MERGERS AND ACQUISITIONS IN INDIAN BANKS AFTER LIBERALISATION: AN ANALYSIS

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ABSTRACT

Mergers and Acquisitions (M &A) aim towards business restructuring thereby increasing competitiveness and shareholder value via increased efficiency. The banking industry has experienced an unprecedented level of consolidation on a belief that incomparable gains can accrue through expense reduction, increased market power, reduced earnings volatility, and scale and scope economies. Whether or not bank mergers actually achieve this expected performance gains is the critical question. This article looks at some M&As that have happened post-2000 in India to understand the intent (of the targets and the acquirers), resulting synergies (both operational and financial), modalities of the deal, congruence of the process with the vision and goals of the involved banks, and the long term implications of the merger.
In this paper, we have attempted to study mergers and acquisitions (M & A) (in Indian banking industry post liberalization and critically examine the reasons for these mergers and analyze whether these mergers can be considered as successful or not. To measure the bank performance after pre merger and post merger, we have selected a sample of 5 bank mergers from 1994 -2004. There have been about 25 significant bank mergers post liberalization, if we ignore mergers of cooperative banks and regional rural banks. Using this sample, we have tried to measure and analyze pre merger and post merger financial performance of these banks. We have also tried to understand the major factors involved for being successful on mergers and acquisitions operations in banking industry in India.

***Keywords**: Merger, Acquisition, Economies of scale, Diversification, Technical efficiency, Economic reforms, Balance of payment, Recapitalized, Unification, Entity, Amalgamation, Operational risk, Capital adequacy, Synergy, Leverage, Secondary data, Exploratory research, Hypothesis testing, Leasing, Brokerage, Globalization, World Trade Organization.*

Introduction:

Mergers and acquisitions (M & A) have become a global phenomenon in today's free market economies wherein banks need to constantly evolve to remain competitive. Banking has become an increasingly global industry, which knows no geographic and territorial boundaries. The failure of a bank has more widespread implications than a failure of a manufacturing company. Moreover, the government and policy makers have adopted various policies and measures out of which consolidation of banks emerged as one of the most preferable strategy. There are diverse ways to consolidate the banking industry. The most commonly adopted method 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 than spurring internal growth. One of the major motives behind the mergers and acquisition in the banking industry is to achieve economies of scale and scope. It also helps in the diversifications of the products, which help to reduce the risk as well. Therefore boost to bank consolidations and mergers in many countries like India, has come through regulatory and governmental actions in public interest.

In this backdrop of emerging global and Indian trends in the banking sector, this article illuminates the key issues surrounding M&As in India. It seeks to analyse some M&A operations on some selected Indian banks that have occurred in India post-2000. The analysis have been made on some parameters related to banks like assets, profits, revenue, deposits, and number of employees etc. which ought to think that they would have very significant impacts on the performance of the banks on post-merger.

The issue of impact of mergers on the efficiency of banks has been well studied in the literature. Most of the

literature related with the impact of mergers on the efficiency of banks is found in European Countries and US. In India, literature on bank merger is very scarce. Very few studies have been conducted with the motive to examine the impact of mergers on the performance of Indian commercial banks. The present study will make notable contribution to the existing literature on banking efficiency in India.

Literature Review:

The worldwide financial crisis has promoted consolidation of the banking system faster on the ground that this would contribute to the stabilization on the banking system of the region.

Frei et al. (1996) have suggested that the cost efficiency achieve performance improvement, especially when merger activities focus on geography, economic of scale, and activity lines.

Gourlay et al. (2006) have analysed the efficiency gains from mergers among Indian banks over the period 1991-92 to 2004-05 and observed that the merger led to improvement of efficiency for the merging banks.

Overview of the Indian Banking System:

Banking services are critical to the functioning of any economy because it offers people a medium to exchange and provide variety of financial services which help them to make profit. Traditional banking services include receiving deposits of money, lending money and processing transactions.

