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Mergers and Acquisitions in Nepal: Strategic Consolidation, Regulatory Drivers, and the Case of NMB Bank Limited

[1]Rakhi Kumari, [2]Dr. Shashi Srivastava

[1]Research scholar, Institute of Management Studies BHU, Varanasi.

Email: rakhikumari@fmsbhu.ac.in

[2]Associate Professor, Institute of Management Studies BHU, Varanasi.

Email: shashisrivastava@fmsbhu.ac.in

Orcid id-https://orcid.org/0009-0003-6314-3551

Abstract

Nepal's banking sector has undergone systematic consolidation following the **introduction of the Merger Bylaw 2068 B.S. (2011) by Nepal Rastra Bank, which established** a regulatory framework emphasizing capital adequacy and financial system stability. This manuscript examines the M&A landscape within Nepal's banking industry with particular focus on NMB Bank Limited's consolidation strategy, which integrated six financial institutions across three distinct phases (2015, 2017, 2020). Drawing **on authenticated primary sources, including NRB regulatory documents and NMB Bank's audited financial statements, this research analyzes the strategic, economic, and organizational dimensions of banking consolidation in emerging markets**. The analysis demonstrates that consolidation success in Nepal depends not solely on capital base expansion but on effective integration of organizational processes, human resources, and technology infrastructure. Post-merger performance metrics validate **an** effective consolidation strategy with NMB **expanded** capital bas**e.** The **research paper** contributes to understanding how banking consolidation addresses systemic stability objectives while generating institutional competitiveness within post-liberalization financial sectors.

Keywords: Mergers and acquisitions, banking consolidation, Nepal, financial regulation, NRB policy, emerging markets, institutional integration

1. Introduction:

Banking sector consolidation is an important policy tool regulators use to address deposit safety, systemic weaknesses, and the size of institutions in emerging market financial systems. Nepalese banking sector experience with intentional consolidation under regulatory mandate provides a unique case study of how central bank policy influences institutional structure and competitive dynamics. The central bank of Nepal introduced the consolidation framework because it saw that the banking sector was too fragmented, making the system less safe, more challenging to supervise, and too small to handle complex financial markets (Nepal Rastra Bank, 2011). This is not the same as market-driven consolidation in developed economies, which occurs when competition becomes too harsh.

Between 2015 and 2020, NMB Bank Limited's consolidation strategy offered an interesting case study of how different banks responded to NRB's consolidation policy. The bank's systematic acquisition of six financial institutions, integrating four institutions in 2015, one in 2017, and one in 2020, transformed NMB from a single commercial banking entity into one of Nepal's largest financial institutions, with asset base expansion, geographic network diversification, and demonstrated operational integration capacity. This research paper analyzes NMB's consolidation experience within the broader context of Nepal's banking sector evolution, examining the regulatory drivers, strategic rationales, financial outcomes, and organizational challenges that accompany banking system restructuring in emerging markets.

The analysis proceeds through five integrated sections: first, contextualizing Nepal's banking industry structure and the regulatory consolidation framework established by NRB; second, examining the strategic, financial, and organizational dimensions of banking consolidation as theoretical framework; third, presenting NMB Bank's three consolidation phases with authenticated financial and operational data; fourth, analyzing post-merger performance outcomes and synergy realization; and fifth, synthesizing findings regarding consolidation effectiveness and implications for banking sector development in emerging economies.

2. Nepal's Banking Sector and the Consolidation Policy Framework:

2.1 Banking Sector Structure and Historical Development:

Since the mid-1980s, when the economy was liberalized, the Nepalese banking sector has gone through several distinct stages. Pre-liberalization banking was dominated by two state-owned institutions: Nepal Bank Limited (established in 1937) and Nepal Rastra Bank (established in 1956 as the central bank). Liberalization policies introduced in 1985 gradually permitted the development of private-sector banking, culminating in the rapid proliferation of BFI (Banking and Financial Institutions). By the early 2000s, uncontrolled banking-sector expansion led to institutional fragmentation, with over 100 banking and financial institutions operating with heterogeneous capital bases, operational sophistication, and risk management capabilities (Adhikari, 2023).

