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The Role of Banking Merger and Acquisition in Improving Operational Performance: Empirical Study on Palestinian Banks

Feda Kannan
Accounting Department,
Palestine AliyaUniversity, Bethlehem , Palestine

Akram Rahhal
Accounting Department,
Al Quds University, Jerusalem, Palestine

Niveen Issa
Business Administration Department,
Al Quds University, Jerusalem, Palestine

ABSTRACT

This study examines the role of mergers and acquisitions (M&A) in enhancing the operational performance of banks within the Palestinian banking sector. A quantitative research methodology was employed, using simple linear regression analysis to assess the relationship between M&A activities and operational efficiency. The study sample comprised financial data from Palestinian banks involved in M&A transactions since the sector's inception. The analysis covered a ten-year period, segmented into two intervals: five years preceding and five years following the M&A events. The results reveal a statistically significant positive correlation between M&A and improvements in key operational performance indicators (Assets Turnover, Cash Flow Margin, bank efficiency ratio, Credit to Deposit Ratio). Based on these findings, the study advocates for the consolidation of smaller banks to form larger, more competitive financial institutions capable of meeting the evolving demands of the Palestinian economy. Furthermore, the study highlights the importance of proactive regulatory support from the Palestinian Monetary Authority, including capital adequacy directives designed to incentivize M&A activity and strengthen the resilience of the banking sector.

Keywords: Mergers and Acquisitions, Operational Performance, Palestinian Banking Sector, Assets Turnover, Cash Flow Margin, bank efficiency ratio, Credit to Deposit Ratio.

INTRODUCTION

The economic system around the world has witnessed major developments resulting from many factors. Globalization has contributed to openness to global markets and freedom from financial and legislative trade restrictions, in addition to the exceptional services produced by the tremendous technological revolution in the field of information and communications technology. This has led to the increased emergence of economic blocks around the world. With the increasing emergence of economic units, the banking sector has witnessed significant development. The number of banks around the world has increased, and the types of services they provide have diversified. This has created an urgent need for them to work seriously to develop their systems, confront the challenges they face, and maintain their competitiveness, which contributes to achieving their goals and ensuring the continuity of their work (Leykun, 2016). As a result of the above, the banking sector began to move towards developing strategies that would help it improve its financial position, raise its efficiency, improve the level of its services, and enhance its competitiveness. Bank mergers are one of the most important strategies used to achieve these goals. This strategy has become one of the most important global banking trends since the 1980s (Al-Atoum, et al 2019). Corporate mergers are a mechanism used by banks to address many of the risks they face, which cause low profitability, weak share prices, and to address their administrative problems (Okoye, Modebe, & Isibor, 2016).

The banking sector in Palestine is facing many challenges, especially given its recent emergence and emergence in difficult circumstances resulting from the Israeli occupation and its destructive policies towards the Palestinian economic structure. Considering the limited national banking resources, these banks are unable to create entities with highly competitive capabilities that can confront what foreign banks offer, which prompts them to adopt strategies that enhance their efficiency (Eid and Mudallal, 2016). In line with global trends, merger strategies have emerged in Palestine since the early years of the twentieth century, as they are considered strategies that enhance the performance of small banks and increase their ability to continue in the markets. Accordingly, Palestinian banks have worked since that time to adopt banking mergers to form strong banking entities with high efficiency and capacity and increase their competitiveness. Given the importance of this step, the Palestine Monetary Authority adopted a slogan in 2003 indicating that this year would be the year of merger in the Palestinian banking system (Awad, 2019). Given the need for Palestinian banks to undertake a merger, and its proven importance in improving the level of financial performance of banks and enhancing their competitiveness, the idea of this study arose to identify the role of mergers in improving operational performance in Palestinian banks.

RESEARCH PROBLEM

The banking system in Palestine faces unique challenges resulting from the difficult economic conditions of the Palestinian economy, which is constrained by the policies and activities of the Israeli occupation, which limit the availability of capital capable of driving the economy and its development (Mahasin, 2018). Anyone who examines the current situation of the Palestinian markets will see the almost total reliance on the banking sector to carry out monetary and financial functions, build capital, stimulate investments, and enhance the movement of trade and various sectors (Awad, 2019).

As a result of the weakness of capital in Palestinian banks, their modernity, and their inability to demonstrate highly competitive capabilities compared to foreign banks, they had to work seriously to achieve merger to improve their financial performance and increase their ability to increase their level of liquidity and credit facilities. Under these circumstances, Palestinian banks are seeking to improve their financial performance, which depends primarily on the level of deposits, loan prices, and their profits. Given the importance of mergers in achieving this, the study's problem was to identify the impact of acquisitions and mergers in Palestinian banks on financial and operational performance.

