

**CHRISTIAN SERVICE UNIVERSITY COLLEGE**



**SCHOOL OF BUSINESS**

**DEPARTMENT OF ACCOUNTING**

**FINANCING THE ACTIVITIES OF RURAL BANKS IN GHANA**

**(CASE STUDY: AMANSIE RURAL BANK)**

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**A RESEARCH SUBMITTED TO THE DEPARTMENT OF BUSINESS STUDIES IN  
PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE  
BACHELOR OF BUSINESS ADMINISTRATION (ACCOUNTING)**

**JUNE 2015**

## STATEMENT OF AUTHENTICITY

We have read the university regulations relating to plagiarism and certify that this report is all our own work and do not contain any unacknowledged work for any other source. We also declare that, we have been under supervision for this report herein submitted.

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## SUPERVISOR'S DECLARATION

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## **ABSTRACT**

The Bank of Ghana in 2009 increased the minimum stated capital of Rural and Community Banks from 50000 to 150000, however the Bank of Ghana gave specific deadline to meet this mandate. This requirement has become so important to boost the operations of the banks, improve their financial capacity and enable them fit in the rapidly changing banking industry.

The sector also has its peculiar inefficiencies that arise from clustering and in the nature of the banks. It has therefore become necessary for the sector to consider the financing option that will improve efficiently and strengthen their financials. This study explored the forming of mergers and acquisitions among rural banks in Ghana. The study found that mergers and acquisitions in the sector has become imperative to eliminate inefficiencies in the sector and increase their financial positions to serve the community better. Some of the challenges of mergers and acquisitions in the sector include high financial cost, social impediment and managerial impediment. The study reviews that successful mergers and acquisitions in the sector will need the support of regulating authorities, support fund, education of directors and shareholders. Gains from synergy, better internal control are some of the ways that mergers and acquisitions will improve the sector.

Key words: mergers and acquisitions, synergy and financial capacity.

## **ACKNOWLEDGEMENT**

First and foremost, we thank the Almighty God for his abundant mercies and guidance throughout our stay on campus. We would like to express our sincere gratitude to Dr. Solomon Arhin our project supervisor for his valuable contributions, supervision and contribution in formulating the study topic. Not only did he provide insight into the study, he also gave us his contact which really helped us when we encountered any difficulties with respect to the study. We will also not forget Mr. Kofi Owusu and Mr. Boamah who in diverse ways contributed to the quality of this research paper. They were of immense benefit in editing, structuring and proof-reading this study.

Finally, we wish to render our special thanks to our parents, siblings and children for their understanding and encouragement throughout our study and also to Mr. Kenneth Opoku Sarpong the typist for his time on our work.

## **DEDICATION**

This work is dedicated to our parents, siblings, children and loved ones for their immense support throughout our education.

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## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 BACKGROUND TO THE STUDY**

The banking sector in the 1970's was heavily underdeveloped and commercial banks concentrated their efforts in major cities where they had most of their clients and earned decent profits. Rural dwellers were left to the demise of those in the informal financial sector like money lenders, 'Susu' operators, among others for credit facilities. However, credit providers in the informal financial sector usually exploited rural dwellers and small scale enterprises set up in the rural areas by charging them exorbitant interest rates and seeking for collateral on properties before they benefited from credit facilities. The unavailability of institutional credit in rural areas meant that funds to finance agricultural expansion projects, entrepreneurial initiatives and support small and medium scale enterprises were unavailable. This led to poor farm yields through low acreages, inadequate fertilizer application, poor agronomic and farm maintenance practices (Asiedu Mante, 2011). In a bid to improve financial access to rural areas, the rural banking sector was established in 1976. Rural finance includes other instruments and institutions specifically intended to finance rural activities, both farm and off-farm, the clients being served typically lack the characteristics required by commercial banks or are located beyond the reach of commercial bank branches' (Steel & Andah, 2003).

Since its inception, rural banks in Ghana have been beset by many managerial, financial and operational challenges. The most prominent of 'these problems are those relating to liquidity, loan recovery, low capitalization, connected lending, poor technology and lack of adequate communication facilities' (Asiedu-Mante, 2011). The interrelated nature of most of the problems

single out the raising of additional capital for injection into the companies as a dominant problem confronting most rural banks.

Mergers allow for one corporate entity to align itself with another corporate entity to form one big entity with more assets and capital.

Acquisitions refer to the act where one company buys-off all or a majority of the ownership rights of another corporate entity. Whereas in mergers, the owners of both entities still share in the ownership of the new entity, in acquisitions the buying entity pays-off the owners of the bought corporation. For rural banks, increased capital base through mergers and acquisitions activities allow them to engage in bigger transactions and increase credit facilities to its customers.

## **1.2 PROBLEM STATEMENT**

With an upward revision of the stated capital for Rural and Community Banks in 2009 to GH¢150, 000 by the Bank of Ghana, most Rural and Community Banks are faced with a new challenge of raising additional capital from investors in their various localities. The scale of operations do not allow most Rural and Community Banks to plough back profit while low income levels in the rural areas inhibit deposits. Through Government influence in dictating credit flows, low literacy levels in rural areas and operational inefficiencies, most rural banks are unable to compete and their profitability is heavily affected.

## **1.3 RESEARCH QUESTIONS**

- ◆ What are the main issues and social concerns surrounding rural bank mergers and acquisitions in Ghana and how can the practice be successfully executed?