Table 1: Scenario of Indian banking sector (As on March 2008)

Bank Group	Numbers			Amount in Rs. (Cr.)			
	No. of Banks	Branches	No. of Employees	Investments	Advances	Assets	Deposits
1. Public Sector Banks (A+B)	28	55018	715408	799841	179400	3021924	2453869
Market Share(%)		85.6	78.8	67.9	72.6	69.9	46.1
A. State Bank Of India Group	8	15814	249008	263823	593722	1010959	773874
Market Share (%)		24.6	27.4	22.4	24.0	23.4	14.6
B. Nationalized Banks	20	39204	466400	536018	1203678	2010965	1679993
Market Share (%)		61.0	51.4	45.5	48.3	56.5	31.5
Ii Indian Private Sector Banks	23	8924	158823	278578	518402	940144	2675033
Market Share(%)		13.9	17.5	23.7	20.9	21.7	50.3
Iii Foreign Banks In India	28	279	33969	98910	161133	364099	191161
Market Share(%)		0.5	3.74	8.4	6.5	8.41	3.6
Iv Total Indian Private And Foreign Banks (Ii+Iii)	51	9203	192792	377488	679535	1304243	2866194
Market Share (%)	-	14.4	21.2	32.1	27.4	30.1	53.9
V Total Commercial Banks (I+Iv)	79	64221	908200	1177330	2476936	4326166	5320062
Market Share(%)		**100**	**100**	**100**	**100**	**100**	**100**

Source*: Data Compiled And Edited From The Statistical Tables Relating To Banks In India 2007-08: Nb: Excludes Regional Rural Banks*

effects of merger and acquisition may depend on the type of merger and acquisition. According to Berger & Humphrey (1997), the rationale for consolidation of banking institutions through mergers and acquisitions is to improve cost and revenue efficiency that will in turn improve profitability, safety and soundness of these institutions. Bhattacharyya et al. (1997) have measured the productive efficiency of 70 Indian commercial banks in the period 1986-1991. They found that the public sector banks are the most efficient banks as compared to foreign banks and private banks. They also found a temporal decline in the performance of public sector banks in India.

Landerman (2000) has explored potential diversification benefits to be had from banks merging with non banking financial service firms. Simulated mergers between US banks and non-bank financial service firms show that diversification of banks into insurance business and securities brokerage are optimal for reducing the probability of bankruptcy for bank holding companies. According to Delong (2001), the bank merger phenomenon has been widely accepted as the way to

In India, the Reserve Bank of India acts as a central bank of the country. Banking system has a wide mix, comprising of scheduled and non-scheduled banks, cooperative sector banks, post office saving banks, foreign exchange banks. Table1 provides a brief detail of the structure of Indian commercial banks as on the end March 2008. As on March 2008, the number of commercial banks is 79 comprise of 28 public sector banks, 23 private sector banks and 28 foreign banks. It is evident from the table that public sector banks dominate the commercial banks in India. It has been observed that the market share of public sector banks in terms of investment, advances and assets is near about 70 percent. The public sector banks are the biggest players in the Indian banking system and they account for 70 percent of the branches of commercial banks in India. As on March 2008, private sector banks accounts for nearly 21.7 percent while foreign banks constitutes 8.41 percent share in total assets of commercial banks.

M & A in Indian banking Sector: An overview:

Merger can be defined as a means of unification of two players into single entity. Merger is a process of combining two business entities under the common ownership. Bank merger is an event when previously distinct banks are consolidated into one institution. A merger occurs when an independent bank loses its charter and becomes a part of an existing bank with one headquarter and a unified branch network

Banks today face operational risks such as competition risk, technological risk, casualty risk, interest rate risk, market risk etc. While the 1988 Basel I rules did not take these risks into account, Basel II stipulates that banks set aside 15% of their net income towards coverage for operational risks. Mergers among banks have not taken off on a large scale in India, in spite of the imperatives of Basel II compliance, the imminent threat of competition from foreign banks looming up and the successive merger waves in the global banking sector. This will mean a more efficient use of capital, on one hand, but on other hand it would demand higher capital adequacy level from the more aggressive lenders.

In recent times we have seen few M&As as voluntary efforts of banks. Merger of Times bank with HDFC bank was the first of such consolidations after financial sector reforms ushered in 1991. Merger of Bank of Madura with ICICI bank, reverse merger of ICICI with ICICI bank, coming together of Centurion bank and Bank of Punjab to form Centurion Bank of Punjab and the recent decision of Lord Krishna bank to merge with Federal Bank are voluntary efforts by banks to consolidate and grow (see Table 2).

