

A study on Mergers and Banks Performance in India”

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ABSTRACT

This research aims at evaluating the synergies gained from bank mergers by dividing them into two categories of forced mergers and market driven mergers. The result indicate that market have reacted negatively to the announcement of forced mergers while the reaction has been positive to that of market driven mergers. In line with the market expectation, forced mergers have not added any value to financial performance of merged banks in the post merger period. Although market driven mergers have not immediately improved the financial performance of merged banks, but they have improved the operating performance of merged banks and have provided these banks an edge over the competitors in terms of geographic dispersion and thus have provided a better vehicle growth.

Key Words: Driven Merger, Forced Merger, Banking Industry.

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1.0 INTRODUCTION

Mergers and acquisitions (M&A) and corporate restructuring are a big part of the corporate finance world. Globally mergers and acquisitions have become a major way of corporate restructuring and the financial services industry has also experienced merger waves leading to the emergence of very large banks and financial institutions. The key driving force for merger activity is severe competition among firms of the same industry which puts focus on economies of scale, cost efficiency, and profitability.

The Mergers and acquisitions (M&A) have two types of approaches they are as follows.

DRIVEN MERGERS:

There have been a few mergers in Indian banking with expansion, diversification, and overall growth as the primary objectives. The first of its kind in the post 1993 period was the acquisition of Times Bank by HDFC bank subsequently followed by Bank of Madras's acquisition

by ICICI Bank^[1].

FORCED MERGERS:

Many small and weak banks have been forcefully merged with other banks mainly to protect the interests of depositors. Normally the acquiring bank takes up all assets and liabilities of the weak bank and ensures payment to all depositors in case they wish to withdraw their claims. In 2004 South Gujarat Local Area Bank was acquired by Bank of Baroda followed by Oriental Bank of Commerce acquired Global Trust Bank Ltd^{[2][3]}. Table 1 given below states statistics on number of Bank Mergers in India and Table 2 states the objective behind Merger and Acquisition (M&A) Transaction.

3.0 STATEMENT OF THE PROBLEM:

Now-a-days incidences of merger and acquisition in banks are on a rise at a global level. The main purpose of these merger and acquisition is to improve competitiveness and to gain more market share^{[4][5]}. This research study was aimed to study the impact of mergers on the

operating performance and share price of acquiring corporate in banking, by examining some ratios in pre- merger and post-merger period^{[6] [7]}.

Table: 1 Statistic on Number of Bank Mergers in India

Bank Mergers in India	
Period	Number of Mergers
Pre-nationalization of banks (1961-1968)	46
Nationalization period (1969-1992)	13
Post-reform period (1993-2006)	21
☐ Forced Mergers 13 ☐ Driven Mergers 5 ☐ Convergence of Financial Institutions in to Banks 2 ☐ Other Regulatory Compulsions 1	
Total number of mergers	80

(Source: Compiled from various publications of RBI)

Table: 2 Main objective behind M & A Transaction

Objective behind the M&A Transaction	Response
To improve revenues & Profitability	33%
Faster growth in scale and quicker time to market	28%
Acquisition of new technology or competence	22%
To eliminate competition & increase market share	11%
Tax shields & Investment savings	3%

3.1 OBJECTIVE OF THE STUDY:

- To find the average abnormal return generated by the banks before and after merger.
- To find the operating performance of banks before and after merger.

3.2 LIMITATION OF THE STUDY:

A major limitation of the study is that it has been undertaken with a small sample size that has made difficult to draw proper statistical inferences.

4.0 RESEARCH METHDOLOGY:

- The study is based on the analysis of performance after merger announcements; so the research design is based upon descriptive and analytical type.
- The secondary data is been used in the

analysis because the closing price of the banks has been taken for the pre-merger and post- merger performance analysis from the stock market and the sample size selected is 30.

