A Study of Indian Private and Public Sector Banks with Special Reference to Impact of Post Merger and Acquisition Venture on Liquidity and Profitability

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Abstract

This study was directed to assess the impact of merger and acquisition activities on the performance of Banks in India. The paper reviews the trends in M&A's in Indian banking and then impact of M&A's has been studied. The study covers the area of performance evaluation of M&A's in Indian banking sector during the period pre and post period of six years of Merger and Acquisition activity. The paper studied the post merger financial performance of merged banks with the help of financial parameters. The study recommended that policies and strategies instituted by management, for instance the credit policy, should be re-visited in order to enhance internal and external operations, the logistical framework support should be improved; a more comprehensive approach to integrated marketing communications mix should be put in place in the promotion of the Bank's existing and added products so as to gain more market share.

1. INTRODUCTION

Banks play a crucial role in propelling the entire economy of any nation, of which there is need to reorder them to efficiently perform through reform processes geared towards forestalling bank distress. In India, the reform process of the banking sector or industry is part and parcel of the government strategic agenda aimed at repositioning and integrating the Indian banking sector into the global financial system. To make the Indian banking sector sound, the sector has undergone remarkable changes over the years in terms of the number of institutions, structure of ownership, as well as depth and breadth of operations.

Banks when all is said in done phrasing is alluded to as a budgetary organization or a corporation which is authorized by the state or central government to manage cash by accepting deposits, giving out advance and putting resources into securities. The primary job of banks is the development of economy by giving funds for investments.

In recent years banking sector has been undergoing a lot of changes in terms of regulations and effects of globalization. These changes have affected this sector both structurally and strategically. With the changing Environment, many different strategies have been adopted by this sector in order to remain efficient and to surge ahead in the global arena. One such profitable strategy is the process of consolidation of the banks. There are several ways to consolidate the banking industry; the most common adopted by banks is merger. Merger of two weaker banks or merger of one healthy bank with one weak bank can be treated as the faster and less costly way to improve profitability then spurring internal growth (Franz H Khan 2007). The main motive behind the merger and acquisition in the banking industry is to achieve economies of scale and scope. Mergers also help in the diversification of the products, which help to reduce risk.

Bank's M&A activity results in overall benefits such as improved revenue efficiency related benefits, Return on Asset (ROA) which is decomposed into Total Asset Turnover (efficiency) and profit margin (effectiveness), Return on Investment (ROI), cash flows, reserves, liquidity, etc. to shareholders.

2. MERGER

A particular activity is called a merger when corporations come together to combine and share their resources to achieve common objectives is known as Merger. In a merger, both firms combine to form a third entity and the owners of the combining firms remain as joint owners of the new entity (Sudarsanam, 1995).

3. ACQUISITION

An acquisition is an activity where a firm takes a controlling ownership interest in another firm, a legal subsidiary of another firm or selected assets of another firm. This may involve the purchase of another firm's assets or stock.

4. NEED FOR THE STUDY

Mergers and acquisitions are very older strategies. The reasons might be not the same as time to time and may differ from organization to organization. The assignments of mixes have turned out to be more helpful after the new monetary approach (liberalization policy in 1991). There have been a more noteworthy need of concentrates in the region of mergers and acquisitions, however the vast majority of them concentrated on manufacturing sector. Further not very many investigations have centered to break down the M&A activity in the service industry. Subsequently, there is a requirement for the study in the present scenario.

5. M&A IN BANKING INDUSTRY

The banking industry is a vital zone in which mergers and acquisitions do make gigantic monetary profits. Because of changes in the desire for the corporate client, banks are currently compelled to reevaluate their business and devise new techniques. The Indian banking sector is experiencing a procedure of limiting, for the most part determined by unavoidable patterns, for example, deregulation, disintermediation, technological advancement and innovations. To increase competitive cost advantage, consolidation of activity as M&A is one of the viable techniques generally adopted by the bankers. Mergers in banks are considered with the end goal of :-

1. Expansion/diversification
2. Upgradation of technology
3. Loss making bank merged with another healthy bank for revival
4. Healthy bank merged with another healthy bank to become financially stronger, to meet competitive pressures
5. Growth in profits
6. Increase market share, etc.