HYPOTHESES

The study seeks to verify the impact of the independent variable, bank mergers, on the dependent variables: financial and operational performance. The study hypotheses can be formulated as follows:

- H01: There is no statistically significant impact of bank acquisitions and mergers in Palestinian banks on operational performance (asset turnover ratio, cash flow margin, bank efficiency ratio, and credit-to-deposit ratio).

LITERATURE REVIEW

Mergers and acquisitions (M&A) have long been regarded as strategic tools for corporate expansion, financial restructuring, and achieving operational synergies. In the banking industry, M&A activity has been particularly extensive, motivated by the need for scale, cost efficiencies, regulatory compliance, technological investment, and market consolidation. While evidence suggests potential benefits in profitability and operational performance, the empirical literature reveals mixed results depending on context, country, and methodological approach.

Mergers and Acquisitions in the Banking Sector

Mergers and acquisitions (M&A) play a significant role in the banking industry, often driven by goals of growth, expanded market share, and enhanced operational efficiency. The impact of M&A on bank performance has been extensively studied, though the results remain mixed. While some studies report positive outcomes, others suggest only minimal or negligible effects. This literature review examines the current body of research on the effects of M&A on bank performance, with particular attention to the various factors that influence these outcomes—such as market conditions, regulatory environments, and the specific characteristics of the banks involved.

The analysis of M&A activity in banking draws on several theoretical frameworks, including the Efficiency Hypothesis, which posits that mergers and acquisitions can lead to improved efficiency through economies of scale and scope, thereby boosting profitability (Berger & Humphrey, 1992).

Motives for Bank Mergers

Bank mergers are driven by several factors. Studies by Akkar, 2019; Othmaniya and Boumezaid, 2021 indicate several motivations behind adopting a bank merger, including: expanding into new markets, developing services, reducing the number of competitors, increasing revenues, and enhancing administrative and technical efficiency. Increasing research and development capacity, obtaining tax benefits, increasing market value, facing economic changes, achieving efficiency in economies of scale, improving quality and diversifying the portfolio, in addition to motives related to the process of synergy and cooperation, motives related to agencies and the relationship between managers and shareholders, motives of managerial arrogance, maximizing shareholders' wealth, increasing the efficiency of banking services and achieving their diversity and expanding the scope of their provision (Ngo, 2019).

The literature provides a classification of the motives leading to bank mergers. Long (2015) indicates that there are four main motives for bank mergers: strategic, economic, personal, and market related. The strategic motive is to improve banks' strategic capabilities, such as increasing market power and enhancing financial and human resources. While economic motives include achieving economies of scale, i.e., reducing costs by increasing production volume, personal motives involve administrative issues. Some banks seek to enter new markets in new countries, and mergers are one way to achieve this.

Al-Alafi (2018) classifies them into economic, financial, administrative, and legal motives. Economic motives refer to increasing the efficiency of economies through expanding the scale of activities, or what is known as economies of scale, which leads to increased investment and reduced indirect fixed costs, in addition to enhancing competitiveness and achieving financial stability. Financial motives arise when small banks want to finance large projects. The merger process is a means of obtaining banking facilities to finance these projects. Small banks also resort to merging if the monetary authorities impose an increase in the banks' capital. On the other hand, mergers may be linked to legal reasons and motives, such as legislation that encourages mergers and incentives given to some banks, such as allowing a profitable bank to absorb the losses of other banks and benefit from tax deductions.

Types of Bank Mergers

Bank mergers take many forms and types, depending on the criteria used in the classification process. Most literature classifies bank mergers based on two criteria: the nature of the merged units' activities, the nature of the relationship between the parties to the merger, and the reasons for the merger. These criteria can be explained as follows:

Types of Bank Mergers According to the Activities of the Merged Units

Horizontal Merger: Horizontal merger refers to the merger of two banks operating in the same activity or related activities, such as the merger of two investment banks, with the aim of raising operating levels and increasing the volume of activity (benefiting from economies of scale), achieving economic savings and increasing market share, which reduces the number of competitors.

Vertical merger: A merger between two banks of different sizes and capabilities, one of which is small and located in different regions, and another bank in a large city or capital. The smaller banks become extended branches of the larger banks (Siam, 2014). This type of merger aims to provide enhanced service levels and market expansion (Akkar, 2019).

