

REVENUE OPTIMIZATION IN A BUSINESS MERGER

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Abstract

Businesses fuse to become one to assume an advantage in a weak business function. The most critical area of interest that drives merger is taxation, strategic management, technology, geographical location, and access to product-market. This article is centred on the concept of how Firms can optimize revenue, and the goal is to thoroughly examine the significant perception of why some mergers succeed or fail in maximizing revenue. Merger in business is a quicker way to entrench a business into another, a better way to diversify an enterprise product. Workforce development is essential for the Firm to not only survive, but be able to create goodwill and optimize profit: which is the reason a business is created in the first instance. The manpower in the organization is overlooked in the build-up to a merger plan, indicating one of the many reasons business mergers fail. In this study, Cobb Douglass's production function is deployed to reveal that labour has the propensity to optimize revenue when compared to capital. The result shows that if the staff of an organization is strategically developed during the pre-merger stage to fit into the new Company, higher revenue will be achieved within the shortest possible period.

Keywords: General Financial Markets, Financial Institutions and Services, Compensation, Labour Costs, Wages, Mergers; Acquisitions; Restructuring; Voting; Proxy Contests; Corporate Governance, Production; Cost; Capital; Capital, Total Factor, and Multifactor Productivity; Capacity

JEL classification: G1, G2, J3, G34, D24

1. INTRODUCTION

The African economy financial sector growth is contributing to its Gross Domestic Product (GDP) (Kar, Nazlıoğlu, & Ağır, 2011). With these new business strides, leaders of banks have begun the process of merging. According to Duncheon and Goldman (1986), the purpose of a merger results in the emergence of a new organization, increasing company profits, and business continuity. Business managers use mergers as an effective way to optimize business revenue (Rigby & Bilodeau, 2011). Mergers usually involve the consolidation of companies, whereas an acquisition is the complete purchase of one company by another without forming a new company (Buckley & Casson, 2016). Company

mergers may occur at any stage of company development either during the start-up phase or the mature phase.

Intensifying competition in the organization is driving a growing tendency towards mergers of businesses around the world. However, business merger failures are common (Chatterjee, 1986). Smythe (2010), questions whether realizing increased profit is possible. The roles of business leaders include taking benefit of economies of scale, increasing investments in technology, reducing operating costs, and increasing shareholder value (Grant, 2016). Therefore, for a business leader, the primary aim of acquiring a company is to increase shareholder value and reduce operating costs. Less competitive company leaders seek refuge in mergers when the times are tough, and generating revenue becomes difficult (Deng & Yang, 2015). The leaders of a more competitive business organization will purchase another company to build a stronger, more competitive, and cost-efficient business. Furthermore, Piloff and Santomero (1998) state that companies consolidate to attain a more significant market share or achieve increased efficiency in revenue.

The rate of improvement in the financial sector has enabled an equal increase in merger activities in Africa (Phambuka-Nsimbi, Makgosa, Themba, & Iyanda, 2015). Specifically, in Nigeria, notable mergers include Access Bank merging with Marina and Capital Bank, and the merger of Tropical Commercial Bank, New Africa Bank, Centrepont Bank, Bank of the North, New Nigerian Bank, Intercity Bank, Societe Bancaire, First Interstate Bank, and Pacific Bank to become Unity Bank. Although changes in government policies in Nigeria caused the rise in merger activity, the success of such mergers in maximizing revenue for organizations is investigated in this study.

The primary purpose of a merger initiative is to maximize revenue and create additional value for a newly developed organization. Significant potential revenues are recognized during pre-mergers. In addition, although there is no guarantee of the realization of the anticipated revenue, in the final analysis, leaders will attempt the merger for sustainability. Mergers are considered an attractive means of market share expansion and acquiring new products and technology resources (Gomes, Weber, Brown, & Shlomo, 2011). Business mergers have become a surviving strategy for many Companies. Additionally, staff input in a merger is less important than the financial side, but organizational staff strategically implement the merger plan (Harding & Rouse, 2007). Therefore, a successful merger is dependent on input by the staff within the organization. The problem is that the failure of business mergers is caused by a decreased focus on integration and the lack of skills to manage the human side (Cartwright, 2011). In Nigeria, business mergers are failing despite experiencing an enormous increase in the level of Foreign Direct Investments (FDI) (Olusanya, 2013). In 1997, 10 merger bids were recorded in Nigeria; in 2005, the Nigerian banking sector witnessed 25 merger activities (Okpanachi, 2011). Conversely, the unexpected liquidation of 26 Nigerian banks in 1998 and the earlier closure of five banks in 1994 and 1995 was a sign of distress in the banking sector (Umoh, 2004). In 2009,