- ❖ Can mergers and acquisitions be a better way of increasing financing capital for Rural Banks?
- ❖ Do mergers and acquisitions in the rural banking sector have the potential to benefit rural individuals and businesses as well as increase the sector's efficiency and profitability?

#### **1.4 RESEARCH OBJECTIVES**

- ❖ To explore and discuss policy recommendations for enabling rural banks in Ghana to successfully engage in mergers and acquisitions.
- ❖ To provide information that will enable the Association of Rural Banks and interested stakeholders build stronger rural banks by expanding their capital base through mergers and acquisitions.
- ❖ To enlighten policy makers as to the challenges of raising additional capital by rural banks and take appropriate steps to address such hindrances.
- ❖ To enable rural banks raise more equity capital through mergers and acquisitions while fostering performance and profitability.
- ❖ To provide some evidence on how merger and acquisition activities can build stronger rural banks.

#### **1.5 SCOPE OF THE STUDY**

The discussion will focus filling the existing literature gap by exploring the legal, regulatory and social factors surrounding the mergers and acquisitions of rural banks in Ghana and guide policy recommendations in securing additional capital accumulation for the rural banking sector. The

paper will also act as a framework to enable rural banks successfully merge or go through acquisitions.

Due to mass of different rural bank, it is necessary to limit our scope of this thesis. This study also limits its focus to the Amansie Rural Bank.

## **1.6 LIMITATION OF THE STUDY**

The entire process of data collection was not without setbacks. The major problem, which the exercise encountered, was the unwillingness on the part of the rural banks to give out certain information concerning the credit recipients which could have made the study very simple, especially in the selection of the sample. Those institutions were of the view that it was against the ethics of the financial institution to give out such information. Another problem was financial constraints since the researcher had to rely on his own resources to conduct the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

The theoretical framework for understanding the mergers and acquisitions in the rural banking sector in developing countries like Ghana is crucial for any study into such areas. Existing literature on mergers and acquisitions help us to understand and set boundaries for relevant conceptual terms. More often than not, consolidation, mergers and acquisitions are used interchangeably but have some similarities and differences. Mergers and acquisitions should be grounded on certain legal, environmental and regulatory framework that will foster its successful implementation and avoid excessive consolidation and monopolization in the rural banking industry. Literature on the set-backs in merger and acquisition activities will also be examined to highlight the downside of financing through consolidation.

#### **2.2 RURAL BANKING AND THE DEVELOPMENT OF RURAL AREAS**

Is there enough evidence of a direct relationship between access to credit in rural areas and poverty reduction or rural development? If such a relationship does exist, then the premise can be made that the development of the rural area is dependent on systems such as the rural and community banking system currently operating in countries like Ghana, Philippines and India. Burgess and Pande (2005) in their study on India found that state-led rural branch expansion and the extension of financial credit was associated with poverty reduction in rural areas. The underlying reason for the development of the rural areas was linked to increase saving mobilization and the provision of credit facilities. Burgess and Pande (2005) further make a claim for a direct relationship between credit provision and economic growth. Rural banks usually provide more attractive interest rates

on savings and deposits than the informal sector in rural areas and are therefore a better boost of economic activities. In a control experiment in Ghana, Essel and Newsome (2000) found that the financial activities of the case bank had minimal effects on their customers' income, economic activities and general welfare. However, their study attributed the minimal economic impact by the case bank on the inadequacy of credit to the recipients. Since credit is inadequate, rural investors are unable to expand their production facilities to create jobs and improve the standards of living. It can be inferred that any attempt to increase the credit facilities of rural banks in Ghana will have a positive impact in the standard of living of the people in the local community.

Keeton (1996) concluded that in a survey of ten districts in The United States, there is not enough evidence that mergers reduce the lending of rural banks. On the other side, Walraven (1999) found that mergers involving rural banks were more profitable since they held a small proportion of their assets in loans. Mergers and acquisitions have the potential to increase lending and spread credit facilities to rural areas and dwellers. This will positively translate into economic growth, wellbeing and improved standards of living for rural dwellers if the appropriate supporting structures are put in place and the risk of merger failures are reduced among rural banks.

