Impact of Mergers on Operating Efficiency: A Comparative Study on Pre and Post Mergers in Indian Banking Sector

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Abstract-The banking system in India should not only be hassle free but also be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India's banking system has had several outstanding achievements to its credit. In Indian banking sector Mergers and acquisitions has become admired trend throughout the country. A large number of public sector bank, private sector bank and other banks are engaged in mergers and acquisitions activities in India. Merger and acquisition encourage banks to gain global reach and better synergy and allow large banks to acquire the stressed assets of weaker banks. Merger in India between weak banks should grow faster so that they could rehabilitate providing continuity of employment with the working force, utilization of assets blocked up in the weak banks and adding constructively to the prosperity of nation through increased flow of funds. The small and medium size banks are working under threat from the economic environment which is full of problems for them, viz, inadequacy of resources, outdated technology, on-systemized management pattern, uncertain marketing efforts, weak financial structure and lack of product innovations. Therefore, restructuring through merger and acquisitions could offer re-establishment of those in feasible banks of most advantageous size with global presence. In Indian banking sector, merger and acquisition has been taking place with a view to provide the safeguard and hedging weak banks and also to achieve the objective of universal banking. As per the trend and scenario in Indian baking sector in terms of mergers, this study identified three public and private sector acquirer banks. These are Bank of Rajasthan merger with ICICI, Ganesh Bank Kurandwad merger with Federl Bank, Centurian Bank merger with HDFC, South Gujrat Local area Bank merger with Bank of Baroda, Bharat Overseas merger with Indian Overseas Bank and Global Trust Bank merger with Oriental Bank of Commerce. The study has brought into sharp focus on the reasons and impact of merger and evaluating the performance of the selected banks during pre-merger and post-merger periods. To analyse the performance of the selected banks this study considered operating profits, net profits, Capital Adequacy Ratio, Return n equity, Net interest margin, Return on investments etc. as these are the very important parameters to evaluate performance of the banks and also considered relevant statistical tools for analyzing and interpreting the results. The study period considered for analysis is five years prior to merger and five years after merger depending upon the year of merger took place to know the operational performance of merged banks pre and post merger and also factors influencing the operational performance of those banks. This study is descriptive in nature and used secondary data which is collected from the official website f the Reserve bank of Indi. Based on the analysis made, the researcher has

given the summary of findings. The findings of this paper will be useful to the banks to take certain policy decision in future.

Keywords-Mergers and acquisitions, performance evaluation, banking sector, Net interest margin, operating profits, return on equity, Capital Adequacy Ratio etc.

INTRODUCTION

Banking is an important segment of the tertiary sector and acts as a backbone of economic progress. The banks render vital services to the masses belonging to the various sectors of the economy like Agriculture, industry whether small scale large scale. The increasing horizon of commercial banks identifies itself with the problems and responsibilities for making banking an instrument for bringing about social and economic transformation of a developing country. The operations of commercial banks record the economic pulse of economy of almost all countries big or small, rich or poor, socialist or capitalist and they are faced with the problem of regional disparities in economic development. Thus, banking is a basic industry, which not only caters to the development of a trade, commerce and industry, but also helps in removing many obstacles in the way of economic development. A large number of public sector bank, private sector bank and other banks are engaged in mergers and acquisitions activities in India. The Main motive behind Mergers and acquisitions in the banking sector is to harvest the benefit of economies of scales and also restructuring process. Prudential norms which were introduced at the time of financial sector reforms in the year 1991 by the Narasimham Committee led many banks to think over abut banks financial soundness and quality of the assets they maintain. In Indian banking sector Mergers and acquisitions has become popular trend throughout the country. Mergers and acquisitions are considered as a relatively fast and efficient approach to expand into new markets and incorporate new technologies and the main motive behind strategic decision to strengthen the banks in terms of sound financial health and sustain their position in the market place. Mergers and acquisitions have played a major role for corporate restructuring and the financial services industry. Pressures on the employees of banks around the world have been numerous across, entry of new players and products with superior technology, globalization of financial markets and changing demographics of customer behavior, consumer pressure for wider choice and low cost service, shareholder wealth demands, reduction in margins. The key driving force for merger activity is severe competition among the banks which focus on economies of scale, cost efficiency, and profitability. Due to such reasons there is great merger activity took place as all associates of State Bank of India merged in to SBI in recent past in the year 2017. In the history of Indian Banking sector as far as mergers and acquisitions are concerned it is a sweeping decision taken by the bankers.

