Lindgren *et al*, 1996*)*. The study covered the period 1999 to 2006, divided into pre and post merger eras for both cases. Both primary and secondary data were collected from the two banks, both of which operate from Dar es Salaam, as well as other relevant and reliable sources. Interviews and structured questionnaires were used to collect primary data. Purposive sampling was adopted to include only staff with working experience of more than 5 years to fill in the questionnaires. The overall performance of mergers was judged using weighted average of ratios. Implications were derived from the results of the majority performance variables.

The study used Hotelling's $T^2$ to test whether there was a statistical significant change in the mean values of the performance indicators calculated before and after merger, hence concluding whether or not there had been an improvement in post-merger period. The test was based on the squared statistical difference (T²) where critical distance (C²) was determined from the distribution of the two samples, T²-statistics. T² and C² were computed for each performance proxy. Under this test the difference in performance between the two periods was considered significant if on average T² is greater than C² (i.e. T²> C²).

## THE STUDY FINDINGS

The study findings are based on administered questionnaires and interviews held with senior management at HBC, ANC and BoT and the analysis of financial statements. Staff members with working experience of more than 5 years were purposively selected to fill in the questionnaires. 61.5% of the respondents had working experience of more than 10 years. Forty questionnaires were received, out of which 70% had useful responses. Performance assessment using ratios for capital adequacy, assets quality analysis, earnings analysis, and liquidity analysis were calculated using three-year average figures in the pre and post-merger periods. The pre-merger and post-merger periods were years 1999 to 2001 Vs 2002 to 2004 for HBC and years 2001-2003 Vs 2004 to 2006 for ANC.

### Capital Adequacy

In Tanzania, banks' capital management is governed by the Capital Adequacy Regulations of 2006, which require banks to hold a minimum core capital to TRWA +OBSE and total capital to TRWA + OBSE of 10% and 12% respectively. Table 2 summarizes the performance in terms of capital adequacy of both banks

The study findings show a deteriorating trend in the post-merger banks' capital. In the case of ANC, the average ratio of core capital to TRWA declined by 0.90%, from 31.73% recorded in the pre-merger period to 30.83% in the post-merger period. Similarly, the average total capital to total assets dropped by 3.0% from 21.04% registered in the pre-merger period to 18.04% the post-merger period. The deterioration is partly explained by the 29% growth in the loan book from TZS 3.45 billion, to TZS 5.45 billion which is likely to increase provisions. A remarkable growth was recorded in shareholders' funds, which grew from minus 5.30% in the pre-merger period to plus in the 16.6% post-merger. Despite ANC's capital deterioration in the post-merger period, the levels were within the regulatory thresholds.

**Table 2: HBC and ANC Capital Adequacy Ratios**

| 3-YEAR AVERAGE CAPITAL ADEQUACY RATIOS | PRE | POST | PRE | POST | % CHANGE | |
|---|---|---|---|---|---|---|
| | HBC | HBC | ANC | ANC | HBC | ANC |
| Core Capital / TRWA + OBSE | 31.15% | 10.60% | 31.73% | 30.83% | -20.56% | -0.90% |
| Total Capital / TRWA + OBSE | 31.15% | 10.60% | 21.04% | 18.04% | -20.56% | -0.90% |
| Total Capital / Total Assets | 23.89% | 6.81% | -5.30% | 16.67% | -17.08% | -3.00% |
| Shareholders' funds growth | 10.67% | 41.49% | 31.73% | 30.83% | 30.82% | 21.97% |

In the case of HBC, the ratio of core capital to TRWA dropped significantly by 20.56% from 31.15% registered in pre-merger period to 10.60%. Further, average ratio of total capital to total assets declined by 17.08% from 23.89% recorded in the pre-merger period to 6.81% in the post-merger period. After shareholders had injected additional capital of TZS 4.9 billion in 2006, shareholders' funds in 2006 grew by 30.82%, from 10.67% recorded in the pre-merger period to 41.49% in the post-merger period. The study noted that the deterioration in the level of capitalization post merger was due to increase the level of non-performing loans.