the CBN declared five Nigerian banks insolvent because of inadequate Capital Adequacy Ratio (CAR) as a result of reckless lending (Okpanachi, 2011). Value creation can prevent organizations from failing and prevent companies from deserting Nigeria and the continent of Africa. A merger is supposed to cut costs and increase revenues by more than enough to justify the cost of investments.

The purpose of this study is to examine the merger of Access Bank of Nigeria and assess the capacity of the Company at optimizing revenue after the fusion. Furthermore, the revenue optimization model is introduced as an important tool for financial growth in Nigeria. Business leaders use the revenue optimization model to save merging organizations from operating with loss of revenue or operating without anticipated revenue. Revenue maximization is measured by comparing the financial value of Access Bank after the merger with the projected value of Marina and Capital Bank, assuming there was no merger. Also, the optimization model is applied to the merged Firm to show strategic mismanagement in banking operations and highlight the availability of opportunities for improvement. The results of this article are timely and of utmost importance to save merged companies in Nigeria by deploying the tool of optimization to the businesses. In addition, the results will encourage FDI and local investments within the African economy to save jobs, create income for stakeholders, and develop the society.

2. TYPES OF MERGERS

The types of mergers include either consortium or absorption. According to Cartwright and Cooper (2014), mergers by consolidation occur when one company absorbs the rest and involves the dissolution of all the merging businesses. Furthermore, the identities of the merged companies are lost (Cartwright & Cooper, 2014). Meanwhile, mergers through absorption occur when all the companies, except one, lose identity (Aluko & Amidu, 2005). Thus, all the merging company leaders agree to maintain the identity of the Firm with the stronger marketing brand.

The primary types of mergers according to Calipha, Tarba, and Brock (2010), are horizontal, vertical, conglomerate, and concentric mergers. A horizontal merger involves the combination of two firms in the same area of business (Ravenscraft & Scherer, 2011). Furthermore, a horizontal merger occurs between companies producing the same type of product. On the other hand, according to Ahern and Harford (2014), the joining of two companies involved in distribution of the same product or different stages of production is a vertical merger. Gaughan (2015) states that vertical mergers can occur in two ways, forward vertical or backward vertical mergers. Ahern (2012) states that a forward merger involves moving towards the market in which the product is sold. An example of a forward merger is the consolidation of a retail gas station by the oil refining companies. A backward merger, however, involves the purchase of other enterprises (Gareche, Hosseini, & Taheri, 2013). For example, a baking industry acquiring a flourmill.

Conversely, a conglomerate merger is between companies where either business is not in the same operating arena either vertically or horizontally (Ashenfelter, Hosken, & Weinberg, 2014). A typical conglomerate might have operating areas in manufacturing, electronics, and insurance. The other type of merger is concentric and involves an outward move from the firm's core activity into a related business to benefit from the economies of scope or the exploitation of shareholders (Korican, Barac, & Jelavic, 2014). The objective of a concentric merger is to diversify around a common core of strategy resources and activities (Ahuja & Novelli, 2017). In addition, a concentric merger involves two firms or organizations operating within separate forms of business.

3. THEORIES OF MERGERS

Evidence exists that merger motivations are agency hubris, synergy, market timing, and response to industry economic shocks (Nguyen, Yung, & Sun, 2012). Approximately 80% of the 3,520 sampled acquirers had multiple motives for merging (Coccorese, Ferri, & Spiniello, 2017). Acquiring managers use overvalued shares to push for personal goals and objectives through merger activities (Nguyen et al., 2012). In general terms, the underlying motivations for mergers are value-increasing and value-decreasing motives (Lebedev, Peng, Xie, & Stevens, 2015; Zhu & Zhu, 2016). Also, cultural factors have a significant impact on the ability of the leaders of the acquiring firm to assimilate merger gains. Empire interests are some of the other motives behind mergers that are different from revenue (Mihai, 2013). The section that follows includes theories on the reasons behind mergers.

