North Asian International Research Journal of Multidisciplinary
CIF IMPACT FACTOR:4.465
ISSN: 2454-2326 Vol. 4, Issue-7 July-2018
Index Copernicus Value 58.12

IMPACT OF MERGER AND ACQUISITION ON THE FINANCIAL GROWTH OF INDIAN BANKING SECTOR: A STUDY

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INTRODUCTION

The International Banking scenario has witnessed sea level changes in the past few years in terms of the Mergers and Acquisitions. Due to the financial system deregulation, entry of new players and products with advanced technology, globalization of the financial markets, changing customer behaviour, wider services at cheaper rates, shareholder wealth demands etc., have been on rise.

In this scenario, Mergers and Acquisitions is one of the widely used strategies by the banks to strengthen and maintain their position in the market. Companies are confronted with the facts that the only big players can survive as there is a cut throat competition in the market and the success of the merger depends on how well the two companies integrate themselves in carrying out thy to thy operations. Banks are too expected to get the benefits of economies of scale through mergers and acquisition. For expanding the operations and cutting costs, Business Entrepreneur and Banking Sector is using mergers and acquisitions worldwide as a strategy for achieving larger size, increased market share, faster growth, and synergy for becoming more competitive through economies of scale.

The past four and half decades and particularly the last two and half decades witnessed cataclysmic change in the sphere of commercial banking all over the world. Indian banking system has also followed the same trend. As a matter of fact, the changes here have been far more pronounced than anywhere else.

Since Nationalization, various Banks have been either merged or acquired and the same along with the dates or Merger/Amalgamation is provided in the Table 1:

Table: List of Merger and Acquisitions (M&As) in Indian Banking Industry since Nationalization of Banks

Sl. No.	Name of the Transferor Bank	Name of the Transferee Bank	Date of Merger/ Amalgamation
1	Bank of Bihar Ltd.	State Bank of India	November 8, 1969
2	Bank of Cochin Ltd.	State Bank of India	August 26, 1985
3	Hindustan Commercial Bank Ltd.	Punjab National Bank	December 19, 1986
4	United Industrial Bank Ltd.	Allahabad Bank	October 31, 1989
5	Parur Central Bank Ltd.	Bank of India	February 20, 1990
6	Purbanchal Bank Ltd.	Central Bank of India	August 29, 1990
7	New Bank of India	Punjab National Bank	September 4, 1993
8	Punjab Co-operative Bank Ltd.	Oriental Bank of Commerce	April 8, 1997
9	ICICI Ltd.	ICICI Bank Ltd.	May 3, 2002
10	South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 25, 2004
11	Ganesh Bank of Kurundwad Ltd.	Federal Bank Ltd.	September 2, 2006
12	United Western Bank Ltd.	IDBI Ltd.	October 3, 2006
13	Sangli Bank Ltd.	ICICI Bank Ltd.	April 19, 2007
14	Centurion Bank of Punjab Ltd.	FIDFC Bank Ltd.	May 23, 2008
15	The Bank of Rajasthan	ICICI Bank Ltd.	August 13, 2010
16	State Bank of Indore	State Bank of India	August 26, 2010

Source: Compiled from Report on Trend and Progress, RBI, Various Issues

The banking industry is an important area in which mergers and acquisitions do make enormous financial gains. The traditional corporate customers of a banker turn away increasingly from traditional loan. They are in favour of alternative sources of financial instruments like commercial papers etc. As a result of changes in the expectation of the corporate customers, banks are now constrained to rethink their business and devise new strategies. On the other hand, competitors both from India and abroad are encroaching upon every area of business in the prevailing policy of Liberalisation, Privatisation and Globalisation (LPG). Therefore, Indian bankers have to struggle to survive in a competitive environment, bankers adopt different strategies. They have no other option expect to reduce their costs (both operational costs and the cost of credit). The only way to manage competitiveness is cost reduction through acquisition, which enables the bankers to spread its overhead cost over a large customer base. From the current trends, one can safely predict that consolidation will also be one of the effective strategies widely adopted by the bankers.

