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# FULFILMENT OF MERGER MOTIVES - EVIDENCES FROM MERGERS AND ACQUISITIONS IN THE INDIAN BANKING SCENARIO

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## ABSTRACT
*The Government of India has adopted the route of mergers among others with a view to restructure the banking system. Mergers and Acquisitions are considered to be the fast track for increasing the size, expanding branch network and enlarging business operations. This study makes a probe into the fulfillment of motives as vowed in the merger deals of the nine select merged banks. The study uses Summary Statistics, Wilcoxon Matched Paired Signed Rank Test and 't' test for analysis and interpretation of data pertaining to the five pre and post merger periods each. The result indicates that there has been only partial fulfillment of the motives as envisaged in the merger deals.*

## KEYWORDS
Merger, Acquisitions, Banking.

## INTRODUCTION
Mergers and acquisitions in banking sector have become familiar in majority of the countries in the world. A large number of international and domestic banks all over the world are engaged in merger and acquisition activities. The phenomenon of mergers and acquisitions among Indian banks is not restricted to the post reform era of the Indian Banking System. Between 1961- 2004, there have been 71 mergers among various banks in India (Lakshminarayanan, 2005). Of these, 55 mergers occurred during the pre-reform period of 1960-1990. It is important to note that many mergers during the pre-reform period were instituted by the Government in an effort to restructure ailing banking units. Market driven mergers, which are on a gradual rise, are thus, outcomes of the post reform period, driven by the change in the competitive landscape of the Indian banking system which forced many of the incumbent banks to restructure themselves and boost their efficiency in an attempt to ensure long-term profitability and survival.

## OBEJCTIVE OF THE STUDY
- To identify the motives of mergers
- To evaluate pre and post-merger performance of the merged banking companies vis-à-vis motives variables

## METHODOLOGY AND ANALYTICAL TOOLS
This study covers a period of ten years, five years before the merger and five years after the merger. The year of merger has been excluded to have consistency in evaluating post merger performance of the acquirer banks. Mergers in India have assumed great significance with the advent of the policy of deregulation initiated in the year 1991. Hence, for the selection of the merger cases, M&As that occured post 1991 have been considered. The basic premise was to select those mergers which have the financial coverage of the acquirer banks in database related to the study period. Accordingly, of the 18 merger deals, the following nine mergers (Table 1) were selected for the study.

**TABLE 1: LIST OF SELECTED BANK MERGERS**

| S.No | Target Banks | Acquirer Banks |
|---|---|---|
| 1 | Benares State Bank Ltd | Bank of Baroda (BOB) |
| 2 | Global Trust Bank Ltd | Oriental Bank of Commerce (OBC) |
| 3 | Nedungadi Bank Ltd | Punjab National Bank (PNB) |
| 4 | Kashinath Seth Bank | State Bank of India (SBI) |
| 5 | Sikkim Bank Ltd | Union Bank of India (UBI) |
| 6 | Times Bank Ltd | HDFC Bank Ltd (HDFC) |
| 7 | Bank of Madura | ICICI Bank Ltd (ICICI) |
| 8 | The British Bank of Middle East | Hongkong Shangai Banking Corporation (HSBC) |
| 9 | ANZ Grinlays Bank | Standard Chartered Bank (SCB) |

The present study is based on the secondary data. The required data for the study were obtained from the Prowess, the corporate database software of CMIE and CAPITALINE, the database software developed by Capital Market Publishers Private India Ltd. For the analysis and interpretation of the data, Summary Statistics, Wilcoxon Matched Pairs Signed Ranks' Test (Z Statistic) and't' test were used. For the purpose of the analysis, the following null hypothesis has also been formulated and tested:

**$H_0$:** There is no significant difference between pre-merger and post-merger financial performance of the banks measured in terms of: Profitability, Growth, Leverage, Risk Reduction (Diversification) and Tax Consideration.