- The study covers two classifications as Bank mergers (Driven Merger & Forced Merger).
- ✓ Driven mergers - HDFC, IOB, SBI and ICICI.
- ✓ Forced mergers - BOB, FEDERAL, Oriental, and IDBI.
- The statistical tools used in the study are “Paired t’ test” and “Regression”
- The financial ratios used in the study like operating profit margin, gross profit margin, net profit margin, ROCE, Return on net worth are taken to find out the financial performance of the banks in pre- merger and post-merger period.

4.1 ANALYSIS AND INTERPRETATION:

4.1.1 COMPARING MEANS – DRIVEN MERGER & FORCED MERGER

OBJECTIVE

It is indented to study whether there is any significant difference in share prices of banks during pre and post merger period. To find out this the ‘t’ test was applied. Table 4.1.1 given below shows the comparison of average abnormal returns generated by banks.

HYPOTHESIS

H₀ – There is no significant difference in Average abnormal return of banks before and after merger.

H₁ – There is significant difference in Average abnormal return of banks before and after merger.

INFERENCES

From the above tables, the value of t is less than table value (2.045) at 5% level of significance, so we accept the null

hypothesis.

Table 4.1.1: Comparison of Average abnormal returns generated by banks

Bank	Period	N	Mean	T ₀
HDFC	Before merger	30	-0.974	1.69
	After merger	30	0.73	
IOB	Before merger	30	-0.334	1.32
	After merger	30	0.548	
SBI	Before merger	30	-0.523	1.10
	After merger	30	0.408	
ICICI	Before merger	30	-0.077	-0.3
	After merger	30	-0.316	
BOB	Before merger	30	-0.348	-0.01
	After merger	30	-0.356	
FEDERAL	Before merger	30	0.362	-1.36
	After merger	30	-0.374	
Oriental	Before merger	30	0.246	-0.84
	After merger	30	-0.500	
IDBI	Before merger	30	-0.999	0.27
	After merger	30	0.088	

4.2 OPERATING PERFORMANCE ANALYSIS – DRIVEN MERGER: OBJECTIVE:

It is indented to study whether there is any significant difference in operating profit margin, gross profit margin, net profit margin, ROCE, Return on net worth of banks during pre and post merger period. To find out this the 't' test was applied. Table 4.2.1, 4.2.2, 4.2.3, 4.2.4 & 4.2.5 given below calculates Operating Profit, Gross Profit Margin, Net Profit Margin, return on net worth and Return on Capital employed mean pre-merger and post merger operating profit margin for acquiring banks respectively. Also, table no. 4.3 given below lists down the Financial performance driven mergers.

NULL HYPOTHESIS

There is no significant difference in operating profit margin, gross profit margin, net profit margin, ROCE, Return on net worth of market driven banks before and after merger.

4.2.1 COMPARING MEANS – OPERATING PROFIT MARGIN - DRIVEN MERGER

INFERENCES

From the above table, the value of T_0 is

greater than the table value (3.182) at 5% level of significance for HDFC, IOB and SBI so we reject the null hypothesis. So, it is concluded the operating profit margin have increased considerably after merger. In the other hand to is less than the table value (3.182) at 5% level of significance for ICICI. So, we accept the null hypothesis.

Table 4.2.1 Mean pre-merger and post-merger operating profit margin for acquiring Banks

Operating margin	profit	Before merger	After merger	T (0.05)
HDFC		78.91	89.60	3.488
IOB		78.35	87.64	3.493
SBI		82.87	94.78	3.297
ICICI		87.84	97.46	1.508

4.2.2 COMPARING MEANS – GROSS PROFIT MARGIN - DRIVEN MERGER

Table 4.2.2 Mean pre-merger and post-merger Gross profit margin for acquiring Banks

Gross margin	profit	Before merger	After merger	T(0.05)
HDFC		77.76	85.53	2.336
IOB		77.18	86.62	3.598
SBI		81.23	83.76	2.664
ICICI		82.55	56.36	-2.720

INFERENCE

From the above table, the value of T_0 is less than the table value (3.182) at 5% level of significance for HDFC, ICICI and SBI so we accept the null hypothesis. In the other hand T_0 is greater than the table value (3.182) at 5% level of significance for IOB. So, we reject the null hypothesis. So, it is concluded the Gross profit margin have showed significant change after merger.