## **2.3 MERGERS AND ACQUISITIONS**

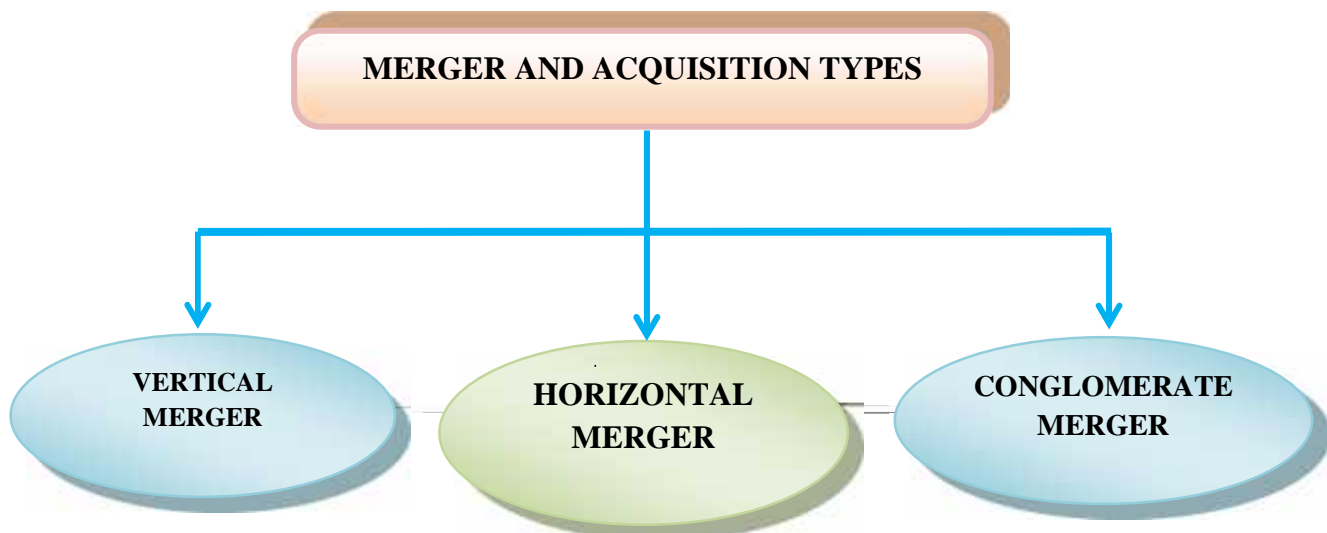
More often the two words mergers and acquisitions are used to denote a consolidation of two or more companies into one entity. Mergers can be defined as the joining or coming together of two or more companies into a bigger entity. Section 590 of the Nigerian Companies and Allied Matters Act 1990 defines merger as 'any amalgamation of the undertakings or any part of the undertakings or part of the undertakings of one or more companies and one or more bodies corporate' (Jimmy,

2008). Gaughan (2007) also defines mergers as ‘a combination of two or more corporations in which only one corporation survives’. Mergers are friendlier than acquisitions and may result in a complete change in name of the new bigger entity. A classical merger example is the merger between Platinum Bank Limited and Habib Nigeria Bank Limited to form the Bank PHB Plc in 2004/2005.

Acquisitions on the other hand involve one company buying over all or a majority of the assets of another company. Acquisitions therefore put decision making authority into the hands of the acquiring company. Okonkwo (2004) explains that consolidation through acquisition means that the shareholders of the purchased firm are paid off, their ownership rights over assets are bought and they cease to be owners of the new entity.

Acquisitions can result in two main outcomes: whether the acquired institutions are consolidated into one single institution or continue to operate as separate entities under new ownership (Pilloff & Santomero, 1996). The undertaking of mergers result in the sharing of assets wherein the shareholders of both joining companies still retain some level of ownership in the new entity. Acquisitions on the other hand result in a complete change or handing over in the ownership structure of the new entity.

#### 2.4 Types of Mergers and Acquisitions





Vertical merger 'is a merger in which one firm supplies its products to the other and results in the consolidation of firms that have potential or actual buyer-seller relationship' (Jimmy, 2008). In vertical mergers or consolidation, the firms involved need not to be in the same industry but there must be the existence of a buyer-seller relationship among the parties. This sort of merger allows acquiring firms to produce its own inputs or process in order to further its initial outputs.

Horizontal merger is the merger of two or more companies in the same industry, that is, it 'is a combination of firms that are direct rivals selling substitute products within overlapping geographical market' (Jimmy, 2008). Horizontal mergers may involve firms who are close competitors, serve the same target market, in the same industry among others. When firms undertake horizontal mergers, the new entity will have a bigger market share in the same industry which consists of the customer base of the separate firms involved. An example is the merger between Guinness Ghana Limited and Ghana Breweries Limited to form Guinness Ghana Breweries Limited in 2004.

Conglomerate mergers involve the merger of firms in different and diverse industries with diverse product markets, production technology among others. In this paper, the focus will be on horizontal mergers in the rural banking industry in Ghana. The examination of mergers and acquisitions financing options will only study possible mergers among rural banks across geographical boundaries.

## **2.5 BENEFITS OF MERGERS AND ACQUISITIONS**

The benefits of mergers and acquisitions are complex and may need individual contextual assessment to ascertain the benefits of a merger or acquisitions. However, the basic traditional view of the benefits of mergers and acquisition is in synergy; the greater outcome of the combination of two or more substances than the individual combined outcomes. Coyle (2000) therefore concludes that companies engage in mergers and acquisitions to create synergies. The effect of synergies in mergers and acquisitions is that it enables the new combined business to be more valuable than the addition of the values of the individual separate businesses.

The following underlines the possible causes of such synergies resulting from amalgamation activities:

### **2.5.1 Economies of Scale**

One possible explanation for the benefits in amalgamation activities is economies of scale: the reduction in per unit cost as a result of increased capacity and utilization. Economies of scale may result from efficient and specialized management, operational efficiencies in the use of assets and financial economies in size. Among banks, mergers and acquisition can offer the acquiring bank some managerial expertise and specialization in some products/services from the acquired bank. 'Larger institutions may be more efficient if redundant facilities and personnel are eliminated within the post merger organization' (Pilloff & Santomero, 1996).