## Assets Quality

The results of the performance of the mergers in terms of assets quality give a mixed picture, as summarized in table 3.

Table 3: **HBC and ANC Average Assets Quality Ratios**

| 3-YEAR AVERAGE ASSETS QUALITY RATIOS | PRE-MERGER | | POST-MERGER | | % CHANGE | |
|---|---|---|---|---|---|---|
| | HBC | ANC | HBC | ANC | HBC | ANC |
| Earnings Assets/Total Assets | 71.60% | 81.53% | 78.44% | 70.53% | 6.85% | -0.99% |
| Gross Loans / Total Assets | 40.65% | 41.06% | 54.58% | 42.85% | 13.93% | 1.79% |
| NPLs/Gross loans | 0.24% | 0.44% | 8.60% | 0.04% | -8.36% | 0.40% |
| Total provision/Total loans | 0.13% | 7.65% | 4.22% | 3.04% | -4.09% | 4.61% |

On average, in the case of ANC, the ratio of gross loans to total assets shows an increase by 1.79% to 42.85% in the post-merger period. Traditionally, an increased loan portfolio is expected to increase banks' earnings. However, these expectations are only met if such an increase is accompanied by sound risk management practices. Further, the ratio of earnings assets to total assets had dropped slightly by 0.99% to 70.53% in the post-merger period from 81.53% recorded in the pre-merger period.

However, in terms of the ratio of loans NPLs to gross ANC recorded an improvement, as the ratio dropped significantly to a post-merger level of 0.04% from a pre-merger

level of 0.44%. The decline is well augmented and improved by more than 50% to 3.04% in the post-merger period from a per-merger level of 7.65%. This is a clear evidence of strong credit risk management and asset quality.

In the case of HBC, asset quality deteriorated overall. As indicated in table 3 the ratio of earnings assets to total assets declined by 6.85% from 71.60% pre merger to 78.44% in the post-merger period. The ratio of gross loans to total assets increased by 13.93%, from 40.65% recorded in the pre-merger period to 54.58%. The increase was not beneficial to HBC because it was eroded by the increase in the percentage non-performing loans, from 0.24% the in pre-merger period to 8.60% post-merger indicating a deterioration in asset quality. The growth in loan portfolios of 73.93% to TZS 19.55 billion post, was undermined by increased provisions, leading to poor asset quality.

## Earnings Quality Analysis

Table 4 shows that ANC is post-merger earnings improved considerably. On average ROA and ROE went up from negative 0.12% and 0.08% pre-merger to positive 2.99% and 16.63%   post merger. Furthermore, the ratio of non-interest income to gross income increased from 29.49% registered in the pre-merger period to 49.14% post-merger. This implies that the ANC's reliance on non-core and unstable income, such as commissions and service charges, increased. In contrast, the ratio of net interest income to earning assets deteriorated slightly, from 7.18% pre merger to 3.96% in the post-merger period.

Consistent with asset quality, HBC experienced a sharp deterioration in earnings. Post merger, the ratio of ROA and ROE declined to negative 2.14% and negative 260.18% respectively compared with negative 0.08% and negative 4.94% recorded in the pre and post merger periods respectively. Despite gross loans accounting for 54.58% of HBC's assets post merger, dependence on non-interest income grew by 30.06% from 5.37% to 35.43% post merger. Although the ratio of earnings assets to total assets increased by 6.85%, the ratio of net interest income to earnings assets dropped sharply by 28.33% to a very low level of 3.50% in the post- merger period. Detailed analysis shows that in 2001 and 2002 HBC had a positive ROA of 1.00% and 0.47%, and a positive ROE of 2.51% and 2.79% . The worst ROE was in 2005 when 705.5% was registered. This is partly explained by, the 7.0% increase in NPLs from 1.70% in 2004 to 8.70% in 2005 and increased administrative costs. Inability to manage costs could also explain the deteriorating performance.