Table 2: List of Banks Merged Since Liberalization

Target Bank	Acquirer Bank	Year
Bank of Thanjavur Ltd.	Indian Bank	1990
Parur Central Bank Ltd.	Bank Of India	1990
Purbanchal Bank Ltd.	Central Bank Of India	1990
New Bank Of India	Punjab National Bank	1993
Bank Of Karad Ltd.	Bank Of India	1993
Kashi Nath Seth Bank	State Bank Of India	1996
Punjab Co-op Bank Ltd.	Oriental Bank Of Commerce	1997
Bari Doab Bank Ltd.	Oriental Bank Of Commerce	1997
Sikkam Bank Ltd.	Union Bank Of India	1999
Times Bank India	HDFC Bank Ltd.	2000
ICICI Bank	ICICI	2001
Benaras State Bank Ltd.	Bank Of Baroda	2002
Nedungadi Bank Ltd.	Punjab National Bank	2003
Bank Of Madura	ICICI Bank	2004
Global Trust Bank Ltd.	Oriental Bank Of Commerce	2004
Bank Of Punjab (BOP)	Centurion Bank	2005
Corporation Bank	Chikmagalur kodagu Grameena Bank	2005
IDBI Bank	IDBI	2005
Bank of Baroda	Nainital Bank	2006
Federal Bank	Ganesh bank of Kurundwad	2006
Centurion Bank Of Punjab Ltd	Lord Krishna Bank ltd	2006
United Western Bank	IDBI	2006
Sangli Bank	ICICI Bank	2007
Bharat Overseas Bank	Indian Overseas Bank	2007
Centurian Bank of Punjab	HDFC Bank	2008

Source: Statistical data of Banking in India, RBI and various sources; Data compiled and edited

Advantages of M&A in Indian banking Sector:

Merger is generally accepted to promote synergies. The basic idea is that the combined entity will create more value than the individual banks operating independently.

(i) Economies of Scale & Scope.
(ii) Greater efficiency.
(iii) Leveraging technology.
(iv) Managerial efficiency.
(v) Changing / Liberal Laws.
(vi) Diversification.
(vii) Improved market reach and Industry visibility.
(viii) Increase Revenue.

Research methodology of the study:

Research is the systematic process of collecting and analyzing information to gain new knowledge. In short, the search for knowledge through objective and systematic method of finding solution to a problem, is research (Kothari, 2005).

The choice of data collection methods for this study includes secondary data from websites, reports, CMIE, books and journals. Exploratory research has been done

Table 3: List of Sample Banks For Data Analysis

Sl No	Name of the Bank	Date of Merger
1	HDFC Bank	2000
2	ICICI Bank	2001
3	Bank of Baroda	2002
4	Punjab National Bank	2003
5	Oriental Bank of Commerce	2004

Table 4

S.No	Name of the bank	Mean		t	Growth rate
		Before	After	Value	
1	HDFC Bank Ltd. (2000)	8223.46	21570.8	3.71	162.30%
2	ICICI Bank (2001)	6028.9	89651.5	3.5	1387.03%
3	Bank of Baroda (2002)	55004.7	81776.9	4.16	48.67%
4	Punjab National Bank (2003)	59237.9	115068	3.92	94.25%
5	Oriental Bank Of Commerce (2004)	29462.4	57028.9	3.84	93.57%

and for this secondary data has been used. This secondary data has been collected from various published materials like annual reports, newspapers, magazines, books etc. and from internet web sites.
The various statistical tools are used here:
(i) Statistical Mean - In statistics, the mean is the mathematical average of a set of numbers. The average is calculated by adding up two or more scores and dividing the total by the number of scores.
(ii) T-test - The *t-test* is the most commonly used method to evaluate the differences in means between two groups. Theoretically, the *t-test* can be used even if the sample sizes are very small (e.g., as small as 10; some researchers claim that even smaller n's are possible), as long as the variables are approximately normally distributed and the variation of scores in the two groups is not reliably different

Data analysis:

The study is intended to examine the performance of merged banks in terms of its growth of total assets, profits, revenue, deposits, number of employees etc.. The performance of merged banks is compared taking four years of pre merger and four years of post-merger as the time frame. The year of merger uniformly included in the post- merger period of all sample banks. A random sample of 5 banking units was drawn from the list of about 25 banking units, which have undergone mergers and acquisitions post liberalization (See table 3). While drawing the sample banks for this study the availability of financial data such as financial statement, history of the companies etc. was taken into account.
For the purpose of study, suitable null hypotheses are drawn. The null hypotheses are there is no substantial difference in mean value of all stated parameters before merger and after merger. And alternate hypotheses are that there is substantial difference in mean values before merger and after merger. i.e. mean values after merger have increased substantially from mean values before merger.