Table 2: Summary Profile of the Indian Banking Industry

Bank Group	1990-91	1995-96	2004-05
	PSB Private Foreign	PSB Private Foreign	PSB Private Foreign
1. No. of			
Reporting			
Banks	28 25	27 35	28 29 31
(a) Listed	23	29	20 18 NA
(b) Non-Listed	None None	2 9	
2. Share (in per	NA	NA	
cent of)			75.3 18.2 6.5
(a) Assets			78.0 17.3 4.7
(b) Deposits	91.4 3.7	84.5 6.5	73.2 20.0 6.8
(c) Credit	4.9	7.9	76.4 16.9 6.7
(d) Income	92.0 4.0	85.4 6.6	76.7 16.9 6.4
(e) Expenses	4.0	6.7	74.2 16.4 7.4
(f) Profile	93.0 4.0	82.4 6.8	
3. Bank	3.0	8.9	80.4
Assets/GDP	89.4 3.3	82.5 8.2	
	7.3	9.4	
	90.0 3.3	84.1 7.5	
	6.8	8.4	
	68.5 4.1	33.3 55.6	
	27.4	77.8	
	56.3	50.4	

Source: RBI Bulletins, various issues

A number of measures have been taken for enhancing the transparency and disclosers standards, For example, all the cases of penalty imposed by the RBI on the bank have been published in the RBI annual report.

MERGERS AND ACQUISITIONS STRATEGY: THE WAY TOWARDS MANAGING COMPETITIVENESS

Merger & Acquisitions have become a major force in the financial and economic environment all over the world. On the Indian scene, thanks to the liberalization of FERA, MRPT Act and industrial licensing and the compulsion to be more competitive, corporates are looking seriously at mergers and acquisitions.

Merger can be defined as a process, which involves a transaction that combines two firms into one new firm. An acquisition is the purchase of one firm by another firm. Growth is an essential ingredient to the success. Growth can be either internal or external. Internal growth is when company acquires specific assets and finances them by the retention of earning. External growth involves the acquisition of another company. In principle, growth by acquiring another company is little different from growth by acquiring specific assets.

M & A activity has increased substantially since the mid 1960's. In 1967, the total dollar value of the corporate merger & acquisition was under $ 20 billion, by 1984 this grew to a total dollar volume of $ 100 billion and by 1998 the dollar volume exceeded one trillion.

The role of mergers and acquisitions had evolved as a strategy tool for fast-track technology-led companies. In current rapidly changing environment and in the era of systemic innovation, where technology is embedded in people and processes, well-planned M & A are recognized as critical to fast track technology company success and even survival.

The size and number of merger and acquisition transactions continue to grow worldwide. Evidence suggests that M & As activity tends to benefit society because it results in an increase in shareholder value of both the target and acquiring shareholders without increasing concentration. The increase is related to improved operating efficiency of the combined forms **(Machiraju, 2008).**

Merger is primarily a strategy of inorganic growth. It is one of the most frequently used forms of corporate restructuring around the world. On the other hand, Acquisition is an attempt or a process by which a company or an Individual or a group of individuals acquires control over another company called 'target company'.[12] In today's corporate world, both in Indian and abroad, acquisition has been well accepted as a growth strategy. Every day in the newspapers there is news about some new acquisition. Therefore, there are umpteen number of examples of acquisitions that can be given. However, some of the notable acquisitions in the Indian context in the recent past have been listed below:

I. Acquisition of Corus by Tata Steel
II. Acquisition of Novelis by Hindalco
III. Acquisition of Spice Communication by Idea Cellular
IV. Acquisition of Ranbaxy by Daiichi Sankyo
V. Acquisition of Hutchison Essar by Vodafone

VI. Acquisition of Sahara Airlines by Jet Airways

VII. Deccan Airways by King Fisher Airlines

BANK MERGERS AND AMALGAMATIONS

Since the early 1950s, there has been an earnest attempt on the part of the authorities to strengthen the banking system by eliminating the weak links. Between 1950 and 1970, the number of functioning non-scheduled banks declined from 474 to 15 and that of scheduled banks from 92 to 72. When banks developed weaknesses, they were merged so that although they lost their separate identity their business was put on a better footing. The process of consolidation thus contributed to the improvement in the quality of banking business.

