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**POST-MERGER FINANCIAL PERFORMANCE APPRAISAL OF ACQUIRING BANKS IN INDIA: A CASE ANALYSIS**

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**ABSTRACT**

*This paper presents a comparative study of the pre and post merger financial performance appraisal of acquiring banks. The researcher has selected randomly two cases of mergers occurred in the year 2004 in the Indian banking sector. Ratios analyses have been used to examine the pre and post merger financial performance appraisal of acquiring banks. In order to test the statistical significance, researcher has applied independent sample t-test. The result indicates that the post M&A's have not created difference in the financial performance of the acquiring banks.*

**KEYWORDS**

Banks, Profitability, Merger and Acquisitions, Financial Performance, Accounting Ratios.

**INTRODUCTION**

**M**erger and Acquisitions are strategic decisions taken for maximization of a company's growth by increasing its production and marketing operations. Therefore many companies find the best way to go ahead and like to expand ownership precincts through Merger and acquisitions (M&As). Merger creates synergy and economies of scale. For expanding the operations and cutting costs, business entrepreneur and banking sector are using Merger 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 companies must follow legal procedure of Merger and Acquisitions (M&As) as enshrined by RBI, SEBI, Companies' Act 1956 and Banking Regulation Act 1949. The mergers which are taking place in the present era are mainly motivated by strategic and economic gains in the longer run, synergy opportunities may exist only in the mind of corporate leaders. A merger can also improve company's standing in the investment community; bigger firms often have an easier time raising capital than smaller ones. Many of the mergers were successful but history trends show that roughly two-third of the merger would disappoint on their own terms, which means they lose value in the stock market. But still this strategy used by corporate in a wide assortment of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional businesses are purported at gaining strength, expanding the customer base, cutting competition or entering into a new market or product segment.

**LITERATURE REVIEW AND GAP**

After going through the available relevant literature on M&As and it comes to know that most of the work high lightened the impact of M&As on different aspects of the companies. Raju Guntar Anjana and Gauncar Dipa Ratnakar (2011) examined the effect of merger on business houses in India and they took the case of the Tata Group of Companies and drew conclusions that merger does not creates wealth for business houses in India. 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. Joshua O K Panachi (2011) studies the comparative analysis of the impact of Merger and Acquisitions financial efficiency of bank in Nigeria. Kemal Mohammad Usman (2011) finds the post merger profitability of the Royal Bank of Scotland and from the accounting ratio analysis it is proved that RBS merger proves to be a failure in Banking Industry. Kuriakose Sony & Gireesh Kumar G. S (2010) in their paper, they assessed the strategic and financial similarities of merged Banks, and relevant financial variables of respective Banks were considered to assess their relatedness. Benard 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. Kuriakose Sony et al., (2009) focused on the valuation practices and adequacy of swap ratio fixed in voluntary amalgamation in the Indian Banking Sector and used swap ratio for valuation of banks. 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

**RESEARCH GAP**

It seems from the above review that various studies have been made on Merger and Acquisitions in the Indian Banking Industry, but these studies provide mixed result and not adequately explore the other varied dimensions of M&As. The present study would go to investigate the detail of M&As with greater focus on acquiring bank in the Indian Banking sector. This study will also discuss the Pre merger and Post merger performance of acquiring banks

**OBJECTIVES OF THE STUDY**

The present study has aimed to analyze the post merger operating performance appraisal of Acquiring Banks in terms of profitability in the Indian Banking Industry and compare the pre and post Merger performance of Acquiring Banks.

**HYPOTHESIS**

To substantiate the objectives mentioned above, the hypothesis has been formulated and tested.