Mergers in Indian banking Sector-An overview

Mergers in India in broad-spectrum have experienced an amplified number in diverse sectors particularly after the New Economic Policy in the year 1991 which has opened the doors for markets worldwide and there is need to compete with foreign banks which are very much established in India. Banking Sector in India has witnessed many Mergers after the financial sector reforms for various reasons such as Restructuring of Weak Banks, Economies of Scale, Expansion of Market, Business Consolidation etc. If consider the history of Mergers in Banking Sector in India, initially they have taken place as a measure to protect the interests of the customers of the weak banks as they are backbone for the sustainability of any business but subsequently a few Mergers also have take place voluntarily in the Post Liberalization period between various banks for several reasons like expansion, maintain strong customer base, sustainability, Competition etc. The Indian economy, which is one of the fastest growing economies in the world, is balanced to maintain its leading position, despite the global financial disaster and economic slowdown. India has managed to beat the global financial disorder due to sound regulation, prudent financial supervision and proactive policies and majorly introduction of financial sector reforms in the year 1992. India's growth is driven predominantly by domestic consumption and investment and the Indian banking system had no direct exposure to the US sub-prime mortgage assets or to the failed institutions. During this period two mergers have taken place in Indian Banking Sector one between two profit making Public Sector Banks in the lines of consolidation and the other one was between two profit-making Private Sector Banks for the synergies of merger. In this context, the study of performance of the banks that have merged voluntarily assumes importance.

REVIEW LITERATURE

An attempt has been made to summarize the important research literature on the Mergers and Acquisitions carried so far in order to find out the research gap and also to define the statement of the problem to proceed with the present study. Evaluating the performance of banks involved in Mergers and Acquisitions has become a subject matter of a great deal of research. Many researchers were contributed in this area to throw light on the motives behind the merger and acquisitions in the banking sector. Berger and Humphrey (1994) reported that most studies that examined pre-merger and post-merger financial ratios found no impact on operating cost and profit ratios. The reasons for the mixed evidence are: the lag between completion of merger process and realization of benefits of mergers, selection of sample and the methods adopted in financing the mergers. Pilloff and Santomero (1997) conducted a survey of the empirical evidence and reported that most studies fail to find a positive relationship between merger activity and gains in either performance or stockholder wealth. Laxman G(2004) in his research article "Impact of Merger and Acquisitions on Financial Performance of Private Sector Banks", has made an attempt to asses the impact of merger on financial performance in terms of CAR, NPAs, Interest income, Interest Expenditure, Operating expenditure, Provisions and Contingencies, Spread, Gross Profit, Net profit as percentage to total assets before and after merger. The study concluded that there is a decreasing trend in spreads and increasing tendency in NPAs of the target bank. But these indicators are more or less remained the same when compared to average indicators of the Private Sector Banks during the period under study.Wheelock and Wilson (2004) find that expected merger activity in US banking is positively related to management rating, bank size, competitive position and geographical location of banks and negatively related to market concentration. Substantial gains from mergers are expected to come from cost savings owing to economies of scale and scope. Sathya Swaroop Debasish5 (2005) in her study "Merger in Indian Banking – Case of ICICI Bank and Bank of Madura" has analyzed the conceptual overview on the series of recent merger and acquisitions. It suggested that the removal of entry barriers saw emergence of private sector banks (both old and new) in India and how market forces are compelling these to conglomerate and consolidate their competitive abilities. Kavitha Bhatnagar7 (2006) in her study entitled on "M&A in Indian Banking Sector", discussed the India Banking Association document "Banking Industry Vision 2010". It is visualized that the merger in India either between the public sector banks, or public sector and private sector banks is the logical thing to happen in the competitive race. The study concluded that merger and acquisition route is providing a quick step to acquire competitive size, an opportunity to share markets and reduce the cost of product development and delivery.Schiereck Dirk et al., (2009), explained the relationship between bank reputation after Merger and Acquisitions and its effects on shareholder's wealth. It is found in the study of Bhaskar A Uday et al., (2009) that Banking sector witness of Merger activities in India when banks facing the problem of loosing old customer and failed to attract the new customers. Benkard C Lanier et al., (2010) studied the simulating the dynamic effect of horizontal merger and took the case the case of U S Airlines. Aharon David Y et al., (2010), analyzed the stock market bubble effect on Merger and Acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investors take more risk. Goyal K.A. & Joshi Vijay (2011) in their paper entitled "Mergers in Banking Industry of India: Some Emerging Issues" gave an overview on Indian banking industry and highlighted the changes occurred in the banking sector after post liberalization.