It was the failure of the Palai Central Bank and the Laxmi Bank that underlined the urgent need for action to consolidate and strengthen the weaker segments of the banking structure. Although the RBI had been carrying out inspection of banks and pursuing the defects observed in their working, it was found that a large number of small and medium-sized banks had not still come up to the eligibility standards required for the grant of licence under section 22 of the Banking Regulation Act.

There have been several bank amalgamations in India in the post-reform period. In all, there have been 33 M & As since the nationalization of 14 major banks in 1969. Of these mergers, 25 involved mergers of private sector banks with public sector banks, while in the remaining eight cases, mergers involved private sector banks. Out of 33, 21 M & As took place during the post-reform period with as many as 17 mergers/amalgamations taking place during 1999 and after. Prior to 1999, the amalgamations of banks were primarily triggered by the weak financials of the bank being merged, whereas in the post-1999 period, there have also been mergers between healthy banks, driven by the business and commercial considerations.

GUIDELINES ON MERGERS AND AMALGAMATIONS OF BANKS

The guidelines on merger and amalgamation announced by the Reserve Bank in May 2005, inter alia, stipulated the following:

- The draft scheme of amalgamation be approved individually by two-thirds of the total strength of the total members of board of directors of each of the two banking companies.

- The members of the boards of directors who approve the draft scheme of amalgamation are required to be signatories of the Deed of Covenants as recommended by the Ganguly Working Group on Corporate Governance.
- The draft scheme of amalgamation be approved by shareholders of each banking company by a resolution passed by a majority in number representing two-thirds in value of shareholders, present in person or by proxy at a meeting called for the purpose.
- The swap ratio be determined by independent values having required competence and experience; the board should indicate whether such swap ratio is fair and proper.
- The value to be paid by the respective banking company to the dissenting shareholders in respect of the shares held by them is to be determined by the Reserve Bank.
- The shareholding pattern and composition of the board of the amalgamating banking company after the amalgamation are to be in conformity with the Reserve Bank's company after the amalgamation are to be in conformity with the Reserve Bank's guidelines.
- Were as NBFC is proposed to be amalgamated into a banking company in terms of Sections 391 to 394 of the Companies Act, 1956, the banking company is required to obtain the approval of the Reserve Bank before the scheme of amalgamation is submitted to the High Court for approval.

STATEMENT OF THE RESEARCH PROBLEM

A Merger is a combination of two or more companies into one company or it may be in the form of one or more companies being merged into the existing companies. On the other hand, when one company takes over another company and clearly well-known itself as the new owner, this is called as acquisition. The banks must follow the legal procedure of mergers and acquisition which is given by the Reserve Bank of India, SEBI, Indian Companies Act and Banking Regulation Act 1949. Mergers and acquisitions is not a short term process, it takes time to take decisions after examining all the aspects. Indian Corporate Sector had stringent control before liberalization but, the Government has initiated the reform after 1991 which resulted in the adaptation of the different growth and expansion strategies by the Companies.

The RBI has been constantly reviewing and refining its regulatory and supervisory policies to evolve a strong capital base, effective risk management and best corporate governance standards in the banking sector. In recent years, the focus has also been on improving credit delivery and customer service and promoting financial inclusion. It is against this backdrop that a new wave is being seen, the wave of corporate restructuring.

Today with the fast changing economic environment, companies seek corporate restructuring not just to stay afloat amidst cut-throat competition but also to increase their cutting edge over others. Thus, the significance of mergers and acquisition can never be over emphasized in the corporate world. On the same line, bank mergers have been considered as a possible avenue for improving the structure and efficiency of the banking industry. The phenomenon of mergers in the banking sector is a relatively recent on in India. This study attempts to assess the successfulness of Mergers and Acquisitions strategy in Indian banking industry.

The present study make an appraisal to find the impact of merger and acquisition in the financial growth of Indian banking sector. Pre and post merger financial performances have also been compared.

Table 3: Sample Banks

S. No.	Acquirer Bank	Merged Bank	Date of Merger
1	ICICI Bank	Bank of Rajasthan	Aug 13, 2010
2	State Bank of India (SBI)	State Bank of Indore	Aug 26, 2010

(Source: Compiled from Table 1)

In table 3, the selection of two cases for the study is presented. First, the merger of the ICICI Bank and Bank of Rajasthan on Aug 13, 2010, and the second, the merger of the State Bank of Indore with the State Bank of India on August 26, 2010 are selected and will be analysed. ICICI Bank is from the Private Sector and SBI is from the Public Sector.