### **2.5.2 Acquisitions of specific and complementary assets**

Sometimes the acquisition and use of specific assets that could give competitive advantage is the main reason for a consolidation or acquisition. A good management team that can drive down cost,

a strong research and investment team, source of raw materials, a patented technology or a development facility can be the motive for a merger. Mergers also allow companies to quickly acquire new products, production and distribution lines among others.

### **2.5.3 Reduction in Cost**

Most traditional theorists arguing for mergers and acquisitions believe that costs can be lowered through amalgamation activities. Cost reduction primarily comes from increased scope advantages in size, where scope economies measure the ability of a firm to use its assets to provide a broader scope of products and services (Gaughan, 2007). The managerial capabilities of any one of the firm involved in any consolidation activity will flow through the new amalgamated bank for lower overall cost and higher profitability margins.

### **2.5.4 Increase Market Share and Competitiveness**

Market share and a firm's competitiveness in an industry can be enhanced from the activities of mergers and acquisitions. Consolidation or acquisition transfers the customers of one acquired firm to the acquiring firm or pools together the customer base of the two merging firms. This broadens the customer base of the new corporate entity and increases its revenue.

Moreover, the bigger asset base enables it to be more competitive while offering more products or services or specialized ones to its new customer base. Pilloff & Santomero (1996) states that the new corporate firm can increase their revenues through cross-selling of products or services to the various customers of the firms involved in the amalgamation.

## 2.6 SET BACKS OR PITFALLS IN MERGERS AND ACQUISITIONS

Although mergers and acquisitions have the potential to boost the performance of the two companies involved in the amalgamation through synergy, cost reduction, expanded market size, improved competitiveness among others, not all mergers and acquisitions churn out the expected benefits.

The traditional view of an overall benefit to the firms involved in an amalgamation does not always yield the expected outcome. Pilloff & Santomero (1996) in their study on the effects of mergers on value in the American Banking Industry found that mergers on average have no or slightly negative effects on the value of the acquiring firm. Their study assessed value both in terms of accounting or book value and market value.

Hence on the average shareholders of the acquired firms benefited from the mergers in the American banking industry while the shareholders of the acquiring firms lost value or maintained their existing value on average.

McDonald, Coulthard and Lange (2005) however concluded that each merger and acquisition deal is unique and the compound performance of such deal is complex and difficult to measure.

Gadiesh and Ormiston (2003) identified five major causes of consolidation failure:

- ❖ Poor strategic rationale
- ❖ Mismatch of cultures
- ❖ Difficulties in communicating and leading the organization
- ❖ Poor integration planning and execution

### ❖ Paying too much for the target company”

They argue that the greatest of these factors is poor strategic rationale for carrying out mergers and acquisitions activities. Poor strategic rationale by the acquiring firm or both firms involved in a merger will possibly influence a mismatch of cultures, communication difficulties, poor integration, and poor execution among others. The cost of these difficulties and challenges usually overshadows the benefit in synergy that consolidation brings to the new firm.

Lynch and Lind (2002) attributes other reasons for merger failures to culture clashes, lack of appropriate risk management strategies, slow post merger integration. There is also the risk of an overly optimistic view of the benefits of synergy which managers may attach to consolidation.

In most cases, due diligence on credit risk assessment and corporate fit is poorly done. The result is complex challenges confronting the new entity and an overestimated benefit in synergy.

In Ghana, some of the challenges and setbacks for mergers and acquisitions arise from the regulatory framework that requires location specific ownership of rural banks. Although there is not much available information on the reasons for this requirement, there is an implicit assumption that such a requirement will attract local patronage and loyalty necessary to keep the bank operating successfully. However, the use of community names could possibly discourage talks on mergers and acquisitions as such consolidations can result in the ‘highly esteemed’ community name.

Another facet of this requirement is that it inhibits people outside a particular community from investing their capital in any attractive rural bank. These and other setbacks that are peculiar to Ghana and other location-specific barriers mostly relate to regulations in the rural banking industry. The role of regulators in the rural banking sector is crucial for consolidation activities.

## **2.7 RURAL BANK REGULATORS AND ARB APEX BANK**

The rural banking sector has undergone rapid increased and transformation since the first rural bank was established in 1976. The rapid expansion of the number of rural banks countrywide nurtured a lot of challenges for the sector. Coordination among the banks was poor and the Bank of Ghana was outstretched in the performance of its duties the rural banks. Between the years 1999 and 2000, the Bank of Ghana withdrew the licenses of twenty-three distressed banks (Asiedu-Mante, 2011). The ARB Apex Bank was then established in 2000 as a registered public limited liability and later issued with a banking license. The ARB-Apex bank was set-up to ‘provide banking and non-banking support services to the rural banks with the aim of improving their operational efficiency and thereby transforming them into efficient financial institutions which could effectively address the banking needs of the communities in which they operate’ (Asiedu-Mante, 2011). The legal role of the ARB-Apex bank is outlined in Appendix 1.

In addition, the ARB Apex Bank is expected to perform other non-banking and peripheral services as:

- a. Provide training for directors and employees of the Bank and other members of the Bank in a manner that the Bank may consider necessary for the efficient performance of its functions.

- b. Establish a Rural Bank College to provide technical and professional training to the staff directors and members of the Bank.
- c. Provide a deposit insurance scheme to protect the deposits of customers in the event of the failure of a member of the Bank.