$H_0$  (Null Hypothesis) = There is no significance difference between the Pre merger and Post merger Profitability

$H_1$  (Alternative Hypothesis) = There is significance difference between the Pre merger and Post merger Profitability

**DATA AND METHODOLOGY**

For the purpose of analyzing the profitability of acquiring banks after Merger and Acquisitions various financial and accounting ratios are undertaken. Data of operating performance ratios for up to four years prior and seven years after the Merger and Acquisitions were collected from the financial statement of company's extracted from the website of money control. With the help of Independent sample t-test the pre merger spanning for four years and post merger seven years financial ratios have been compared.

The Student's t- distribution is as follows:-

$$t = \frac{\bar{x}_1 - \bar{x}_2}{s} \sqrt{\frac{n_1 n_2}{n_1 + n_2}}$$

$$\bar{x}_1 = \frac{\sum x_1}{n_1}, \quad \bar{x}_2 = \frac{\sum x_2}{n_2}$$

Where  $\bar{x}_1$ , is the mean of pre merger ratios of acquiring bank  $\bar{x}_2$  is the mean of post merger ratios acquiring bank,  $n_1$  and  $n_2$  are the number of observations of 1<sup>st</sup> and 2<sup>nd</sup> series respectively. S is the combined standard deviation.

$$s = \sqrt{\frac{\sum(x_1 - A_1)^2 + \sum(x_2 - A_2)^2 - n_1(\bar{x}_1 - A_1)^2 - n_2(\bar{x}_2 - A_2)^2}{n_1 + n_2 - 2}}$$

( $n_1 + n_2 - 2$ ) Degree of freedom

Where  $A^1$  and  $A^2$  are the assumed means of 1<sup>st</sup> and 2<sup>nd</sup> series

**FINANCIAL PROFITABILITY RATIOS**

Operating Profit Margin = EBIT /Net Sales\*100

Net Profit Margin = Net Profit /Net sales\*100

Return on Net Worth= Pat /Net Worth\*100

Return on Capital Employed = Net Profit /Total Assets\*100

**ANALYSIS AND INTERPRETATION**

Researcher has selected two cases for the study that are shown in table-1. First the Merger of the Global Trust Bank Ltd with the Oriental Bank of Commerce on 14<sup>th</sup> August 2004, and the second the Merger of the South Gujarat Local Area Bank Ltd with Bank of Baroda on 25<sup>th</sup> June 2004 has been undertaken. In order to analyze the financial profitability of Acquiring Banks after the merger the Financial and Accounting ratios like Operating Profit Margin, Net Profit Margin, Return on Net Worth & Return on Capital Employed have been calculated.

Tables: 2 & 3 show the Pre-merger and the Post-merger financial performance of acquiring bank (Oriental Bank of Commerce) in terms of above ratios. The **Pre-merger** financial performance appraisal of the acquiring bank (**Oriental Bank of Commerce**) on the basis of ratio analysis is done. The operating profit margin for the year 2000 was 73.3314 percent. The net profit margin was 7.35447 percent with RONW & ROCE at 19.50574 and 1.13531 percent. The operating profit margin decreased at 71.8403 percent in 2001 but the net profit margin increased at 11.33495 percent. The RONW & ROCE reduced at 13.101 and 0.74943 percent. The operating profit margin remains unchanged with 71.17057 percent and the net profit margin had slightly decline at 10.54277 percent. However, the RONW & ROCE shows improvement in the year 2002 at 19.79033 and 0.99355 percent. But in the financial year before the merger, the operating profit margin dropped at 69.33823 percent as well as the net profit margin, RONW & ROCE escalate in the year 2003 at 13.86928, 21.66317 and 1.34445 percent. The **Post-merger** performance appraisal of acquiring bank (Oriental Bank of Commerce) for the very next year declined in terms of operating profit margin at 66.51977 percent but the net profit margin mount at 20.32727 percent. The RONW & ROCE remain unchanged at 21.82349 and 1.34284 percent in the year 2005. The operating profit margin has improved in the year 2006 with 71.03755 percent however the net profit margin, RONW & ROCE reduced at 13.52684, 10.77516 percent and 0.94534 percent. The operating profit margin has increased in the year 2007 at 75.96332 percent but the other ratios like net profit margin & RONW remain unchanged except the return on capital employed show declined with 11.24532, 10.37103 and 0.78555 percent. The net profit margin, RONW & ROCE reduced in the year 2008 at 5.16454, 6.11541 & 0.38941 percent but the operating profit show improved performance and moved up to 84.8385 percent. The net profit margin, RONW & ROCE again shows positive movement in the year 2009 after declined in the previous year at 10.22326, 12.2297 & 0.80422 percent and the only operating profit margin slightly decline in the year 2009 at 78.45936 percent. The operating profit margins again fell at 75.60757 percent and the net profit margin, RONW & ROCE rose in the year 2010 at 11.06236, 13.77381 & 0.82563 percent. The ratio analyses for the year 2011 had declined in terms of operating profit margin, net profit margin, RONW & ROCE moved at 74.36245, 8.71017, 9.48775 & 0.65256 percent.