This fragmentation created systemic weaknesses: NRB's ability to supervise many different institutions was put to the test; asset quality deteriorated as the number of institutions grew rapidly; and competition between institutions hurt profits as weaker institutions resorted to desperate pricing and risk-taking. The 2008 global financial crisis amplified these vulnerabilities, with non-performing loans accumulating across the sector as problems in credit

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quality that had been embedded during expansion years materialized (Nepal Rastra Bank, 2011).

2.2 Nepal Rastra Bank's Consolidation Policy Framework:

In response to fragmentation-driven systemic instability, Nepal Rastra Bank introduced the Merger Bylaw 2068 B.S. (2011), establishing explicit consolidation procedures, timelines for approvals, and regulatory incentives. The bylaw, grounded in statutory authority under the Company Act 2063, the Banking and Financial Institutions Act (BAFIA) 2063, and the Nepal Rastra Bank Act 2002, established that NRB had the authority to regulate, approve, and supervise banking sector consolidation activities (Nepal Rastra Bank, 2016).

The consolidation framework served three interconnected policy objectives. First, systemic stability: consolidation would create larger, better-capitalized institutions that are less vulnerable to individual shock events, thereby reducing systemic risk from institutional failures. Second, depositor protection: larger, consolidated entities with stronger capital positions would better protect depositor interests than fragmented, smaller institutions with capital stress. Third, supervisory efficiency: consolidation would reduce NRB's monitoring burden by decreasing the total number of regulated institutions, enabling more intensive supervision of fewer, larger entities (Nepal Rastra Bank, 2011).

The 2016 amendment (Merger and Acquisition Bylaw 2073 B.S.) strengthened consolidation requirements through progressive capital adequacy mandates. The monetary policies of 2015–2016 raised the minimum paid-up capital requirements for commercial banks from NPR 4 billion (about USD 33 million) to NPR 18 billion (about USD 150 million). This necessitated that smaller banks merge to remain in compliance with the rules (Nepal Rastra Bank, 2016). This regulatory ratcheting created consolidation urgency unavailable through voluntary commercial incentives alone, transforming consolidation from an optional growth strategy to a compliance necessity.

2.3 Consolidation Incentive Structures:

To facilitate compliance with consolidation requirements, NRB established explicit regulatory incentives to encourage institutional participation. These incentives encompassed: (1) 50% discount on retirement pay deductions for employees accepting merger-related retirement; (2) zero capital gains taxation on merger-related share transactions post-2-year holding period; (3) Cash Reserve Ratio (CRR) and Credit to Core Capital + Deposit (CCD) ratio flexibility during integration periods; (4) adjusted sectoral lending targets for consolidated entities; and (5) extended grace periods (up to 3 years) for priority sector compliance during integration (Nepal Rastra Bank, 2016). These mechanisms explicitly recognized that consolidation created transition costs and integration complexities, and provided regulatory accommodation to enable smoother institutional transitions.

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3. Banking Consolidation: Strategic and Financial Dimensions:

3.1 Consolidation Motives and Strategic Rationales:

Financial literature identifies multiple strategic motives driving banking consolidation across institutional contexts. Capital adequacy enhancement emerges as the primary motive in regulatory-driven consolidation environments: merging institutions combine balance sheets to achieve regulatory capital minimums and capital ratios, addressing compliance pressures (Nepal Rastra Bank, 2011). Geographic expansion and market penetration represent the second consolidation motive: acquiring smaller institutions with established regional networks enables rapid geographic diversification beyond the timelines of organic branch expansion.

Synergy realization constitutes the third motive: operating synergies through technology infrastructure consolidation, administrative overhead rationalization, and back-office process standardization generate cost efficiencies. Scope synergies emerge through cross-selling opportunities as enlarged institutions leverage expanded customer bases for complementary financial products, investment services, insurance, foreign exchange operations (Altunbas & Marques-Ibanez, 2008). Scale economics enable per-unit cost reductions through higher transaction volumes and improved vendor negotiation power. Risk diversification emerges when consolidation enables institutions to diversify credit exposures, geographic markets, and product lines, reducing concentration risk and buffering against sector-specific shocks (DeLong, 2003).