In essence, the ARB Apex bank acts as a mini central bank to all the rural banks. The Bank of Ghana still maintains its primary supervisory role over all rural banks and reserves the right to issue new banking license to rural banks and receive annual performance reports from them.

## **2.8 CHALLENGES OF RURAL AND COMMUNITY BANKS**

Since its inception, rural banks have been beset by their own unique operational and financial problems and challenges that have inhibited growth and undermined the performance of its core functions. The Bank of Ghana of Ghana has had to withdraw the banking license of 23 distressed rural banks in 1993/1994, 23 rural banks in 1999/2000 and 3 other rural banks in 2008/2009 (Asiedu-Mante, 2011). Asiedu-Mante (2011) mentioned the most pronounced of these distresses as those relating to liquidity, poor staffing, weak management, low capitalization, bad loan recovery and profitability, weak internal control and poor technology. He broadly classified the problems under four main categories:

- ◆ Institutional factors
- ◆ Economic and political factors
- ◆ Regulatory and supervisory factors
- ◆ Fraudulent factors

## **2.9 OTHER SOURCE OF FUNDING RURAL BANKS**

Since rural banks operate as limited liability companies, they are exposed to the numerous sources where trading concerns generate funds. The following are some of the sources of funds available to rural banks;

### **2.9.1 Short Term Borrowing from Commercial Banks**

Rural banks operate at both retail and wholesale levels. Retail banking is serving the rural public and small business traditionally through a branch network whilst wholesale banking comprises of dealing with fellow rural banks, central bank and other international banks and financial institutions. In wholesale banking, rural banks lend and borrow among themselves on short term basis. As the financial needs of the rural bank increase, it asks other banks preferably international banks provide funds on short term basis. Where the request of additional fund is denied the alternative is to look for other sources or slow down the rate of growth or cut operations.



## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1 INTRODUCTION**

This study used these three sources of information on the sector in addition to primary information from notable professionals in the sector. This section examines the data gathering tools and the methods of gathering data to understand and find answers to the research questions.

#### **3.2 SOURCES AND TYPES OF DATA**

The study mainly used qualitative research methods. Secondary quantitative data was collected from the regulators of the rural banking sector – ARB-Apex Bank and the Association of Rural Bank. The study also used qualitative data which was gathered through recorded personal interviews with stakeholders in both rural banks and merger and acquisition practitioners.

#### **3.3 SAMPLING TECHNIQUE**

For the purpose of exploring the structures and mechanisms of possible mergers and acquisitions in the rural banking sector, the purposive method of sampling was used to gather secondary data from Association of Rural Banks and the ARB-Apex Bank. These institutions were purposefully chosen since they are responsible for gathering performance and monitoring data on all rural banks in the country. Moreover, personal interviews with selected persons from these institutions complimented quantitative data that was gathered on the structures and framework for current financing options and/or challenges and the possible exploration of mergers and acquisitions.

### **3.4 DATA COLLECTION**

Data collection methods included personal interviews with senior managers from each of the two regulatory bodies of the rural banking sector:

The Association of Rural Banks and the ARB-Apex Bank. There were also personal interviews with senior managers of the Securities and Exchange Commission, Ghana and the Ghana Stock Exchange. This enabled the study gain relevant insight into some of the legal regulations that inhibit consolidation activities in the industry as well as assess the readiness of these institutions to support mergers and acquisitions activities among rural banks.

Interviews for the framework of mergers and acquisitions in Ghana were generally structured to create an objective framework. The framework included legal structures, economic and demographic factors, social and cultural environments.

The next section of data collection found out the operational difficulties and the possibility of amalgamation benefits that could be harnessed by rural banks. Questions were semi-structured to make room for the right environments that enabled the study have access to sensitive but essential data. The final section of data collection dealt with the social, cultural and data handling factors that surround merger and acquisition activities among rural banks in Ghana. Data gathering was done in a non-structured way such that it will not affect the integrity and accuracy of the data gathered. Other relevant source of information was the website.

### **3.5 DATA ANALYSIS**

Data was basically analyzed using tables and graphs. Qualitative data was analyzed using content analysis.

## **CHAPTER FOUR**

### **RESULTS OF THE STUDY**

#### **4.1 INTRODUCTION**

From the interviews, questionnaire administered and analysis of the operational performance of the bank in the previous chapters, the following finds were made.

#### **4.2 INADEQUATE FUNDS FOR LOANS**

Although Amansie west rural bank (AWRB) has got eight agencies, its potentials for the mobilization of funds have not been fully achieved. The bank finds it difficult to meet the current demand of its numerous customers who are demanding loans. This problem came to light as a result of complains from customers about the delay in processing their loan application letters. An interview with some of the bank also confirmed that there are lots of such application letters which are not being attended to due to lack of funds.

#### **4.3 COMPETITION WITH COMMERCIAL BANKS**

An interview with the staff of Amansie west rural bank and a branch manager at Antokrom revealed that the rural banks find it difficult to compete with the rural branches of commercial banks. This is because; the maximum loan size of GH¢ 500.00 given to an individual by the rural banks is low as compared to commercial banks loan scheme. As a result, the small-scale business operator and other sole proprietors whose financial needs exceed what the rural banks offer them cannot be attracted to save with them.