In tables 4 & 5 further shed the light on the Pre Merger and Post Merger ratios of Bank of Baroda (Acquiring Bank) which is used for the analysis. The ratio analyses of the **Pre merger** period of acquiring bank (**Bank of Baroda**) for the years 2000 to 2003. The operating profit margin for the year 2000 at 64.51834 percent with the net profit margin was 9.63125 percent along with the ratios like RONW & ROCE at 15.54349 and 0.85789 percent. The operating profit margin and net profit margin declined in the year 2001 at 58.8454 & 4.7706 percent. The RONW and ROCE also dropped off at 8.18346 and 0.43375 percent. Later in 2002 all the ratios such as operating profit margin, net profit margin, RONW & ROCE improved with 65.12541, 9.16659, 14.26212 & 0.76987 percent. In the year 2003 operating profit margin decreased at 64.00915 percent and the ratios like net profit margin, RONW & ROCE improved before the merger of banks at 12.67361, 17.61534 & 1.01125 percent.

The **Post merger** ratios of acquiring bank for the very next year 2005 were declined, the operating profit margin and net profit margin at 46.80839 and 10.52397 percent. The RONW and ROCE were 12.0268 and 0.71499 percent. The ratio analyses for the year 2006 shows improved performance as comparing with the previous year, the OPM, NPM and ROCE mount at 53.49295, 11.64732 & 0.72928 percent except the return on net worth 10.54198 percent. For the year 2007, the operating profit margin increased at 64.12472 percent and net profit margin has remained same at 11.4197 percent. The return on net worth and return on capital employed were at 11.86678 and 0.71707 percent. The operating profit margin increased in the year 2008 was at 68.2084 percent and ratios like NPM, RONW & ROCE shows improvement and moved at 12.15155, 12.99827 and 0.79928 percent. The operating profit margin and net profit margin showed a positive improvement and moved up to at 69.92945 and 14.75789 percent, while the return on net worth and return on capital employed increased up to at 17.35182 and 0.97939 percent in the year 2009. All the ratios shows positive improvement in the year 2010 the performance of acquiring bank in terms of OPM, NPM, RONW & ROCE and stimulated at 73.00462, 18.31517, 20.24527 & 1.09886 percent. The performance of acquiring bank for the year 2011 continuously increased except the operating profit margin which had slightly reduced. But the net profit margin & return on capital employed moved the highest level at 19.38086 and 1.8351 percent along with return on net worth for the same year was 20.2051 percent.

Table 6 shows t-test analysis of **case I** (the Global Trust Bank Ltd with the Oriental Bank of Commerce). The analysis indicates that the mean of operating profit margin (71.4201 vs 75.2555) and t-value of -1.279 which leads to the conclusion that there is improvement in the Operating Profit Margin after the Merger but not significant statistically, the results also indicate that the mean of Net Profit Margin (10.7754 vs 11.4658) and t-value of -.267 which shows the performance in terms of net profit margin of oriental bank of commerce improved but not significant statistically, it is found that there is increase in the mean of Return on Net Worth (18.5151 vs 12.0823) and t-value 2.254. It seems to have declined so it is considered that it is not affected by merger therefore it is not significant statistically. The mean value of Return on Capital Employed (1.0557 vs 0.8208) and t-value 1.352 which leads to the conclusion that the performance of bank in terms of return on capital employed has declined so it is not significant statistically.