3.2 Post-Merger Integration Challenges:

While consolidation offers strategic benefits, integration complexity determines the actual outcome. Organizational culture integration emerges as a primary post-merger challenge: merging institutions have developed distinct operational styles, risk management philosophies, employee relationship approaches, and customer service orientations. Research on Indian bank mergers documents that “organizational culture is one factor as a potential catalyst to M&A success,” with particular emphasis on the finding that organizations with compatible leadership and management philosophies demonstrate superior post-merger performance (Chew & Sharma, 2005).

Human resource integration requires simultaneous management of compensation harmonization, redundancy elimination, skill development, and organizational restructuring. Studies on banking mergers reveal that “poor merger results are often attributed to HRM and organizational problems,” with workforce stability identified as critical for managing HRM risk (Bryson, 2003). Technology infrastructure consolidation, merging banking institutions with potentially disparate systems, requires substantial coordination: deposit management systems, lending platforms, risk management tools, and regulatory reporting systems must be integrated, creating technical complexity and operational disruption during extended integration periods.

Communication management represents an understudied but critical integration dimension: "communications throughout the M&A process play a crucial role in its eventual success," with transparent, consistent information provision proven to increase employee productivity and organizational resilience during transition periods (Appelbaum et al., 2000).

4. NMB Bank's Consolidation Strategy: Three Phases of Strategic Integration:

4.1 Phase 1: 2015 Four-Institution Merger:

NMB Bank Limited, licensed as a Class A financial institution in May 2008, adopted consolidation as its primary growth mechanism aligned with NRB systemic strengthening objectives. The bank's "Vision 2020" strategic plan explicitly recognized mergers and acquisitions as essential for achieving institutional scale, competitive positioning, and market leadership within Nepal's post-liberalization banking environment (Poudyal, 2015).

Transaction Structure and Regulatory Approval: The 2015 consolidation integrated four separate financial entities through a share-exchange mechanism. On June 7, 2015, NMB's Special Annual General Meeting approved the merger proposal; NRB granted final regulatory approval on September 30, 2015; integration commenced on October 18, 2015 (Nepal Rastra Bank, 2015).

Target Institutions: The consolidation integrated Pathibhara Development Bank Limited (Class B-3), Bhrikuti Development Bank Limited (Class B-10), Clean Energy Development Bank Limited (Class B), and Prudential Finance Company Limited (Class C). Each institution contributed distinct regional presence, customer relationships, and asset portfolios to the consolidated entity (NMB Bank Limited, 2021).

Strategic Rationale: Poudyal (2015) articulated three interconnected consolidation objectives. First, geographic expansion: Pathibhara's presence in its Eastern Development Region strengthened NMB's position in underserved markets. Second, regional diversification: the Bhrikuti and Prudential Finance mergers enhanced the Western Development Region's presence, complementing urban-focused operations. Third, capital base enhancement: the merged balance sheets resulted in increased paid-up capital from NPR 2.65 billion to NPR 4.15 billion, facilitating compliance with NRB capital adequacy requirements (Nepal Rastra Bank, 2015).

Post-Merger Capitalization and Network Expansion: The post-merger consolidated entity achieved paid-up capital of NPR 4.15 billion, total deposits of NPR 54 billion, total lending of NPR 41 billion, and network expansion to 68 branches, 38 ATMs, and 8 extension counters (Nepal Rastra Bank, 2015). Foreign investment participation included Young Lian Bank (Malaysia) and FMO (a Netherlands development finance institution), reflecting NRB's openness to international banking partnerships that support institutional consolidation.

4.2 Phase 2: 2017 Om Development Bank Acquisition:

Transaction Details: The 2017 Om Development Bank acquisition represented NMB's continued consolidation strategy, emphasizing Class A-to-Class A consolidation to enhance institutional scale and competitive market positioning. Regulatory approval and implementation occurred in 2017 within NRB's consolidation framework (Nepal Rastra Bank Official Database, 2017).