Research gap and the Statement of the problem

The above review of literature points to the fact that, studies have been made on Mergers relating mainly to the performance of select banks; analyze the problems of mergers; benefits to the stakeholders; Financial performance of the transferee bank after the merger. However an analysis relating to certain key parameters which indicate sound financial health and profitability of the banks prior to merger and after merger. This study is undertaken to fill the research gap by considering different banks in different time periods as per the banks year merger. It really gives the insight to understand and measure the impact of mergers.

OBJECTIVES OF THE STUDY

This study is attempted to meet the following objectives

1. To study the financial health and profitability conditions of the acquirer banks under the study.
2. To compare the impact on financial and profitability conditions of the selected banks with respect to pre and post mergers.
3. To offer suggestions if necessary for the better functioning of the Indian banks in terms of its operational efficiency.

METHODOLOGY

This study is descriptive in nature and purely based on secondary data collected from the official website of the Reserve Bank of India. Six banks are selected for the study, three from public sector and three from private sector. These are Bank of Baroda, Oriental bank of commerce, Indian Overseas Bank and ICICI, Federal Bank, HDFC from public sector and private sector respectively. Operating profits, Net interest Margin, Return on Assets, Return on equity, Return on Investments and Capital Adequacy Ratios were considered as parameters for analyzing and evaluating pre and post merger effect on the efficiency of the selected banks. Prior to merger five years and post merger five years period is considered for the study depending upon the date of merger of each respective bank considered. Percentages, Mean, Standard Deviation and t-test are used as statistical tools for analyzing the data.

Hypothesis of the study

In order to meet the objectives of the study the following hypothesis formulated:

Null Hypothesis: Ho_1: There is no significance impact of the merger on the operational efficiency of the banks

Alternative Hypothesis: Ho_2: There is a significance impact of the merger on the operational efficiency of the banks

Results and discussions

Table: 1 Banks covered under the study

Sl.No.	Acquirer Bank	Target Bank	Year	Reasons for merger	Type
1.	Bank of Baroda	South Gujrat Local area Bank	2004	Restructuring of Weak Bank	Forced Merger
2.	Indian Overseas Bank	Bharat Overseas	2007	Restructuring of Weak Bank	Compulsory merger
3.	Oriental Bank of Commerce	Global Trust Bank	2004	Restructuring of Weak Bank	Forced merger
4.	ICICI	Bank of Rajasthan	2010	Expansion of size	Voluntary Merger
5.	Federal Bank	Ganesh Bank of	2006	Restructuring of Weak	Forced merger

		Kurundwad		Bank	
6.	HDFC	Centurian Bank	2008	Expansion of size and benefits of scope economics	Voluntary Merger

Table:2 Pre merger ratio analysis of Bank of Baroda (South Gujrat Local area Bank)

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
1999-00	1.24	2.35	7.03	0.31	10.57	10.47
2000-01	1.34	2.86	9.69	0.44	12.23	10.35
2001-02	2.18	2.84	18.4	0.78	10.68	9.52
2002-03	2.33	2.86	18.81	1.05	12.65	10.01
2003-04	3.08	3.18	20.32	1.2	13.91	8.6

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:3 Post merger ratio analysis of Bank of Baroda (South Gujrat Local area Bank)

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2004-05	2.56	3.31	12.58	0.75	12.61	7.96
2005-06	1.84	3.05	12.28	0.79	13.65	8.05
2006-07	1.88	2.79	12.45	0.8	11.8	7.31
2007-08	1.81	2.42	14.58	0.89	12.94	6.95
2008-09	2.12	2.52	18.62	1.09	14.05	6.87

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:4 Pre merger ratio analysis of Indian Overseas Bank

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2002-03	2.07	3.19	32.1	1.01	11.3	9.88
2003-04	3	3.62	28.96	1.08	12.49	9.38
2004-05	3.05	3.78	27.98	1.28	14.2	9.04
2005-06	2.44	3.75	27.23	1.32	13.04	8.81
2006-07	2.2	3.62	28.14	1.36	13.27	7.94

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:5 Post merger ratio analysis of Indian Overseas Bank

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2007-08	2.17	2.66	27.15	1.3	11.93	7.65
2008-09	2.26	2.57	22.07	1.17	13.2	7.23
2010-11	1.85	2.72	12.73	0.71	14.55	6.88
2011-12	1.77	2.52	9.88	0.52	13.32	7.57
2012-13	1.64	2.26	4.47	0.24	11.85	7.48

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:6 Pre merger ratio analysis of Oriental Bank of Commerce

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment

1999-00	1.5	3.68	13.79	0.15	9.15	15.73
2000-01	2.07	3.06	13.63	0.8	12.08	12.17
2001-02	3.09	3.28	20.23	1	11.82	10.99
2002-03	3.51	3.64	24.51	1.3	14.04	11.25
2003-04	4.09	3.88	28.67	1.7	14.47	10.35