#### **4.4 HIGH DEFAULTING RATE**

The research also revealed that the defaulting rate of the loan given to the customers is very high. Many of the beneficiaries are unable to repay the loans due to factors such as poor harvesting of crops, low price of their crops and high cost of labour. Others also use the loans for different purposes such as funerals, payment of school fees rather than using the loans to farm or invest in a profitable business for a return to be used to pay back the loan.

#### **4.5 EARNINGS FROM HANDLING OF AKUAFO CHEQUES**

The performance of the rural banks in the purchases of Akuafu cheque has been significant. For the 2012/2013 season, the rural banks purchased over GHc19.6 million or one-third of the total purchases throughout the country. Purchases for 2013/2014 season amounted to Ghc16.4 million.

Although rural banks have been active in this area, only 5% commission is paid to the rural banks for the handling of Akuafu cheques.

Also, purchasing of cocoa has been privatized with several companies competing with Produce Buying Companies (PBC). Much against the expectation of the rural banks, very few of the new buying companies use the rural banks for their purchasing programmes. Since PBC is now a private company and does not obtain funds from Bank of Ghana. Its financial resource has been severely strained and as a result has not been able to supply adequate advances known as “Seed funds” to the rural banks. As a result, the rural banks are compelled to pre-finance the purchases of the cocoa but the re-imbursement delays.

#### **4.6 SOURCES OF FINANCING AMANSIE WEST RURAL BANK (AWRB)**

The outcome of a questionnaire administered on the manager of Amansie West rural bank in the Amansie West District and the researchers' findings from other rural banks in the same district revealed that the following sources of finance are relied on by the banks.

##### **4.6.1 DEPOSITS FROM CUSTOMERS**

This is an amount received from the customers of the bank as deposit for operating savings and current accounts. According to information contained in the bank's financial statement for the 2013 accounting period, total deposits mobilized amounted to GHc2,017,743 million as against GHc743,927 in the previous accounting period.

##### **4.6.2 IFAD/SCIMP LOAN**

The International Fund for Agriculture Development/Small-holder Credit Input and Marketing Project (IFAD/SCIMP) is a fund from outside countries to be given to farmers to enhance agriculture development in Ghana. Since most of beneficiaries are located in the rural areas, the best means through which this money can get to the farmer is through the rural banks. For this reason, the rural banks go in for this money in the form of loan from international bodies, pay interest on it and then lend it to the farmers at their borrowing rates. The difference between the interest received from customers in excess of the interest paid to the international bodies and the length of credit period given to the rural banks by the international bodies make the fund a good source of capital to the rural banks.

The length is normally one year period. But since the contract of the loan is regularly renewed, it has become a form of long term capital to the banks.

#### **4.6.3 RETAINED PROFIT**

According to the questionnaire, Amansie west rural bank annually sets aside part of its net earnings after distributions are made to equity holders. The bank has been able to set aside over GHc2, 305.00 for the 2013 financial year. This seems to be a good achievement but looking at the obligations to be settled shortly in the next financial year, cash flow problems may arise. Some of these expenses are Audit expenses, provision for AGM, and many others which were incurred in the 2012 financial year were not paid for.

#### **4.6.4 OTHER SOURCES**

The bank gets fund from other sources like the Rural Enterprise Project (REP), deferred taxation, preference shares and ordinary shares.

#### **4.6.5 CAPITAL STRUCTURE OF AMANSIE WEST RURAL BANK**

On examining the financial statement of the bank, it was found that Amansie West is financed with the combination of long term capital (i.e. ordinary shares, surpluses and preference shares) and short term liabilities.

**THE TABLE SHOWS SOME RELEVANT FIGURES PERTAINING TO THE CAPITAL STRUCTURE OF AMANSIE WEST RURAL BANK**

EQUITY	PRIOR CHARGE CAPITAL	BAD DEBT WRITTEN OFF
GH¢68,930.68	GH¢548,382.25	GH¢8,009.94

**SOURCE: FINANCIAL STATEMENT OF AWRB FOR 2013 FINANCIAL YEAR**

**GEARING RATIO OF AMANSIE WEST RURAL BANK**

$$\begin{aligned}
 \text{Gearing} &= \frac{\text{Total Debt Capital}}{\text{Total Equity Capital} + \text{Total Debt Capital}} \times 100 \\
 &= \frac{\text{GHc}548,382.25}{\text{GHc}68,930.68 + \text{GHc}548,382.25} \times 100 \\
 &= \frac{\text{GHc}548,382.25}{\text{GHc}617,312.93} \times 100 \\
 &= \underline{\underline{88.83\%}}
 \end{aligned}$$

Per the above, explanations and calculations, it was observed that the debt to equity ratio was very high, and the bank has not considered using the Merger and Acquisition method to solve their financing problems.

With the issue of merger and acquisition, some officials explained that there have been seminars and discussions, like one held last year in Koforidua, have highlighted the importance of raising capital to aid Rural and Community Banks expand their operation for rural development. There have also been initiatives to create advocacy to support the initiative. From some sensitization

seminars held by the Association of Rural Banks on mergers and acquisitions late last year, three rural banks in the Central Region have expressed interest in merging to the association (Ofori, 2012). However no proper documentation has been made to summarize the direction of discussions, issues and proposals. This study will be a first of its kind to document some of these discussions in the sector.