Analysis 1: Changes in growth of total assets of merged banks:

Assets represent economic resources that are the valuable possessions owned by a firm. They are mainly used to generate earnings. The total assets refer to net fixed assets and current assets. The growth of total assets indicates firm's ability to produce large volume of sales and to earn larger revenue. One aim of business strategy namely, merger and acquisition is the maximization of total assets of merged banks i.e., firms' ability to produce large volume of sales.
Table 4 shows changes in average total assets and its variability of sample merged banks. It is clear that all sample- merged banks (Bank of Baroda, , HDFC Bank, ICICI bank, and Punjab National Bank) have shown tremendous upward growth in total assets after merger. The application of t-test revealed that all merged banks (Oriental Bank of Commerce, Bank of Baroda, HDFC Bank, ICICI Bank, Punjab National Bank) got significant‘t’ values in their assets growth. The analysis of growth rate (mean value) of total assets of sample banks clearly showed that ICICI Bank – 2001 achieved high rate of growth (1387.03%), HDFC Bank – 2000 (162.30%), Punjab National Bank-2003 (94.25%), Oriental Bank of Commerce 2004-(93.57%), , Bank of Baroda-2002 (48.67%)

Analysis 2: Changes in growth of profits of merged banks

The profit is an indication of the efficiency with which the business operations are carried out by corporate sector.

Table 5

S. No.	Name of the Bank	Mean		t	Growth Rate
		Before	After	Value	
1	HDFC Bank Ltd. (2000)	257.22	641.48	3.26	149.39%
2	ICICI Bank (2001)	87.45	984.68	2.2	1026.06%
3	Bank Of Baroda (2002)	602.73	1092.44	2.67	81.25%.
4	Punjab National Bank (2003)	589.33	1758.51	5.55	198.39%
5	Oriental Bank Of Commerce (2004)	481.28	1054.44	2.46	119.09%

Table 6

S. No.	Name of the Bank	Mean		t	Growth Rate
		Before	After	Value	
1	HDFC Bank Ltd. (2000)	1117.57	2431.85	3.37	117.60%
2	ICICI Bank (2001)	544.09	6813.71	2.27	1152.32%
3	Bank Of Baroda (2002)	5464.31	7332.35	4.49	34.18%
4	Punjab National Bank (2003)	6234.37	9955.14	4.99	59.682%
5	Oriental Bank Of Commerce (2004)	3247.63	4640.58	2.59	42.89%

The merger intends to boost profits through elimination of overlapping activities and to ensure savings through economies of scale. The amount of profit may be increased through reduction in overheads, optimum utilization of facilities, raising funds at lower cost and expansion of business. Here the profit refers to profit before tax.

Table 5 illustrates changes in average profit and its variability in select merged banks. According to the table 5, the average profit earned by merged banks taken for this study during post merger period was higher than the profit earned during pre merger period.

The't' test clearly showed that the HDFC Bank-2000, ICICI Bank-2001, Bank of Baroda-2002, Punjab National and Oriental Bank of Commerce-2004 have significant profits earned by them. This shows that growth of profits of all merged banks is significant. It is understood from the growth rate (mean value) that ICICI Bank achieved highest growth rate in respect of profits among sample banks. The low growth rate was seen in case of Bank of Baroda -2002

Analysis 3: Changes in growth of revenue of merged banks

The revenue is earned from the main line of business. In the case of financial institutions including banking units, interest income is treated as main income. For the purpose of this study, revenue income refers to interest received, dividend earned, security transactions, leasing and hire services, exchange transactions, commission and brokerage and others.

Table 6 presents change in average growth of revenue income and its t value of sample merged banks. It is clear that the all sample merged banks have shown a tremendous growth in revenue income after merger rather than the revenue income of merged banks before merger. The t-test brought out the fact that all merged banks have achieved significant growth of revenue.

The mean growth rate regarding revenue income clearly indicates the fact that the ICICI Bank achieved high growth rate following HDFC Bank-2000 (117.60%), Punjab National Bank-2003 (59.682).Oriental Bank of Commerce-2004 (42.89%), Bank of Baroda-2002 (34.18%).

Analysis 4: Changes in growth of deposits of merged banks

The important element of conventional banking business is to accept deposits from the customers. In this study , deposits refers to bank balance in deposits a/c, bank balance in deposit a/c (abroad), deposits with government.