Table 7 shows the **case II** (the South Gujarat Local Area Bank Ltd with the Bank of Baroda). The comparison of the Pre Merger and Post Merger operating performance ratios for the sample of banks merger shows that there is no change in the mean of Operating Profit Margin (63.1446 vs 64.0480) and t-value -.174 which is statistically insignificant but there is positive improvement in the Net Profit Margin after the merger with mean value (9.0605 vs 14.0281) and t-value -2.292 which is however significant statistically. While Return on Net Worth the mean is (13.9011 vs 15.0337) and t-value -.440 which records slightly improvement in post merger period but leads to the conclusion that it is not significant statistically. The mean value of Return on Capital Employed (0.7682 vs 0.8889) and t-value -0.901 which leads to the conclusion that there is no change in the return on capital employed after the merger therefore it is statistically insignificant. It is therefore concluded that all the financial ratios do not improve after the merger so the performances of banks in terms of financial profitability remain unchanged.

**TABLE 1: LIST OF SELECTED BANKS MERGER FOR STUDY**

S. No	Name of the Transferor Bank	Name of the Transferee Bank	Date of Merger
1	Global Trust Bank Ltd.	Oriental Bank of Commerce	August 14, 2004
2	South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 25, 2004

Source: Researcher's compilation from Report on Trend and Progress, RBI, Various Issues, VIII competition and consolidation, 04 Sep 2008.



TABLE 2: PRE MERGER RATIO ANALYSIS OF ORIENTAL BANK OF COMMERCE FOR THE YEARS 2000 TO 2003 *Financial Ratios* (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2000	73.3314	7.35447	19.50574	1.13531
2001	71.8403	11.33495	13.101	0.74943
2002	71.17057	10.54277	19.79033	0.99355
2003	69.33823	13.86928	21.66317	1.34445

Source: Researcher's compilation from financial statement of Banks retrieved from <http://www.moneycontrol.com/stocksmarketsindia/>

TABLE 3: POST MERGER RATIO ANALYSIS OF ORIENTAL BANK OF COMMERCE FOR THE YEARS 2005 TO 2011 *Financial Ratios* (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2005	66.51977	20.32727	21.82349	1.34284
2006	71.03755	13.52684	10.77516	0.94534
2007	75.96332	11.24532	10.37103	0.78555
2008	84.8385	5.1654	6.11541	0.38941
2009	78.45936	10.22326	12.2297	0.80422
2010	75.60757	11.06236	13.77381	0.82563
2011	74.36245	8.71017	9.48775	0.65256

Source: Researcher's compilation from financial statement of Banks retrieved from <http://www.moneycontrol.com/stocksmarketsindia/>

TABLE 4: PRE MERGER RATIO ANALYSIS OF BANK OF BARODA FOR THE YEARS 2000 TO 2003 *Financial Ratios* (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2000	64.51834	9.63125	15.54349	0.85789
2001	58.8454	4.7706	8.18346	0.43375
2002	65.12541	9.16659	14.26212	0.76987
2003	64.00915	12.67361	17.61534	1.01125

Source: Researcher's compilation from financial statement of Banks retrieved from <http://www.moneycontrol.com/stocksmarketsindia/>