## EMPIRICAL ANALYSIS AND RESULTS
All the sample merger schemes have been scrutinized to unfold the motives mentioned therein. Based on the type of mergers the motives identified as outlined in the scheme are Profit Maximisation, Growth, Leverage, Risk Reduction (Diversification) and Tax Consideration. In order to empirically analyze the performance of sample merged banks over time (i.e., pre and post-merger period) to assess if merger motives as avowed in the merger schemes have been fulfilled or not,

the values of relevant performance appraisal variables have been computed for five pre-merger years and same number of post-merger years along with their means of respective periods. The sample statistic "Mean" of all the variables for both the pre and post-merger periods has been compared and presented.

## EFFECT ON PROFITABILITY

Achieving profitability being the major cause of merger, the ratios like Return on Assets (ROA), Return on Capital Employed (ROCE), Return on Net Worth (RONW), Profit Margin and Total Income to Total Assets (Asset Utilization) have been computed for the merged banks and their mean ratios of both pre-merger and post-merger periods are presented in Table 2.

**TABLE 2: EFFECTS OF MERGER ON PROFITABILITY** (Mean Ratios in Percentages)

| Banks | ROA | | ROCE | | RONW | | Profit Margin | | TI to TA | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Pre | Post | Pre | Post | Pre | Post | Pre | Post | Pre | Post |
| **Public Sector Banks** | | | | | | | | | | |
| BOB | 7.16 | 5.11 | 7.62 | 5.35 | 13.42 | 13.26 | 7.23 | 10.08 | 10.28 | 8.07 |
| OBC | 8.31 | 6.45 | 8.56 | 6.69 | 19.94 | 9.98 | 10.96 | 8.45 | 6.31 | 5.30 |
| PNB | 7.47 | 5.36 | 7.90 | 5.67 | 20.35 | 17.23 | 7.71 | 12.28 | 11.11 | 8.44 |
| SBI | 6.34 | 7.05 | 8.05 | 8.42 | 10.97 | 14.99 | 2.60 | 6.97 | 10.73 | 10.38 |
| UBI | 7.26 | 6.48 | 7.56 | 6.73 | 12.99 | 17.56 | 6.42 | 9.42 | 10.61 | 9.58 |
| **Private Sector Indian Banks** | | | | | | | | | | |
| HDFC | 6.70 | 5.59 | 7.20 | 6.29 | 14.45 | 17.69 | 16.33 | 15.78 | 9.00 | 8.11 |
| ICICI | 8.04 | 5.47 | 8.52 | 5.92 | 16.23 | 13.37 | 12.75 | 12.23 | 10.68 | 7.84 |
| **Private Sector Foreign Banks** | | | | | | | | | | |
| HSBC | 7.70 | 6.03 | 8.42 | 6.85 | 10.97 | 11.20 | 9.74 | 10.15 | 11.95 | 9.60 |
| SCB | 8.02 | 6.55 | 8.66 | 7.30 | 12.43 | 23.17 | 9.59 | 20.65 | 13.64 | 9.90 |

Source: Compiled and calculated from the annual reports of the banks

As reported in Table 2, Return on Assets had higher mean value in the pre-merger period compared to the post-merger period, indicating that, on an average, the profitability of the select acquirer banks has declined in the post-merger period except for State Bank of India. The same trend was noted in case of ROCE. More than 50% of the select acquirer banks such as, SBI, UBI, HDFC, HSBC and SCB were able to improve profitability in terms of post-merger RONW which is evident from the mean ratios in the post-merger period.The post-merger mean ratio of Profit Margin of the select public sector banks like BOB, PNB, SBI and UBI and the private sector foreign banks were greater in the post-merger period than the pre-merger period. OBC, HDFC Bank and ICICI Banks were not able to improve their profit margin in the post-merger period. None of the sampled banks have succeeded in improving their post-merger mean ratio of Total Income to Total Assets which is indicative of the fact that the banks could not utilize their assets more profitably after merger. The significance of these ratios were tested through Z statistic and given in Table 3.