Strategic Rationale: Om Development Bank's acquisition enabled market share concentration, customer base expansion through existing retail and corporate relationships, and sustained asset growth. Financial reporting demonstrates that consolidation did not materially disrupt profitability metrics or capital adequacy, suggesting successful integration execution (NMB Bank Limited, 2021).

4.3 Phase 3: 2020 Kanchan Development Bank Acquisition:

Transaction Mechanics: The 2020 acquisition of Kanchan Development Bank (KDB) was NMB's most substantial consolidation. NRB granted final approval on August 9, 2020; integration commenced on August 23, 2020 (7th Bhadra 2077 B.S.). Board approval was embedded within the broader multi-institution consolidation authorization of June 7, 2015 (NMB Bank Limited, 2020, 2021).

Financial Impact and Accounting Treatment: NRB's consolidation regulations prescribed specific accounting treatment distinct from IFRS 3. Key accounting entries recognized: Capital Reserve NPR 87.66 million, Regulatory Reserve Transfer NPR 56.79 million, Deferred Tax Assets adjustment NPR 5.36 million, Loan Impairment NPR 251.1 million, and Investment Adjustment Reserve NPR 4.85 million (NMB Bank Limited, 2021).

Post-acquisition performance in FY 2020/21 validated the consolidation strategy. Deposits grew from NPR 134.81 billion (FY 2019/20) to NPR 166.45 billion (+23.47%), loans and advances from NPR 121.78 billion to NPR 158.04 billion (+29.78%), total investment from NPR 15.37 billion to NPR 17.83 billion (+15.97%), and paid-up capital from NPR 13.95 billion to NPR 16.33 billion (+17.02%) (NMB Bank Limited, 2021). Growth rates substantially exceeded industry averages, demonstrating Kanchan's significant contribution to the expansion of the consolidated asset base.

Network Expansion and Geographic Diversification: Post-acquisition consolidation expanded service delivery network across Nepal's seven provinces: Province 1 (30 branches), Province 2 (27 branches), Bagmati Province (51 branches), Gandaki Province (38 branches), Lumbini Province (32 branches), Karnali Province (3 branches), and Sudur Paschim Province (20 branches), totaling 201 branches with 9 extension counters and 138 ATMs (NMB Bank Limited, 2021). Branchless banking services were deployed in 12 districts (Bhaktapur, Dolakha, Ilam, Jhapa, Kapilvastu, Kaski, Morang, Nawalpur, Ramechhap, Rasuwa, Saptari, Sunsari, and Udayapur), extending financial services to underbanked populations in geographically challenging regions.

5. Post-Merger Performance Analysis and Consolidation Effectiveness:

5.1 Financial Performance Trajectory:

Consolidated Operating Performance (FY 2020/21): Post-acquisition operating performance demonstrated substantial revenue generation through diversified income streams. The total operating income was NPR 7,416.36 million, with net interest income accounting for NPR 5,660.66 million (76.38% of total operating income). These metrics demonstrate operational efficiency and revenue diversification beyond traditional net interest income, reducing institutional dependence on interest margin compression.

Capital Adequacy and Regulatory Compliance: Post-acquisition, NMB maintained regulatory capital metrics substantially above NRB minimums: Capital Adequacy Ratio of 15.08%, Credit to Core Capital + Deposit ratio of 77.06% (within mandated range), and Liquidity Ratio of 27.52% (above prescribed minimum). Substantial capital buffers above regulatory requirements showed that Kanchan's capital integration was successful and didn't cause any capital stress or compliance problems (NMB Bank Limited, 2021).

Asset Quality Management: The NPA ratio of 2.27% in FY 2020/21 (from 2.68% pre-acquisition in FY 2019/20) demonstrated effective integration of credit risk management despite pandemic-related credit stress. The 0.41 percentage-point NPA improvement during the consolidation period demonstrated management's ability to integrate legacy asset portfolios while maintaining credit quality standards.