Table 4: **HBC and ANC Average Earning Ratios**

| 3-YEAR AVERAGE EARNINGS RATIOS | PRE-MERGER | | POST-MERGER | | % CHANGE | |
|---|---|---|---|---|---|---|
| | HBC | ANC | HBC | ANC | HBC | ANC |
| Return on Assets (ROA) | -0.08% | -0.12% | -2.14% | 2.99% | -2.06% | 3.11% |
| Return on Equity (ROE) | -4.94% | 0.08% | -260.18% | 16.63% | -255.25% | 16.55% |
| Non-interest income/Gross income | 5.37% | 29.49% | 35.43% | 49.14% | 30.06% | 19.65% |
| Net interest income/Earnings Assets | 31.83% | 7.18% | 3.50% | 3.96% | -28.33% | -3.22% |

**Liquidity Analysis**

In Tanzania, banks' liquidity management is governed by the Liquid Assets Ratio Regulations, 2000, which require banks to hold a minimum and maximum ratio of liquid assets to demand liabilities and gross loans to total deposits of 20% and 80%, respectively. In the banking business, liquidity is considered to be at the heart of banks' survival and success. This is because history has shown that many banks fail due to liquidity problems. In contrast holding too many liquid assets is considered reckless as they have low yield. The ANC and HBC liquidity analysis is shown in Table 5.

Table 5: **HBC and ANC Average Liquidity Ratios**

| 3-YEAR AVERAGE LIQUIDITY RATIOS | PRE-MERGER | | POST-MERGER | | % CHANGE | |
|---|---|---|---|---|---|---|
| | HBC | ANC | HBC | ANC | HBC | ANC |
| Liquid Assets /Demand Liabilities | 84.12% | 60.00% | 39.46% | 65.78% | -44.66% | 5.78% |
| Liquid Assets /Total Assets | 45.45% | 42.02% | 33.35% | 49.49% | -12.09% | 7.47% |
| Liquid Assets/Total Liabilities | 61.18% | 53.10% | 47.95% | 62.41% | -13.23% | 9.31% |
| Gross Loans / Total Deposits | 61.25% | 57.73% | 65.61% | 53.92% | 4.35% | -3.80% |

The ANC merger improved the liquidity position. The ratio of post-merger liquid assets to demand liabilities rose by 5.78% from 60.0% in the pre-merger period. Similarly, the ratio of average liquid assets to total assets grew by 7.47% from 42.02% pre merger to 49.49 post mergers. The ratio of liquid assets to total liabilities improved by 9.31% to 62.41% post member from the pre-merger level of 53.10%. The merger however could not enhance the lending capacity from deposits as the ration of gross loans to total deposits fell to 53.92% from 57.73% in the pre-merger period. This is despite the tremendous increase in post-merger deposits, which grew from TZS 5.168 billion to TZS 9.379 billion.

HBC's liquidity position declined with the merger. The ratio of liquid assets to demand liabilities recorded a decline of 45%, from the pre-merger level of 84.12%. The declining trend was also depicted in the ratio of average liquid assets to total assets and that of liquid assets to total liabilities, which dropped by 12.09% and 13.23% respectively, from their pre-merger levels. Nonetheless, the ratio of gross loans to deposits increased by 4.35%, from 57.47% recorded in the pre-merger period to 61.25% post merger. During the period under review loans had grown by 140.92%, from TZS 11.65 billion pre merger to TZS 28.08billion post merger, while deposits grew by 73.93% from TZS 11.24 billion to TZS 19.55 billion post merger. Despite the banks meeting all the prudential limits with the exception of the ratio of gross loans to total deposits (80.07%), these trends indicate that their ability to meet legitimate claims is a declining.