To analyse the financial performance of the Banks before and after merger, a few ratios like Operating Profit Ratios, Net Profit Margin, Return on Assets, Return on Equity, Debt Equity Ratio, Dividend Pay-out Ratio, Earning per share and Market price of Share have been calculated and the same has been presented for ICICI Bank and the SBI respectively.

OBJECTIVES OF THE STUDY

The present study attempts:

- To study the resultant performance of Mergers and Acquisitions of Banks from 1969 to till date
- To evaluate the banks performance in terms of Operating and Net Profitability
- To analyse the Performance of the Banks after merger in terms of Return on Assets
- To find out the impact of merger on Banks' Debt equity ratio
- To examine the effects of merger on Equity shareholders through EPS and Market Share Price.

RATIONALE OF THE STUDY

Mergers and acquisitions (M & As) have been a very important market entry strategy as well as expansion strategy. This present era is known as competition era. In this era, companies to avoid the competition, go for merger, and enjoy sometimes monopoly. Corporate India is waking up to the new millennium imperative of mergers and acquisitions in a desperate search for a panacea for facing the global competition. This is hardly surprising as stiff competition is, in a sense, implicit in any bid to integrate the national economy with the global economy. The ongoing process of liberalization has exposed the unproductive use of capital by the Indian corporate both in public and private sectors. Consolidation through mergers and acquisitions (M & As) is considered one of the best ways of restructuring structure of corporate units. The concept of mergers and acquisitions is very much popular in the current scenario, so it is significantly popular concept, after 1990s, where India entered in to the Liberalization, Privatization and Globalization (LPG) era. The winds of LPG are blowing over all the sectors of the Indian economy but its maximum impact of seen in the industrial sector. It caused the market to become hyper-competitive. As competition increased in the economy, so to avoid unhealthy competition and to face international and multinational companies, Indian companies are going for mergers and acquisitions and the Indian Banking sector is no exception. In this context the present study is needed. The study examines whether the merger has led to a profitable situation or not.

HYPOTHESIS

Our study is based on the following hypothesis:

1. There is no significant difference between the pre and post-merger operating profit margin.
2. There is no significant difference between the pre and post-merger Net profit Margin.
3. There is no significant difference between the pre and post-merger return on capital employed.
4. There is no significant difference between the pre and post-merger return on equity.
5. There is no significant difference between the pre and post-merger earning per share.
6. There is no significant difference between the pre and post-merger Debt Equity Ratio.
7. There is no significant difference between the pre and post-merger return market share ratio.

RESEARCH METHODOLOGY

- **Sources of Data:** The study is based on secondary data. The financial and accounting data of banks have been collected from the Annual Reports of the selected Banks to examine the impact of Mergers and

Acquisitions on the performance of the sample banks. Data has also been collected from the Bombay Stock Exchange, National Stock Exchange, Securities and Exchange Board of India and Money Market for the study.

- **Sample:** Two banks, one from Public Sector and the other from Private Sector have been taken as the sample banks to evaluate the impact of mergers and acquisitions on the performance of the Banks. The banks are: ICICI Bank Ltd. and State Bank of India.
- **Period of the Study:** To compare the performance of banks, three years pre-merger and three years' post-merger financial ratios have been computed and compared. The year of merger has been considered as a base year.
- **Financial Parameters:** The performance of the Banks has been in respect of the financial parameters such as Net Profit Margin, Operating Profit Margin, Return on Assets, Return on Equity, Debt Equity Ratio, Earning Per Share and Market Share Price.
- **Tools for Analysis:** Ratios and percentages have been used for the analysis of data and for better understanding, Bar Diagrams have been used for the presentation of the data. To test the hypothesis, 't' test has been employed. The performance of the banks before and after the mergers and acquisitions has been compared. For the pre-merger, the combined ratios of both the banks have been considered and for the post-merger the ratios of acquiring bank have been used.

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