3.1 EFFICIENCY THEORY

The uses of mergers create shareholder value through increase in revenue. Efficiency describes the magnitude to which resources, including cost, time, raw material, expertise, space, and energy are well utilized for strategic reasons (Yampolskiy, 2013). Additionally, a company that produces multiple products can reduce costs by a scope economy when the total production and selling expenses of the products are smaller than the full cost of producing and selling. Similarly, efficiency reasons drive merger transactions. Tax advantages, cheap labour, and technological expertise of target companies are exceptional qualities that acquirers are not prepared to lose (Vecchi, 2016). Cost reduction is a source of revenue accomplished from economies of scale and scope (Fatima & Shehzad, 2014). Furthermore, increased bargaining power against suppliers is a source of financial gain. Increased revenue occurs when the merged companies gain superior sales or increase growth levels.

3.2 MONOPOLY THEORY

Mergers can lead to a kind of financial gain called collusive synergy. Collusive synergy involves transferring the wealth from customers to shareholders without actually adding energy to the organization (Chatterjee, 1986). When profit is accessed from a single market as completion in another market, the monopoly is attained (Suwandi & Foster, 2016). The monopolistic market is a situation where there is a complete absence of competition and rising market power (Hennart, 2012). Investor's greed and collusion with policymakers can result in a monopoly. Furthermore, economic reasons such as local content and indigenization policy, where domestic industries are protected from foreign competition, create a monopoly. According to Kennedy (2017), in a monopoly, the protected Company continues to take over similar companies within the same line of business in a hidden way.

3.3 VALUATION THEORY

Target company shareholders experience lower returns in earnings and stock value upon the announcement of a merger. Furthermore, deciding to complete the merger stems from assuming the accounting quality is high within the target company, which comes at the expense of the shareholders from the target firm (Shleifer & Vishny, 2003). The shareholders of the target company extract less from buyers because of higher-quality accounting information (McNichols & Stubben, 2015). Similarly, Goodman, Neamtiu, Shroff, and White (2013), note that high-quality accounting information from a precise valuation of the target firm, allows acquirers to bid more efficiently and pay a smaller purchase amount for a given merger or acquisition. After acquiring the target business, the shareholders of the acquiring Firm are more likely to have an immediate wealth effect.

3.4 DIVERSIFICATION

Diversification can provide risk distribution from one or more businesses (Wolke, 2017). Diversification is a strategic expansion plan that involves a significant increase in organizational performance (Thomas, 2016). Organizational leaders' need for diversification and revenue growth is part of the growing desire to move operations abroad (Chester, 2015). There exists a correlation between diversification in the Firm and an increase in income and opportunity (McWilliams & Siegel, 2001). According to Neffke and Henning (2013), corporate diversification shows overwhelming evidence that companies mainly diversify into industries that are strictly skill-related to the core operating activities. Skill-relatedness among industries impacts diversification decisions within companies (Villasalero, 2013). Although there are possibilities that the relatedness structure changes over time and can be different depending on the country.

4. METHODOLOGY

Cobb-Douglas production function using Econometric Views (Eviews) was used, and the data analysis for this study includes the financial statements from Access Bank on Nigeria between 2003 and 2009 as well as the financial statements from Marina and Capital Bank, between 2003 to 2005, before the business merger. The sources of the data for this study are secondary. The secondary data that is used for quantitative analysis is collected from published financial reports of Access Bank for the years 2005 to 2009. The financial statements for the capital and Marina banks are for the year 2005 before the merger. The optimization is a time series analysis, which utilizes Access Bank financial statements from the years 2005 to 2009. The financial statements and annual reports of Access Bank and Marina Bank are retrieved from the internet, Access Bank, and stockbrokers, respectively.

4.1 MODEL OF STUDY

This study is revenue optimization using the Cobb-Douglas production function. A typical Cobb-Douglas production function is expressed mathematically as follows:

$$Q = AL\alpha K\beta, (1)$$

Where: Q = total production (the monetary value of all goods produced in a year)

L = labour input

K = capital input

A = total factor productivity or efficiency parameter.