4.2.3 COMPARING MEANS – NET PROFIT MARGIN- DRIVEN MERGER

INFERENCE

From the above table, the value of T_0 is

less than the table value (3.182) at 5% level of significance for HDFC, ICICI, SBI and IOB so we accept the null hypothesis.

Table 4.2.3 Mean pre-merger and post-merger Net profit margin for acquiring Banks

Net profit margin	Before merger	After merger	T (0.05)
HDFC	13.88	17.25	3.180
IOB	15.96	15.52	-1.460
SBI	16.57	19.54	3.172
ICICI	11.46	14.35	1.202

4.2.4 COMPARING MEANS – RETURN ON NET WORTH- DRIVEN MERGER

Table 4.2.4 Mean pre-merger and post-merger Return on net worth for acquiring Banks

Return on net worth	Before merger	After merger	T(0.05)
HDFC	19.17	22.69	2.295
IOB	30.04	27.26	-1.500
SBI	28.93	32.67	2.268
ICICI	12.87	16	0.591

INFERENCE

From the above table, the value of T_0 is less than the table value (3.182) at 5% level of significance for HDFC, ICICI, SBI and IOB so we accept the null hypothesis.

4.2.5 COMPARING MEANS – RETURN ON CAPITAL EMPLOYED-DRIVEN MERGER

Table 4.2.5 Mean pre-merger and post-merger Return on capital employed for acquiring Banks

ROCE	Before merger	After merger	T(0.05)
HDFC	1.06	1.2	1.052
IOB	1.22	1.16	-1.500
SBI	1.12	1.14	1.076
ICICI	0.65	0.88	0.518

INFERENCE

From the above table, the value of T_0 is less than the table value (3.182) at 5% level of significance for HDFC, ICICI, SBI and IOB so we accept the null

hypothesis.

4.3 FINANCIAL PERFORMANCE – DRIVEN MERGER:

Table 4.3 Financial Performance (Driven merger)

RATIOS	Accepted	Rejected
Operating profit margin	1	3
Gross profit margin	3	1
Net profit margin	4	0
Return on net worth	4	0
Return on capital employed	4	0

INFERENCE

Out of four, market driven bank mergers three banks showed a significant change in operating profit margin and one bank showed a significant change in gross profit margin and remaining showed insignificant change.

4.4 OPERATING PERFORMANCE ANALYSIS – FORCED MERGER:

OBJECTIVE

It is indented to study whether there is any significant difference in operating profit margin, gross profit margin, net profit margin, ROCE, Return on net worth of banks during pre and post merger period. To find out this the 't' test was applied. Refer table no. 4.4.1, 4.4.2, 4.4.3, 4.4.4, 4.4.5 & 4.5 given below listing down details of Operating Profit Margin, Goss Profit Margin, Net Profit Margin, Return on Net Worth, Return of Capital Employed and Financial performance pre and post Forced Merger.

NULL HYPOTHESIS

There is no significant difference in operating profit margin, gross profit margin, net profit margin, ROCE, Return on net worth of non-market driven banks before and after merger.

4.4.1 COMPARING MEANS – OPERATING PROFIT MARGIN- FORCED MERGER

INFERENCE

From the above table, the value of T_0 is

less than the table value (3.182) at 5% level of significance for BOB, Federal, Oriental and IDBI. So, we accept the null hypothesis.

Table 4.4.1 Mean pre-merger and post-merger operating profit margin for acquiring Banks

Operating profit margin	Before merger	After merger	T (0.05)
BOB	79.57	79.61	0.005
Federal	80.43	83.25	0819
Oriental	85.94	80.30	-1.602
IDBI	108.74	100.89	-4.347

4.4.2 COMPARING MEANS – GROSS PROFIT MARGIN- FORCED MERGER

Table 4.4.2 Mean pre-merger and post-merger Gross profit margin for acquiring Banks

Gross profit margin	Before merger	After merger	T (0.05)
BOB	78.50	78.29	-0.032
Federal	78.41	81.83	1.002
Oriental	84.59	78.37	-1.593
IDBI	105.35	99.75	-3.802

INFERENCE

From the above table, the value of T_0 is less than the table value (3.182) at 5% level of significance for BOB, Federal, Oriental and IDBI. So, we accept the null hypothesis.