## Management Quality

Despite the mixed results in terms of performance, some improvement can be observed in the quality of management of both banks. Board and senior management oversight was strengthened via board organs in terms of the management of assets and liabilities (ALCO), audit, risk management and credit committees, internal audit function, internal controls, policies and procedures, compliance with regulatory provisions, the hiring of competent staff members and improved risk management practices. The improved performance of management was also substantiated by 15.4% and 76.9% of banks, examiners, rating it strong and satisfactory, respectively.

## Market Share Analysis

In the post-merger period, the market share of the banks changed insignificantly, contrary to the theory that mergers increase market share (Kaijage and Tarimo, 1999). As shown in Table 6, there was a slight loss in market share in terms of loans and customers' deposits for both mergers, save for the minor increase of 0.19% in total assets for the ANC bank.

**Table 6: HBC and ANC Average Market Share**

| RATIOS | PRE-MERGER | | POST-MERGER | | % CHANGE | |
|---|---|---|---|---|---|---|
| | HBC | ANC | HBC | ANC | HBC | ANC |
| % of Total Assets | 1.06% | 0.52% | 0.90% | 0.71% | -0.16% | 0.19% |
| % of Gross Loans and Advances | 1.42% | 0.89% | 0.96% | 0.18% | -0.46% | -0.71% |
| % of Customer Deposits | 0.67% | 0.50% | 0.62% | 0.33% | -0.05% | -0.17% |

## DISCUSSION OF THE RESULTS

This study attempted to assess the impact of mergers on the performance of merged banks in Tanzania. Using the CAMEL model, it was found that there was no conclusive evidence to support the assertion that mergers improve banks' performance, as the study had mixed results. While overall ANC's performance changed favourably, HBC experienced negative/adverse performance in the post-merger period.

ANC had improved performance in four aspects; asset quality, earnings quality, liquidity position and management quality. However, it experienced deterioration in capital and a slight loss of market share.  For HBC, except for management quality, all other CAMEL components changed adversely. These findings are consistent with the study by OSFI (1998), which revealed that there is no evidence to show that mergers improve banks' financial strength. The findings confirm Spong and Shoenhair is (1992) assertion that post-merger performance is largely dependent on the ability of the bank to strengthen its asset quality. The deterioration in HBC's performance post merger is largely ascribed to the increased level of non-performing loans, leading to the low quality of assets.

It is worth noting that despite quantitative aspects showing that ANC's performance improved, statistical test ($T^2$) evidence indicates that this improvement was not statistically significant. These results augment Rhoades' (1994) observation that bank mergers do not yield any substantial benefits.

## CONCLUSIONS AND IMPLICATIONS

This study revealed mixed results regarding merged banks performance. The study found a direct link between asset quality and banks' performance. We recommend that merging banks  institute robust risk management systems, especially for assets quality, as this is a prerequisite for improving their performance. Merged banks should increase product innovation for expanded market share, invest excess liquidity and improve further the loans to deposits ratio.

Bank mergers are an unavoidable phenomenon in modern economies due to increased global capital movement and competition in financial markets. Policy makers/regulators in Tanzania ought to review the relevant policies and create an appropriate platform, legal framework and regulations for bank mergers. As of now, Tanzania's regulators have yet to put in place prudential guidelines and regulations on bank mergers, except for listed companies.

Austin (2004) and the Basel Committee on banking supervision suggested a thorough scrutiny of all merger proposals to mitigate against potential negative post-merger impacts. This recommendation is a must for all banks' regulators, including those in Tanzania. Compliance with existing laws such as Tanzania Fair Competition Act is also essential.

The study used both secondary and primary data and applied the CAMEL model covering the period from 1999 to 2006. It worth noting that measuring the benefits promised by a merger requires some time to enable the merging organizations to synchronize their culture, processes and human resources. The three-year period used was too short to make general conclusions on the impact of mergers on banks' performance. Despite this limitation, this study adds to the stock of knowledge on bank mergers in a developing country context, Tanzania. Future studies on the impact bank' merger on banking sector efficiency will generate additional knowledge on the banking sector corporate restructuring strategies and the economy.

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