α and β are the output elasticities substitution parameters of labour and capital. These values are constants that are determined by available technology. Assume that the formula $Y = F(K, L)$ presides over the relationship between output Y , capital K , and labour L . Also, that F is differentiable. Therefore, every output price level of p , the wage rate w , and r is the capital rental rate, let $K^*(r, w, p)$, and $L^*(r, w, p)$ maximize profit,

$$pF(K, L) - rK - wL. (2)$$

The first order conditions for an internal maximum are:

$$pFK(K^*, L^*) = r (3)$$

$$pFL(K^*, L^*) = w (4)$$

FK signify the partial derivative of F concerning its first variable K , and FL is with regards to L . Assume now that the fraction of output paid to labour is a constant α . Cobb and Douglas chose $\alpha = 0.75$. Where the constancy can be written as follows:

$$(1 - \alpha) pF(K^*, L^*) = rK^* \tag{5}$$

$$\alpha pF(K^*, L^*) = wL^* \tag{6}$$

Dividing through equation 3 by that of 5 will be:

$$1/K^* = FK(K^*, L^*)/(1 - \alpha)F(K^*, L^*) \tag{7}$$

We now use the chain rule and observe that $d \ln(f(x)) = f'(x) f(x)$ for any function f . This allows us to rewrite (5) as:

$$\partial/\partial K \ln F = FK/F = 1 - \alpha \tag{8}$$

In a similar vein,

$$\partial/\partial L \ln F = \alpha \tag{9}$$

Thus, eliminating p , r , and w implying that the above equations hold for every (K^*, L^*) that can result as a profit maximization Cobb and Douglas (1928). If this is all of R^2_+ , then treat equations 10 and 11 respectively as a system of partial differential equations. Since $\int 1/x = \ln(x) + c$, note that c is a constant of integration, the following will occur:

$$\ln F(K, L) = (1 - \alpha) \ln K + g(L) + c \tag{10}$$

where $g(L)$ represents a constant of integration that depends on L ; and

$$\ln F(K, L) = \alpha \ln L + h(K) + c \tag{11}$$

where $h(K)$ is a constant of integration that may depend on K . Combining these pins down $g(L)$ and $h(K)$, namely,

$$\ln F(K, L) = (1 - \alpha) \ln K + \alpha \ln L + C \tag{12}$$

4.2 RESULTS AND IMPLICATION

Data presented in Table 1, is production data of Access Bank between 2005 and 2009. The data has been gathered from the internal records such as financial statements of the Access Bank.

Table 1 (Annual Production of Access Bank)

Year	Capital (000)	Labour, (000) total wage	Production (000)	Total Labour
2005	3,953,161	1,101,176	6,261,274	351
2006	8,161,511	1,843,458	11,941,991	484
2007	13,364,613	4,048,316	22,431,481	729
2008	18,132,114	1,086,778	3,635,2330	1,067
2009	19,161,511	11,245,365	3,984,9626	1,434

Access Bank annual report

Table 2 (shows the results of the analysis carried out by Eviews)

Variable	Coefficient	Std. Error	t-Statistics	Probability
C	82.31	52.83	-1.61	0.03
LOG(Capital)	0.79	4.93	1.61	0.05
LOG (Wages)	0.97	1.34	-0.53	0.06

Table 3 (Values of Constant and Coefficients)

Constant/Coefficient	Value
A	82.31
A	0.79
β	0.97

Table 3 shows the values of constants and coefficients show A is 82.31, which is the value for the total factor productivity. Meanwhile, total factor productivity is a variable that accounts for effects in total output that is not usually measured by normal inputs such as technology and the staff knowledge. The log capital α is 0.79 which indicates the output elasticity of capital or in other words, the responsiveness of output to change in capital. The log wages is the value of β reporting 0.97 which also shows the output elasticity of labour and the rate of responsiveness of output to change in labour. Based on the values generated above, the model is constructed as $Q=82.31 K^{0.798}L^{0.977}$. After we substitute the values of labor and capital, assuming capital and labour is ₦2000000 each, we have:

$$82.31 \cdot 106714.13 \cdot 1432538.51 = 1.25 \cdot 10^{12}$$

The latter result shows that if two million of labour and two million of capital is used Access Bank can produce 1.2583 trillion of production simultaneously.

Substituting capital (k) as 3,000,000 and labour as 2,000,000:

$$82.317 \cdot 147483.27 \cdot 1432538.51 = 1.7392 \cdot 10^{12}$$

Then, if we substitute two million of labour and three million of capital it can produce 1.7392 trillion of output.