#### **4.7 IMPEDIMENTS TO M&A**

The impediments to mergers and acquisition in the rural and community banking sector can be grouped mainly into three broad categories: social and cultural factors, education, financial constraints, managerial and board sentiments. However, the study found no known regulatory impediments to merger and acquisition activities among rural and community banks.

##### **4.7.1 Social and Cultural Factors**

The implementation of the initial concept of rural and community banks in Ghana encouraged local affiliation with the locals in which the bank was established to encourage patronage by the locals so rural and community banks can grow. This encouraged the legislation that capital contribution by rural banks should come from only natives of a community and fosters the use of community names as names for the banks. By far, this initiative has achieved what it was set-out to achieve; high affiliation and patronage of the banks' services. However, in the light of the challenges confronting most rural banks the social importance given to the names of rural and community banks has the potential of being a major impediment to merger and acquisition activities. One of the major challenges that will confront two merging rural banks will be the name to adopt so both communities will still maintain their affiliation to the new entity. Since the pride



of the community is involved, in this case its name, it can be a major set-back to merger and acquisition potentials, especially where the communities are culturally diverse.

#### **4.7.2 Lack of Education among Shareholders**

Most of the shareholders of rural and community banks are native cocoa farmers who are unschooled but are highly esteemed because of their affluence and hence consulted, probably by the chief, in contributing capital to set up the rural and community bank. The majority of these shareholders may not understand the complexities in mergers and acquisitions and may be at the mercies of the highly esteemed directors and managers to feed them information. It will therefore be difficult to evaluate merger and acquisition offers that will promote their interest and that of the bank.

#### **4.7.3 Financial Constraints and Bureaucracy**

Mergers and acquisition are expensive since both parties need to employ the services of an independent advisor must be a broker, investment banker or financial analyst. The services of independent advisors are expensive relative to the capital of most rural and community banks. There is also the difficulty in determining share prices of rural and community banks so that mergers and acquisition can be facilitated. The code on mergers and acquisitions stipulates that “the Board of Directors of the offeree shall within 15 days after the receipt of the takeover offer document under Rule 7 issue a Statement to the holders of voting shares in the offeree to which the takeover offer relates, indicating whether or not the Board of directors of the offeree recommend to holders of the voting shares the acceptance of the takeover offer(s) made by the Offeror” (Securities and Exchange Commission, 2008). These are but a few of the hectic documentation

that is required for mergers and acquisitions. However, the code authorizes the SEC to grant exemptions to any entity as it deems appropriate to protect the interest of shareholders and the public in matters relating to mergers and acquisitions (Securities and Exchange Commission, 2008).

#### **4.8 HOW MERGERS AND ACQUISITIONS CAN IMPROVE RCBS**

##### **4.8.1 Synergy**

The study reveals that mergers and acquisition has the potential to make rural and community banks more efficient and profitable. The first cause of improvement will come from synergies created from consolidation as afore explored in the literature review. The new entity formed from the two banks will have increased capital, human resource and other assets at its disposal. The consolidation has the potential to decrease operational cost while increasing profitability. Moreover the new entity has a larger market share from the customers of both banking entities than the two separate banks. This reduces competition, especially if the two banks were located in the same catchment area.

##### **4.8.2 Better Management, Board Effectiveness and Tighter Internal Control**

Rural and community banks are only allowed to have a maximum of 11 members on its board. With consolidation, the best board members and managers are retained to manage the affairs of the new entity. Moreover monitoring is relatively tighter which will reduce the corrupt, unprofessional and slack conduct of managers and directors. Inefficiencies will also be reduced by eliminating redundant offices and personnel, thereby reducing operational cost and making more resources available for efficient ones.

#### **4.8.3 Complementary Strengths**

Consolidated banks can complement each other's strength and weaknesses. For example, when a bank with strong marketing skills merge or is acquired by another bank with strong financials and internal control mechanisms, there will be a transfer of skills and knowledge to balance out the weaknesses of the two entities. The new entity formed from consolidation always have an edge over competition by benefiting from the best abilities of two entities while reducing or making up for each other's weaknesses. It is this potential transfer of skill between the performing banks and the distressed banks that will improve the overall performance of the rural banking sector.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 SUMMARY**

Mergers and Acquisitions are a viable way of raising capital to finance the operations of Rural Banks while ensuring efficiency in the sector. The benefits of consolidation in the sector are enormous and will require the efforts of all regulatory bodies, stakeholders and bank directors to explore this option. Although there are besetting factors in the current structures of Rural and Community banks, viable solutions can be implemented to facilitate consolidation in the sector. It is hoped that the recommendations of this study will help stakeholders implement initiatives that will strengthen the Rural and Community banking sector to drive economic development in Ghana's rural areas.

#### **5.2 CONCLUSIONS**

Rural and Community banks have served well the communities in which they are established by providing them with financial services like revenue mobilization, access to credit and financial education. This has helped grow the agrarian sectors of most communities while allowing easy transfer of money from their relatives in the urban areas. Banking products like the 'Cocoa Akuafo Account' has also facilitated the payment of cocoa revenue from the government to farmers. Rural Banks have also contributed their quota to rural area development through the various corporate responsibility initiatives that has provided essential social amenities to their catchment areas.