M&A deals undertaken in banking sector during pre and post financial sector Reform period are given in the table1.1

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Table 1: Schedule of M & A deals of Indian Banks- Post Reform Period

1	New Bank of India	Punjab National Bank	4/9/1993
2	Bank of Karad Ltd.	Bank of India	1993-1994
3	Kashinath Seth Bank	State Bank of India	1995-1996
4	Punjab Co-op. Bank Ltd.	Oriental Bank of Commerce	1996-1997
5	Bari Doab Bank Ltd.	Oriental Bank of Commerce	1996-1997
6	Bareilly Corp. Bank Ltd.	Bank of Baroda	3/6/1999
7	Sikkim Bank Ltd.	Union Bank of India	22-12-1999
8	Times Bank Ltd.	HDFC Bank Ltd.	26-02-2000
9	Bank of Madura	ICICI Bank	Mar. 2001
10	Benaras State Bank Ltd.	Bank of Baroda	20-07-2002
11	Nedungadi Bank Ltd.	Punjab National Bank	1/2/2003
12	Global Trust Bank Ltd.	Oriental Bank of Commerce	24-07-2004
13	Centurian Bank	Bank of Punjab Ltd.	01.04.2005
14	United Western Bank Ltd.	IDBI ltd.	02.04.2005
15	The Ganesh Bank of Kurd. Ltd.	The Federal Bank Ltd.	02.09.2006.
16	Bharat Overseas	Indian overseas Bank	31.3.2007
17	The Sangli Bank Ltd	ICICI Bank	19.4.2007
18	Lord Krishna Bank Ltd.	Cent. Bank of Punjab Ltd.	29.8.2007
19	Centurion Bank of Punjab	HDFC Bank	Feb 2008*
20	Bank of Rajasthan	ICICI Bank	Aug 2010*

Source: *Lakshminarayanan, P., (2005), Consolidation in the Banking Industry through Mergers and Acquisitions, Special Issue, Indian Banks Association Bulletin, Indian Banks Association, (January), pp. 92-99.*

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6. OBJECTIVES OF THE STUDY

1. The main objective of this paper is to assess the impacts of merger and acquisitions on the financial performance of the selected banks in India. Post merger study is led on chosen factors to analyze the adequacy of mergers and acquisitions on the banks.
2. To analyze the response of security prices to declaration of Mergers/acquisitions choice decisions during the examination time frame.

7. RESEARCH METHODOLOGY

This paper depends on Secondary information and utilized with the end goal of study. The financial and accounting related information has been gathered from the bank's published yearly reports to look at the effect of mergers and acquisitions on the execution of banks selected as sample. Additionally the information has been gathered from the sites of Bombay Stock Exchange, National Stock Exchange and moneycontrol.com for the purpose of the study. Also, the other required information were gathered from different journals and magazines.

In this study, financial reports and different ratios to analyze the post-merger financial performance of the acquiring banks. Different ratios like ROE, ROA and liquidity, etc are considered.

8. ANALYSIS AND INTERPRETATION OF DATA

The researcher has used accounting ratios viz., liquidity ratios, activity ratio and profitability ratios to analyze the financial position of the banks during post acquisition periods.

(a) Current Ratio:- The current ratio is the most commonly used ratio for measuring liquidity position of the banks. It expresses the relationship between current assets and current liabilities. A higher current ratio shows that the bank is able to pay its short term obligation maturing within a year. From the management point of view, a higher current ratio is an indication of poor planning since an extensive amount of funds would lie idle.

CR= Current Assets, Loans & Advances ÷ Current Liabilities & Provisions

Table 2: CURRENT RATIO

Name of Acquiring Bank (Acquired Bank)	**6 Year**		
	Pre Mean (SD)	**Post Mean (SD)**	t-value
Bank of Baroda	3.45	3.6	-0.22
(Barelly Corporation Banks Ltd)	-0.7711	-1.3097	
Bank of Baroda	4.358	3.242	1.96*
(Banaras State Bank Ltd)	-0.7897	-0.9898	
HDFC Bank Ltd.	4.524	1.094	3.65***
(Times Bank Ltd)	-2.0626	-0.5147	
ICICI Bank Ltd.	4.108	1.612	2.27**
(Bank of Madura)	-2.4284	-0.1475	
Oriental Bank of Commerce	6.492	7.764	-0.88
(Punjab Co-op Bank and Bari Doab Bank Ltd)	-2.3223	-2.2634	
Oriental Bank of Commerce	6.756	4.12	2.09*
(Global Trust Bank Ltd)	-2.5014	-1.2921	
Punjab National Bank	3.906	2.886	1.33
(Nedungadi Bank Ltd)	-1.2272	-1.1936	
State Bank Of India	1.414	1.814	-3.52***
(Kashinath Seth Bank)	-0.1906	-0.161	

Source: Computed on the basis of CMIE Data Source.