If we substitute $K=2,000,000$, $L=3,000,000$ we get:

$$82.317 \cdot 106714.13 \cdot 2128861.78 = 1.8701 \cdot 10^{12}$$

When leaders of Access Bank use three million of labour and two million of capital it can thus produce 1.8701 trillion of production.

Additionally, if capital is 7,000,000 and labour is 6,000,000:

$$82.317 \cdot 289993.48 \cdot 4190383.51 = 1.0003 \cdot 10^{12}$$

The answer indicates a production of 1.0003 trillion

If we substitute the value of capital to be 6,000,000 and labour 7,000,000, the answer will be:

82.317

$82.317 * 256427.59 * 4871478.443 = 1.0283*$

If Access Bank leaders choose to have capital input of 6,000,000 and labour of 7,000,000 the production output will be 1.0283 trillion. The calculations indicate that Access Bank output increases with higher input in labour other than increases in the input of capital.

The Cobb-Douglas production function is estimated through Econometric Views (Eviews) software, to show how Access Bank can optimize revenue. A model is constructed and represented as $Q=82.317K^{0.798}L^{0.977}$, here the value of A, which is called as total factor productivity, is 82.31. The value of α , which is the parameter of Capital (K) and effectively measures the responsiveness of output to change in capital, is 0.798 and the value of $\beta = 0.97$. Beta (β) is the parameter of labour (L) that measures the responsiveness of output to change in the input of labour. The results indicate the value of β , 0.97, is higher than the value of 0.79, and this implies that the responsiveness of labour is more in production compared to the reactivity of the capital. Besides, the model confirms that investment on labour is far more profitable than an investment in capital.

5. CONCLUSION

Optimization has not been considered in the merger exercise of banks and is one of the reasons or justification for this study. Optimization has been suggested as a veritable tool by several academics. For example, Abiola (2010) determines that when Nigerian banks increase in inputs of capital and labour simultaneously, the output of deposits would be more than double. However, in this study, for banks in Nigeria to optimize revenue due to mergers, the input should be more in labour against the capital. Profit maximization utilizes the resources of the company efficiently. The resources such as assets and labour are carefully deployed so that benefits will be automatically enhanced. Unlike profit maximization, profit optimization is reducing the unnecessary costs in the production. By optimizing the profits, the firms can occupy a better place in the international markets. The use of profit optimization is for reducing the costs incurred on wages and the production of finished goods (Meghir, Narita & Robin, 2015). Optimization will improve the profitability of banks and other organizations in Nigeria instead of traditional business ventures where linear programming is implemented or leveraged to increase profits.

Despite the advances in mergers research over the decades, there has been little change in the rates of failure, and the human aspect of the deal is considered as one of the leading causes of the high failure rates. Manpower is of utmost importance in reducing or eliminating merger failures. Mergers can only be considered as satisfactory when more revenues are generated from the exercise.

Labor skills regarding information technology knowledge (Elnaga & Imran, 2013; Kwenin, Muathe & Nzulwa, 2013), emotional intelligence, intelligence quotient, and strategic thinking are significant characteristics with the unique capacity of growing a company's revenue or working in the opposite way to cause failures and disappointments prevalent in Nigeria's merger exercise. Access Bank should leverage on management expertise to improve cash management activities and ensure that the level of cash and cash equivalent is tuned to generate income and ensure that obligation payments are met as the need arises. The Cobb-Douglas production function analysis of this study solves the relevant question of how to optimize revenue in an organization post-merger period.

Based on the analysis Access Bank financial statements before and after the merger, there is marginal growth in the area measuring business performance without actually optimizing revenue. The influencing factors for the absence of enhanced revenue in Access Bank indicate this is partly due to the quality of labour in the post-merger era. Merged institutions such as Access Bank should be more aggressive in business marketing to increase financial efficiency for an improved financial position regarding gross earnings, deposit profile, and profit after tax to reap the benefit of post mergers. The recommendation from this study is the need for companies who merge to enhance the creation of economies of scale, improved bargaining power, business expansions, and community development. Employees are an essential element in human resources and should be a top priority during mergers as well as trained with information technology skills for revenue optimization.

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