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:7 Post merger ratio analysis of Oriental Bank of Commerce

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2004-05	2.59	3.21	24.19	2.01	9.21	9.52
2005-06	2.11	2.84	13.11	1.39	11.04	9.19
2006-07	1.95	2.55	10.78	1.21	12.51	8.73
2007-08	1.48	2.03	6.21	1.02	12.12	8.43
2008-09	1.64	1.96	13.51	0.88	12.98	8.17

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:8 Pre merger ratio analysis of ICICI

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2005-06	1.86	2.25	14.33	1.3	13.1	6.05
2006-07	1.97	1.89	13.17	1.09	11.69	6.13
2007-08	2.14	1.96	11.63	1.12	13.96	7.37
2008-09	2.29	2.15	7.80	0.98	15.53	6.90
2009-10	2.62	2.19	7.96	1.13	19.41	5.77

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:9 Post merger ratio analysis of ICICI

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2010-11	2.35	2.34	9.65	1.58	19.54	6.19
2011-12	2.32	2.40	11.20	1.50	18.52	6.58
2012-13	2.57	2.7	13.1	1.7	18.14	6.65
2013-14	2.93	2.91	14.02	1.78	17.72	7.48
2014-15	3.18	3.07	14.55	1.86	17.02	6.32

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:10 Pre merger ratio analysis of Federal Bank

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2000-01	2.28	2.89	15.7	0.69	10.29	11.29
2001-02	3.22	2.9	18.98	0.53	11.23	11.35
2002-03	3.15	3.04	21.5	0.86	11.2	10.2
2003-04	3.20	3.09	23.14	0.90	11.48	8.68
2004-05	2.51	3.15	13.1	0.62	11.27	6.70

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table:11 Post merger ratio analysis of Federal Bank

(Values in percentages)

YEAR	Operating	Net	Return on	Return on	Capital Adequacy	Return on

	Profit	Interest Margin	Equity	Assets	Ratio	Investment
2005-06	2.41	3.2	22.82	1.28	13.75	7.59
2006-07	2.68	3.13	21.27	1.38	13.43	7.01
2007-08	2.76	3.01	13.56	1.34	22.46	7.29
2008-09	3.53	3.69	12.13	1.48	20.22	6.32
2009-10	3.07	3.42	10.3	1.15	18.36	6.22

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table: 12 Pre merger ratio analysis of HDFC

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2003-04	2.77	3.68	20.61	1.45	8.1	11.66
2004-05	2.87	3.79	18.45	1.47	12.16	6.79
2005-06	3.17	4.08	17.74	1.38	11.41	6.84
2006-07	3.11	4.21	19.46	1.33	13.08	6.98
2007-08	3.36	4.66	17.74	1.32	13.6	7.18

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Table: 13 Post merger ratio analysis of HDFC

(Values in percentages)

YEAR	Operating Profit	Net Interest Margin	Return on Equity	Return on Assets	Capital Adequacy Ratio	Return on Investment
2008-09	3.27	4.69	17.17	1.28	15.69	7.41
2009-10	3.17	4.13	16.3	1.53	17.44	6.78
2010-11	2.35	2.34	9.65	1.35	19.54	6.19
2011-12	3.05	4.19	18.69	1.77	16.52	7.72
2012-13	3.1	4.28	20.34	1.9	16.8	7.48

(Source: Statistical tables relating to banks in India, Official website of Reserve Bank of India)

Findings and suggestions of the study

CONCLUSION

The new economic environment of the 1990s has facilitated Mergers and Acquisitions between banks which facilitated efficient performance and weak banks in terms of financial performance and operational efficiency. But it can be concluded the improvement in terms of various parameters can be identified with supported relative information of their own. The policy makers can use the findings of the study as a base for framing policies relating to M&As in service sector and to identify the areas of improvement for better operational and performance for the banks. The above study reveals that the lower or higher return on equity is discriminating between the groups. The discriminate analysis clearly reveals that both the pre and post merger period of this study either bank with lower return on equity or bank with higher return on equity improved its efficiency due to the following operational ratios and the key variables namely, market capital, share capital, return on asset and earnings per share. Merger in general is considered as a strategic tool for the participants in merger activity for gaining certain synergies. The study focused on the pre and post merger performance of SBI and HDFC Banks, who have participated in mergers for different reasons. Overall growth is observed in the performance of both the banks in key parameters, and productivity ratios, and the same is ascertained by employing the statistical tools.

REFERENCES