However, the sector has been beset by diverse challenges including capital, human resource, weak internal controls, poor deposit mobilization, among others. With the contributions of regulatory

bodies such as the Bank of Ghana, ARB-Apex Bank and Association of Rural Banks many attempts have been made to improve the performance and overcome the challenges of the sector. However the issues of capital and weak internal control play a major role in determining the performance and profitability of Rural and Community Banks. With the technological evolution of the general banking industry in Ghana, there has been the need for rural and community banks to adapt and build costly infrastructure that will improve service delivery to their clients. Whereas the strong loyalty of community locals to the banks has helped the performance of the banks, especially in their initial stages, it has compounded the challenges that are associated with raising additional capital. The fundamental challenge will be to provide a solution that will increase capital contributions to the Rural and Community Banks and improve their control structures without affecting their underlying mission to serve the rural communities.

One major option for rural and community banks to raise capital is through mergers and acquisitions. Some of the Rural and Community Banks are struggling to meet the new capital requirement of the Bank of Ghana which stands at GH 150,000. Mergers and acquisitions can offer the sector economies of scale that will improve performance, efficiency, better control mechanisms as well as provide operational capital to expand the sectors operations to other localities. But the unique governance structure and organization of the sector poses a challenge to merger and acquisition activities. These include social factors like the importance of names in the sector, high illiteracy in the rural areas and among shareholders, managerial and directors' sentiments and the high cost of engaging in mergers and acquisitions relative to their operational capital. If the option of mergers and acquisitions are implemented properly for the rural and community banking sector, the sector will become more competitive and efficient.

### **5.3 RECOMMENDATIONS**

In investigating the rural banking environment and the accessibility of investment capital, the study focused on issues affecting mergers and acquisitions. Rural and Community banks have a major role to play in our national growth and rural area development. Hence this study gathered data from the relevant regulatory institutions of the rural banking sector and some expert opinion on finding ways of making the banks more competitive and viable.

#### **5.3.1 Education, Advocacy and Sensitization**

The study proposes that mergers and acquisition have the potential of improving the performance of most rural banks as well as providing them enough capital to meet their operational and expansion needs. One way to encourage this phenomenon is through education, advocacy and sensitization. Owing to the high illiteracy rates that exist in most rural areas in Ghana, it is recommended that the Association of Rural Banks organize symposia, forums and general educational activities to inform rural dwellers of the need for mergers and acquisitions especially shareholders and other stakeholders like the chiefs. This can be at their Annual General Meetings, management meetings, board meetings, radio talks and discussions among other innovative avenues.

#### **5.3.2 Merge clustered and underperforming banks**

The study also recommends that rural banks within the same catchment area can be encouraged by the regulating bodies to merge. To overcome the problems that might arise out of conflicting names, a common ancestral linkage can be exploited to establish a common name that will cover a wide geographical area and maintain the loyalty of the natives for the new entity. This

recommendation will be particularly useful for banks that operate in the same catchment area or are closely affiliated by traditions and culture. In the case of uncooperative directors, the regulatory authority can use their capital inadequacy and poor performance to force them into merger.

#### **5.3.4 Establish fund to aid consolidation**

The study recommends that donors, Bank of Ghana, ARB-Apex bank and Association of Rural Banks will provide a fund that specifically supports merger and acquisition initiatives among Rural and community Banks. The fund will subsidize the services of independent advisors, documentation processes and other operational expenses required for successful mergers and acquisitions. Interestingly, this initiative has started with a partnership fund of USD2 million between DANIDA and ARB-Apex bank to support mergers and acquisitions initiatives among rural and community banks. Also regulatory bodies like the Securities and Exchange have the authority to waive certain regulatory requirements by parties to a merger or an acquisition under the Security and Exchange Commission's Code on takeovers and Mergers. Hence such bodies can waive some of the demanding processes and bulky requirements, so Rural and Community Banks can conveniently merge with minimal associated costs.

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## **APPENDIX**

### **QUESTIONNAIRE ADMINISTERED ON THE MANAGER OF AMANSIE RURAL BANK**

Dear Respondents,

We are final year students of the Christian service university college and now conducting partial studies with regard to explore “Financing rural and community banks in Ghana.” This research is in partial fulfillment of completing our Bachelor of Business Administration study. We would be delighted if you could spare sometime and thought in completing the survey Questionnaire. We hope that you would co-operate in completing the questionnaire with the best of your ability. Your response will be treated as confidential as used for research purposes only.

Thank you for your willingness to participate in this study.

### **QUESTIONNAIRE**

1. When was your rural bank establishment?

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2. What necessitate the establishment of Amansie Rural Bank?

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3. How many branches does your bank has? .....

4. Where are the branches located?

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5. State some of the ways rural banks finance their activities.

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6. Which one is your favourite and why?

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7. Does Bank of Ghana restrict any possible sources where your bank can raise funds?

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8. What are some of the major challenges that your rural bank face?

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9. Can the location-specific naming of your rural bank be easily amended, what are some of the consequences and challenges?

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10. What are some of the strengths and weaknesses of your rural banks?

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11. Are Rural Banks legally required to keep proper and updated share register?

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**Mergers and Acquisition**

12. Has the option of M&A been explored by your rural bank, if yes why and if not why?

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13. What are the impediments to M&A in your rural bank?

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14. What regulatory structures in most rural banks discourage M&A?

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15. In your opinion, what are the managerial attitudes of rural bank managers to change, such as those that can arise out of M&A activities?

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16. How can mergers and acquisitions improve the performance of rural and community banks?

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