4.4.3 COMPARING MEANS – NET PROFIT MARGIN- FORCED MERGER

Table 4.4.3 Mean pre-merger and post-merger Net profit margin for acquiring Banks

Net profit margin	Before merger	After merger	T(0.05)
BOB	7.73	12.97	2.892
Federal	9.47	15.41	5.790
Oriental	10.57	15.02	4.224
IDBI	7.05	10.20	0.318

INFERENCE

From the above table, the value of T_0 is greater than the table value (3.182) at 5%

level of significance for Federal bank and oriental bank. So, we reject the null hypothesis. So, it is concluded the Net profit margin have increased considerably after merger and the increased showed significant change. In the other hand T_0 is less than the table value (3.182) at 5% level of significance for BOB and IDBI. So, we accept the null hypothesis.

4.4.4 COMPARING MEANS – RETURN ON NET WORTH- FORCED MERGER

Table 4.4.4 Mean pre-merger and post-merger Return on net worth for acquiring Banks

Return on net worth	Before merger	After merger	T(0.05)
BOB	12.43	17.23	1.575
Federal	19.27	19.32	0.009
Oriental	19.45	20.03	0.182
IDBI	7.05	10.20	1.011

INFERENCE

From the above table the value of T_0 is less than the table value (3.182) at 5% level of significance for BOB, Federal, Oriental and IDBI. So, we accept the null hypothesis.

4.4.5 COMPARING MEANS – RETURN ON CAPITAL EMPLOYED- FORCED MERGER

Table 4.4.5 Mean pre-merger and post-merger Return on capital employed for acquiring Banks

ROCE	Before merger	After merger	T(0.05)
BOB	0.72	0.95	1.055
Federal	0.76	1.12	3.787
Oriental	1.02	1.13	0.930
IDBI	0.57	0.55	-0.129

INFERENCE

From the above table, the value of T_0 is less than the table value (3.182) at 5% level of significance for BOB, Oriental and IDBI. So, we accept the null hypothesis. In the other hand the value of T_0 is greater than the table value (3.182) at 5% level of significance for Federal Bank. So, we

reject the null hypothesis. So, it is concluded there is significant change in Return on capital employed after merger.

4.5 FINANCIAL PERFORMANCE – FORCED MERGER:

Table 4.5 Financial Performance (Forced Merger)

RATIOS	Accepted	Rejected
Operating profit margin	4	0
Gross profit margin	4	0
Net profit margin	2	2
Return on net worth	4	0
Return on capital employed	3	1

INFERENCE

Out of four forced bank mergers two banks showed a significant change in Net profit margin and one bank showed a significant change in ROCE and remaining showed insignificant change.

5.0 FINDINGS:

From the analysis, the researcher has found mergers are favourable for banks, in terms of improving shareholders wealth, only when they are market driven. This is the reason why markets react positively to the stocks of these acquiring banks. On the other hand, when mergers were forced by regulatory agencies, they have deteriorated the wealth of shareholders during announcement period.

Furthermore, the analysis of various financial ratios for both forced mergers and market driven mergers have showed weakened signals. But compare with forced mergers, market driven mergers were slightly better. It means market driven mergers have not brought immediate changes in the operating performance.

One of the reasons why forced mergers are value destroying is that most of these

forced mergers were sick banks with healthy one to rehabilitate the former. So instead of bringing any improvements, these mergers burdened the acquiring banks with their huge non-performing assets, negative net worth and negative profitability.

6.CONCLUSION:

From the above analysis it can be concluded that market driven mergers create wealth to shareholders, but it doesn't create synergies in operating performance of the banks. On the other hand, forced mergers have not created wealth to shareholders as well as synergies in operating performance of the banks.

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