5.2 Scale Achievement and Strategic Positioning:

Consolidation analysis across all three phases reveals profound scale transformation. Paid-up capital expanded 294% from NPR 4.15 billion (post-2015 merger) to NPR 16.33 billion (post-2020 merger), representing substantial capital base enhancement. The geographic network expanded from concentrated urban operations to a nationwide presence, with 201 branches across all seven provinces, fundamentally repositioning NMB within the national competitive landscape. Customer base amplification through sequential acquisitions created diversified deposit and lending portfolios, reducing concentration risk and enhancing resilience against sector-specific shocks.

6. Discussion and implications:

Nepalese banking sector consolidation experience demonstrates that regulatory mandates, when supplemented by explicit incentive structures, effectively drive institutional consolidation. The progression from 100+ banking and financial institutions in 2010 to 27 commercial banks by 2023, with NRB Phase 2 consolidation targeting approximately eight commercial banks, represents substantial policy implementation success (Nepal Rastra Bank, 2011, 2016). NMB Bank's consolidation strategy exemplifies how individual institutions navigate regulatory consolidation requirements while achieving institutional growth objectives.

Yet consolidation effectiveness requires more than regulatory mandate and capital adequacy. Successful consolidation integrates financial consolidation (balance sheet combination, capital deployment) with operational consolidation (systems integration, process standardization) and organizational consolidation (cultural alignment, human resource integration). NMB's experience demonstrates that attention to organizational dimensions, communication management, workforce transition support, and technology infrastructure investment determines whether financial consolidation translates into operational performance improvements.

Banking consolidation in emerging markets differs fundamentally from that in developed markets. Regulatory mandates (rather than competitive pressure) drive consolidation, systemic stability objectives supersede shareholder value maximization, and integration timelines extend beyond developed-market norms due to infrastructure heterogeneity and organizational capacity constraints. Nepal's experience suggests that effective emerging market consolidation requires (1) an explicit regulatory framework with defined procedures and timelines, (2) material incentive structures enabling institutional participation, (3) multi-year integration timelines accommodating organizational adaptation, and (4) attention to depositor protection and financial inclusion objectives beyond pure institutional profitability.

Implications for Banking Sector Development:

NMB's consolidation strategy demonstrates that banking consolidation addresses systemic stability while simultaneously generating institutional competitiveness. Larger, better-capitalized institutions can invest in technology infrastructure, develop specialized products, and expand their geographic reach, generating competitive advantage and customer value. The 294% capital expansion and nationwide network diversification position NMB to compete effectively as international banking presence increases through market liberalization.

However, consolidation success requires sustained management attention to integration completion. Extended integration periods create organizational stress, employee uncertainty, and potential disruptions to customer service. Regulatory frameworks must balance consolidation urgency with integration complexity, establishing realistic timelines and providing ongoing supervisory support to enable successful consolidation.

7. Conclusion:

Nepal's banking sector consolidation, as exemplified by NMB Bank Limited's acquisition of six financial institutions across 2015-2020, demonstrates that systematic consolidation mandated by regulators can simultaneously achieve objectives of systemic stability and institutional competitiveness. NMB's transformation from a single commercial bank to a nationwide financial institution with NPR 16.33 billion in capital, 201 branches, and diversified income streams validates the consolidation strategy's effectiveness when supported by comprehensive integration planning, adequate capital investment, and sustained management attention to organizational dimensions.

The research paper contributes to the banking literature in emerging market contexts by demonstrating that consolidation outcomes depend not only on regulatory mandates or capital adequacy, but also on the execution of integration across financial, operational, and organizational dimensions. Nepal's consolidation experience, with an explicitly defined policy framework, material regulatory incentives, and differentiated consolidation strategies across individual institutions, provides case study insights for other emerging economies designing banking sector consolidation policies.

Future research should examine whether consolidation achieves long-term competitiveness objectives as market liberalization accelerates, whether consolidated institutions sustain financial inclusion commitments amid efficiency pressures, and how consolidation affects credit availability and interest rates for priority sectors and underbanked populations. These questions remain critical for evaluating whether consolidation achieves not only systemic stability and institutional scale but also broader financial development objectives within emerging market contexts.

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