Figures in parentheses are standard deviation ***Significant at 1% level; **Significant at 5% level; *Significant at 10% level

Analysis of 6-year mean CR for pre and post event period shows a huge decline in CR against acquisition deal of BOB with Banaras State Bank ($t = 1.96$, $p < 0.10$), HDFC Bank with Times Bank ($t = 3.65$, $p < 0.01$), ICICI Bank with Bank of Madura ($t = 2.27$, $p < 0.05$), OBC with Global Trust Bank ($t = 2.07$, $p < 0.10$) and State Bank of India with Kashinath Seth Bank ($t = -3.52$, $p < 0.01$). However, there is no notable significance decline during the study period of 6 years. CR between pre and post acquisition period in the case of OBC's takeover of Punjab Co-op Bank and Bari Doab Bank Ltd but the scenario is just reverse in the case of OBC's takeover of Global Trust Bank.

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In the case of takeover activity of SBI, there have been significant improvements in CR during 6 year after acquisition deal.

With regard to acquisition activities of BOB (Barelly Corporation Bank), OBC (Nedungadi Bank Ltd) and PNB, the 6 year mean CR about to sane between pre and post period, indicating very less improvement in the period of 6 year after acquisition activities.

(b) Net Profit Margin

The Net Profit Margin (NPM) or simply called Profit Margin is mostly used for internal comparison. It is difficult to accurately compare the net profit ratio for different entities.

Table 3:- Net Profit Margin

Name of Acquiring Bank (Acquired Bank)	6 Year		
	Pre **Mean** **(SD)**	**Post** **Mean** **(SD)**	t-value
Bank of Baroda (Barelly Corporation Banks Ltd)	0.0565 -0.0264	0.0867 -0.0297	-1.93
Bank of Baroda (Banaras State Bank Ltd)	0.0656 -0.0221	0.102 -0.0126	-3.09**
HDFC Bank Ltd. (Times Bank Ltd)	0.1545 -0.0855	0.1588 -0.0129	-0.13
ICICI Bank Ltd. (Bank of Madura)	0.1286 -0.0341	0.1232 -0.0276	0.31
Oriental Bank of Commerce (Punjab Co-op Bank and Bari Doab Bank Ltd.	0.0866 -0.0516	0.1009 -0.0245	-0.56
Oriental Bank of Commerce (Global Trust Bank Ltd)	0.0981 -0.0206	0.1058 -0.0476	-0.33
Punjab National Bank (Nedungadi Bank Ltd)	0.0761 -0.0121	0.1238 -0.007	-6.58***
State Bank Of India (Kashinath Seth Bank)	0.0271 -0.0182	0.0686 -0.0188	-3.57***

Source: Computed on the basis of CMIE Data Source

Figures in parentheses are standard deviation ***Significant at 1% level; **Significant at 5% level; *Significant at 10% level

From the observation of Table-3, reveals that the level of significance for the difference in 6-year NPM has increased in the case of BOB (Banaras) and SBI and decreased for PNB. On an average, the NPM for 6 year 6.56 per cent, 7.61 per cent and 2.71 per cent in pre-event period has significantly increased to 10.20 per cent, 12.38 per cent and 6.86 per cent for BOB (Banaras) (t-value = -3.09, $p < 0.05$), PNB (t-value = -6.58, $p < 0.01$) and SBI (t-value = -3.57, $p < 0.01$) respectively.

For other banks, except BOB with Barelly Corporation, the difference in 6 year NPM between event periods is almost zero. In respect of BOB acquiring Barelly Corporation, NPM, on an average for 6 year, 5.65 per cent in pre period has increased to 8.67 per cent in post-period. The t-value of -1.93, though insignificant, is not trivial. So, it can be concluded that for longer time period also, the acquisition activity of BOB, PNB and SBI has impact on their left-over earnings.

9. CONCLUSION

With regard to reactions to the announcement of merger, the market has initially tried to react negatively to the most of the banks' acquisition announcement but overall there was either destruction or creation in shareholder wealth of investors of public and private sector banks. The merger announcements in the banking sector typically result in no (or slightly positive) cumulative abnormal returns on the stocks of acquiring banks and significantly positive abnormal returns on target bank stocks. But the results should be taken with caution. Although stock prices reveal the market's expectation of future cash flows, actual performance may differ from market expectations. This observation is especially true for bank mergers.

Mergers and acquisitions have proven to be a significant and increasingly popular means for achieving corporate diversity and growth. But the existing failure rate of mergers suggests that neither academicians nor practitioners have a thorough understanding of the variables involved in planning and implementing a successful merger.

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It is suggested that a successful merger involves not only thorough financial and strategic analysis and planning, but also planning regarding congruence between the two companies' preferences about the implementation strategy for the merger.

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