TABLE 5: POST MERGER RATIO ANALYSIS OF BANK OF BARODA FOR THE YEARS 2005 TO 2011 *Financial Ratios* (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2005	46.80839	10.52397	12.0268	0.71499
2006	53.49295	11.64732	10.54198	0.72928
2007	64.12472	11.4197	11.86678	0.71707
2008	68.2084	12.15155	12.99827	0.79928
2009	69.92945	14.75789	17.35182	0.97939
2010	73.00462	18.31517	20.24527	1.09886
2011	72.767276	19.38086	20.2051	1.18351

Source: Researcher's compilation from financial statement of Banks retrieved from <http://www.moneycontrol.com/stocksmarketsindia/>

TABLE 6: MEAN AND MEDIAN OF THE PRE MERGER AND POST MERGER RATIOS OF ACQUIRING BANK (ORIENTAL BANK OF COMMERCE)

	Mean		Standard deviation		t-value	Sig
	Pre	Post	Pre	Post		
Operating Profit Margin	71.4201	75.2555	1.65591	5.73912	-1.279	.233
Net Profit Margin	10.7754	11.4658	2.68589	4.68717	-0.267	.796
Return on net worth	18.5151	12.0823	3.73410	4.91166	2.254	.051
Return on capital employed	1.0557	0.8208	0.24992	0.28982	1.352	.209

Source: Researcher's compilation based on tables 2&3, 5% level of significance

TABLE 7: MEAN AND MEDIAN OF THE PRE MERGER AND POST MERGER RATIOS OF ACQUIRING BANK (BANK OF BARODA)

	Mean		Standard deviation		t-value	Sig
	Pre	Post	Pre	Post		
Operating Profit Margin	63.1246	64.0480	2.88904	10.13876	-0.174	.865
Net Profit Margin	9.0605	14.0281	3.25550	3.55518	-2.292	.048
Return on net worth	13.9011	15.0337	4.05441	4.13656	-0.440	.670
Return on capital employed	0.7682	0.8889	0.24425	0.19679	-0.901	.391

Source: Researcher's compilation based on tables 4&5, 5% level of significance

**RESULTS AND DISCUSSIONS**

The analysis suggests that the performance of Oriental Bank of Commerce after acquired global trust bank Ltd has not been improved in terms of Operating Profit Margin, Net Profit Margin, Return on Net Worth & Return on Capital Employed with t- values (-1.279, -.267, 2.254, 1.352) which led to the conclusion that there is no significance difference in all the ratios after the merger and the performance of Oriental Bank of Commerce was not improved in terms of profitability, similarly the performance of Bank of Baroda after acquired South Gujarat Local Area Bank Ltd has not been improved in terms of Operating Profit Margin, Return on Net Worth & Return on Capital Employed. Only Net Profit Margin shows improvement after the merger with t-values (-.174,-2.292,-.440,-901) which concludes that there is no difference in the mean value of the Pre Merger and Post Merger operating performance of acquiring (Bank of Baroda) and concluded that it is not significant statistically. The profitability of both acquiring banks has not improved after the merger, therefore **Null Hypothesis is accepted and Alternative Hypothesis is rejected**. The results say that though Merger is helpful for expansion and growth but no guarantee for improving the profitability of acquiring banks.

**CONCLUSION**

It is clear from the analysis that the only hypothesis set for the validation has been accepted. Both the acquiring banks (Oriental Bank of Commerce & Bank of Baroda) have not created positive difference after the merger in terms of profitability. For comparing the accounting ratios like, Operating Profit Margin, Net Profit Margin, Return on Net worth etc of the Pre and Post merger the t-test is applied. After the merger we see that the various financial parameters of the bank performance have not improved in both cases, the profits are not visible but it may be possible that improved performance of merged Bank will show in later years. There are various motives, which attract the bank for merger but it is not necessary to achieve all objectives after merger. The size of the bank may

increase but no guarantee to increase net profitability after merger. Result concluded that the merger and acquisitions is the useful tool for growth and expansion in the Indian banking sector. Future research in this area could be the study of impact of merger on share holder's wealth and take more banks to a larger sample concerning a longer time period for the study which would have given better result.

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