Table 7 exhibits changes in average growth of deposits and its t values of sample merged banks. It is clear that all merged banks have shown a significant growth of deposits during post-merger period than the average deposits received during pre-merger period except Bank of Baroda-2002 which has shown decline in growth of average deposits after merger. The application of t test showed that from the list of five merged banks, four have shown significant change in the average deposits after merger. The mean growth rate of deposits clearly shows the fact that ICICI Bank -2001 achieved highest Oriental Bank of Commerce-2004 (139.30%), HDFC Bank-2000 (41.34%) , Punjab National Bank -2003 (17.94) and Bank of Baroda -2002, (-34.73%).

Table 7

S. No.	Name of the Bank	Mean		t Value	Growth Rate
		Before	After		
1	HDFC Bank Ltd. (2000)	330.61	467.28	0.89	41.34%
2	ICICI Bank (2001)	184.27	1726.46	2.33	836.90%
3	Bank of Baroda (2002)	2500.67	1631.99	-1.79	-34.73%
4	Punjab National Bank (2003)	685.88	808.9	0.51	17.94%
5	Oriental Bank Of Commerce (2004)	412.67	987.51	3.66	139.30%

Table 8

S. No.	Name of the Bank	Mean		t Value	Growth Rate
		Before	After		
1	HDFC Bank Ltd. (2000)	605	3319	4.34	448.59%
2	ICICI Bank (2001)	820.75	9100	4.22	1008.74%
3	Bank Of Baroda (2002)	46384	39636	-0.89	-14.54%
4	Punjab National Bank (2003)	45225.25	58549	0.88	29.46%
5	Oriental Bank Of Commerce (2004)	13770.5	14375.67	1.48	4.39%

Analysis 5: Changes in growth of number of employees of merged banks.

Table 8 presents change in average growth of number of employees of sample merged banks. It is clear that the merged banks HDFC Bank-2000, ICICI Bank-2001, Punjab National Bank-2003 and Oriental Bank of Commerce-2004 have shown a growth in Number of Employees after merger rather than the number of employees before merger. The t-test brought out the fact that out of five sample banks four have achieved significant growth of number of employees. The mean growth rate regarding number of employees clearly indicates the fact that ICICI Bank-2001(1008.74%) is the highest followed by HDFC Bank-2000 (448.59%), Oriental Bank of Commerce-1997 (16.23%), Punjab National Bank-2003 (0.03%) and Bank of Baroda - 2002 (-14.54%) & Punjab National Bank - 2003 (0.03%) to (29.46%) and Oriental Bank of Commerce-2004 (4.39%). Bank of Baroda-2002 showed decline in number of employees.

Findings:

The findings of the study are as follows:

i. Changes in growth of total assets – All merged banks showed significant growth of total assets after merger.
ii. Changes in growth of profits – The average profit earned by merged banks during post merger period was higher than the profit earned during pre merger period.
iii. Changes in growth of revenue – All sample merged banks have shown a tremendous growth in revenue income after merger compared to the revenue income before merger.
iv. Changes in growth of deposits – From the list of five merged banks, four have shown significant change in the average growth of deposits after merger.
v. Change in growth of number of employees – Out of five sample banks, four have achieved significant growth of number of employees and one have shown decline in number of employees.

Implications:

The present study analyzed the growth of sample merged banks like HDFC, ICICI Bank, Punjab National Bank, Bank of Baroda, Oriental Bank of Commerce, during pre merger and post merger periods. The above analysis clearly showed that the performance of merged banks in respect of growth of stated parameters was not different from the expectations. As M & A activities in Indian banking circuit are inevitable it is suggested to the corporate sectors who wish to improve performance would follow M & A activities. If the banks want to proceed with M & A activities, they have to proceed more carefully so that they can avoid the common mistakes associated with M & A. Further the banks may develop appropriate measures to gauge the success of the acquisition activities and adopt suitable measures to improve their post merger performance.

Conclusion:

Mergers and acquisitions have become the most acceptable route for growth and stability in the banking sector. As economic boundaries between countries disappear with the forces of globalization we are beginning to see a common financial market in the world. A large number of vulnerable old private sector banks whose financial health is causing a lot of concern, are gobbled up by the more

able ones and there are more such mergers on cards. The financial sector would be open to international competition once the tone for the rules of the game is set under the World Trade Organization (WTO). Banks will have to gear up to meet stringent prudential capital adequacy norms under Basel II as they compete with banks with greater financial strength. So consolidation in the banking sector in India is inevitable..

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