Conglomerate Merger: A merger between two or more banks, each operating in different, unrelated activities, achieving complementarity (Al-Atoum et al. 2019) in activities, enhancing competitive advantages, and helping banks reach high levels of operation and achieve economies of scale.

The positive effects of bank mergers can be explained by referring to the study (Al-Atoum et al., 2019; Awad, 2019), as follows:

Increasing the Capital Base

Bank mergers are a means of improving the quality of banking services and providing them at the lowest possible cost, thus enhancing customer and client confidence.

Restructuring of Merged Banks

Bank mergers have a positive impact on profitability indicators

- Transfer of financial assets
- Increase in stock market value
- Create a defensive strategy, as mergers are a means of solving many problems in banks
- Increase in the ratings of merged banks

Bank mergers may have several negative effects, which can be identified by reference to the study (Shaker, 2015; Al-Atoum et al., 2019), as follows:

- The monopoly of some banks over the banking market
- Increasing the negative effects of the failure of giant banks on the economy, as the failure of merged banks, which have become large, leads to financial disasters
- The merger of two weak banks may also result in an even weaker economic entity
- Reduces performance efficiency

Mergers and Acquisitions in the Palestinian Banking Sector

Since its establishment, the Palestine Monetary Authority (PMA) has been committed to strengthening the Palestinian banking sector through the development and enforcement of regulatory frameworks. Beginning in 2002, the PMA initiated a strategic plan to increase the capital base of local banks, aiming to enhance their financial resilience and ability to withstand economic shocks. As part of this initiative, the PMA introduced the concept of banking mergers as a key reform mechanism to address the challenges faced by smaller financial institutions.

To facilitate this process, the PMA engaged directly with banks to encourage consolidation as a means of achieving greater financial stability and operational efficiency. The first successful banking merger occurred in 2005, when the Palestinian Islamic Bank merged with the Islamic Transactions Branch of Cairo Amman Bank. This was followed in 2010 by a second major merger between the Palestinian Islamic Bank and Al-Aqsa Islamic Bank (Al-Ibrahim, 2018).

In 2012, another notable transaction took place when the Welfare Bank for Financing Small Businesses merged with the Arab Palestinian Investment Bank, resulting in the formation of the National Bank (Abu Madallah & Eid, 2016).

A further wave of mergers and acquisitions was prompted by Instructions No. 6 of 2015 issued by the PMA, which required all banks operating in Palestine to raise their minimum paid-up capital to $75 million USD (PMA, 2015). This directive led to several significant transactions, including:

- The merger of Palestine Commercial Bank with Bank of Palestine
- The acquisition of Jordan Commercial Bank's Palestine branch by the National Bank
- The acquisition of a 51% stake in Arab Islamic Bank by Bank of Palestine

These mergers and acquisitions reflect a broader strategy by the PMA to promote a more robust, competitive, and sustainable banking sector in Palestine. They underscore the importance of regulatory intervention in shaping the financial landscape and responding to both local and global economic pressures.

Operational Performance

Operational performance is an important tool that reflects the efficiency of economic units in operating their businesses and achieving their objectives. In banks, operational efficiency contributes to supporting financial performance and achieving numerous material and moral gains and savings (Moutinho, Vale, Bertuzi, Bandeira, & Palhares, 2021). In this section, we will learn about the concept of operational performance and some of the indicators used to determine it in banks, namely: asset turnover rate, the ratio of operating expenses to net assets, and cash flows from operating activities.

The Concept of Operational Performance

Operational efficiency in economic units in general, and banks in particular, contributes to numerous material and moral gains. Efficient operational performance ensures that these units maintain the stability of their financial systems (Al-Janabi, 2020). Researchers differ in their definition of financial performance. The most prominent of these definitions are:

Operational performance is defined as a measure of operational efficiency in economic units and an assessment of their ability to invest in their available resources to achieve quality, flexibility, and reduce costs to meet customer needs and aspirations (Ismail and Mustafa, 2020). Operational performance is defined as the performance that encompasses a set of elements related to the economic unit's operating mechanism, the quality of its products and services, the speed of their delivery, and the flexibility to change procedures to achieve advanced competitive positions and achieve optimal results (Al-Darawi, et al 2020). Operational performance is defined as the results achieved from the overall interaction of an economic unit's activities and resources (Al-Nafri, 2019).

It is defined as an indicator that determines the efficiency of an economic unit in investing its available resources, improving the quality of the services it provides, and enhancing the mechanism for managing its operations to achieve its goals (Hsu, 2014).

It is also known as the practical translation of the efficiency of all strategic decisions and plans adopted by economic units in managing their operations and formulating their decisions, which is reflected in the quality of their services, the flexibility of their operations, and their ability to meet the needs and desires of their customers (Purwanto, et al 2014)

RESEARCH METHODOLOGY

To achieve the objectives of the current study with high quality, the quantitative analysis approach was used, depending on secondary data extracted from financial statements which were statistically analyzed using SPSS software through comparing the bank performance for five years before the acquisition and merger process and five years after the acquisition and merger process.

Study Population and Sample

The study community consists of banks in Palestinian banks that have undergone the merger experience. First: The Palestinian Islamic Bank, which merged with Al-Aqsa Islamic Bank. Second: The Palestinian Islamic Bank, which merged with Cairo Amman Bank / Islamic Transactions Branch. Third: The merger of the National Bank with the Jordan Commercial Bank.

Fourth: The acquisition of 51.98% of the shares of the Arab Islamic Bank by the Bank of Palestine.

The study sample was selected using the comprehensive sample method in the Palestinian banks that underwent the merger experience. First: Palestine Islamic Bank. Second: National Bank. Third: Bank of Palestine.

Study Variables

Independent Variable is M&A; it is measured using dummy variable as follows:
The period before M&A defined as 0, while period after M&A defined as 1

Dependent Variables:
Financial Performance was measured using following Variables:

- Assets Turnover = Net Sales / Average Total Assets
- Cash Flow Margin = Cash flow from operating / Net Revenues
- bank efficiency ratio = Non-Interest Expense / Net Revenues
- Credit to Deposit Ratio= Total Credits/ Total Deposits

RESULTS

Descriptive Statistics for Variables

Comparison of the averages of the dependent variables. The term "before" refers to the period before the merger, while the term "after" refers to the period after the merger. The table shows that the average asset turnover ratio, bank efficiency ratio, and credit-to-deposit ratio increased during the merger period, in contrast to the cash flow margin, which decreased during the merger period between Palestinian banks.

Variables	Mean	Std. Deviation	M&A
Cash flow Margin	2.937129755185769	4.040664503362861	Before
	1.669492806863267	3.208406599297960	After
Bank Efficiency Ratio	.473174029029937	2.017601926881083	Before
	1.125838421813642	.572951260577443	After
Credit to Deposit Ratio	1.879099044120641	4.821219522783021	Before
	3.323033343951952	6.163423996543041	After
Assets Turnover	.008958458901658	.017885493033320	Before
	.010283766712172	.009261275706879	After

Hypothesis Test

There is no statistically significant relationship at the significance level (α ≤ 0.05) for the role of merger on operational performance indicators in Palestinian banks.

	Model Summary		Sig. Of Coefficients	ANOVA
Dependent Variables	Adjusted R Square	R	M&A	Sig.
Assets Turnover	0.154	0.421	0.009	0.009
Cashflow Margin	0.488	0.709	0.000	0.000
Bank Efficiency Ratio	0.324	0.585	0.000	0.000
Credit to Deposit Ratio	0.173	0.442	0.006	0.006

Table shows the results of testing the second main hypothesis, as the study answered the second main hypothesis, which states that there is a statistically significant relationship at the significance level ($\alpha \leq 0.05$) for the role of integration on operational performance indicators in Palestinian banks The table shows the explanatory power of the role of integration on operational performance indicators. Through R, its power ranged between 70.9% and 42.1%, and the Adjusted R Square ranged between 15.4% and 48.8%. Through analysis of variance (ANOVA), the results showed that the value of $\alpha \leq 0.05$ is statistically significant. The results of the analysis of the coefficients to determine the quality of the relationships showed that there is a relationship and the value of Sig> 0.05 is statistically significant.

CONCLUSION

This study aims to identify the role of mergers in improving operational performance in Palestinian banks. This study is a result of the need for Palestinian banks to undertake mergers and their proven importance in improving the level of operational performance of banks and enhancing their competitiveness. The study examined the impact of bank mergers on operational performance indicators, including asset turnover, cash flow margin, bank efficiency ratio, and credit-to-deposit ratio. The study concluded that bank mergers have a significant relationship with all operational performance indicators, including asset turnover, cash flow margin, bank efficiency ratio, and credit-to-deposit ratio. This is agreed with study of le 2017 and long 2015This suggests that the trend toward mergers and acquisitions in Palestinian banks will lead to improved operational performance for the merged banks.

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