**TABLE 3: RESULTS OF WILCOXON MATCHED PAIRS SIGNED RANKS' TEST (PROFITABILITY)**

| Select Ratios | Z Statistic | Increased after Merger | | Decreased after Merger | |
|---|---|---|---|---|---|
| | | No.of Banks | Percent (%) | No.of Banks | Percent (%) |
| ROCE | -2.547* | 1 | 11 | 8 | 89 |
| | (-0.01) | | | | |
| ROA | -2.547* | 1 | 11 | 8 | 89 |
| | (-0.011) | | | | |
| RONW | -0.77 | 5 | 56 | 4 | 44 |
| | (-0.441) | | | | |
| Profit Margin | -1.599 | 6 | 67 | 3 | 33 |
| | (-0.11) | | | | |
| Total Income/Total Assets | -2.666** | 0 | 0 | 9 | 100 |
| | (-0.008) | | | | |

* denotes significance at 5% level. ** denotes significance at 1% level.

Note: The figures in parenthesis are estimated probabilities.

Results of Matched Pairs Signed Ranks' Test as reported in Table 3 revealed that the decline in profitability in terms of ROCE, ROA and Burden to working fund were significant at 5% level and in terms of Total Income to total assets and Spread to Working Fund were significant at 1% level. For other measures of profitability, however, the decline is not significant. Though, ratios like Profit Margin and Total Income to Total Assets had increased in the post-merger period in majority of the sampled acquirer banks, this increase is not found statistically significant.

## EFFECT ON GROWTH

For the analysis related to fulfilment of merger motives, the growth indicators like Deposits, Advances, Total Assets and Total Income were considered. Analysis of impact on growth in respect of select parameters of growth as per Table 4, indicated substantial growth in the size of deposits for HDFC and ICICI bank at 15 and 20 times respectively. ICICI bank recorded a whopping growth of 48 times and HDFC bank at 21 times in their advances during post M & A period. Similar trend has been noticed in the case of total assets also.

**TABLE 4: EFFECT OF MERGER ON GROWTH**

| Indicators / Banks | Deposits | | | Advances | | | Total Assets | | | Total Income | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Pre (Rs.) | Post (Rs.) | Pre (Rs.) | Pre (Rs.) | Pre (Rs.) | Inc. in Times | Pre (Rs.) | Post (Rs.) | Inc. in Times | Pre (Rs.) | Post (Rs.) | Inc. in Times |
| **Public Sector Banks** | | | | | | | | | | | | |
| BOB | 50177.03 | 104982.58 | 2.09 | 24717.00 | 65847.05 | 2.66 | 58185.78 | 123182.22 | 2.12 | 5954.14 | 9769.39 | 1.64 |
| OBC | 28149.33 | 80523.49 | 2.86 | 13983.56 | 55955.32 | 4.00 | 31771.20 | 92925.64 | 2.92 | 3443.92 | 7942.02 | 2.31 |
| PNB | 48737.70 | 123417.02 | 2.53 | 23063.59 | 79672.58 | 3.45 | 55351.46 | 147113.90 | 2.66 | 6081.24 | 12273.20 | 2.02 |
| SBI | 67282.31 | 170096.77 | 2.53 | 43822.44 | 83186.55 | 1.90 | 100928.77 | 227160.80 | 2.25 | 10783.70 | 23227.75 | 2.15 |
| UBI | 20898.10 | 46364.01 | 2.22 | 8509.50 | 26786.90 | 3.15 | 23389.87 | 53034.85 | 2.27 | 2478.87 | 4984.69 | 2.01 |
| **Private Sector Indian Banks** | | | | | | | | | | | | |
| HDFC | 1542.70 | 23690.22 | 15.36 | 648.03 | 13303.21 | 20.53 | 2676.32 | 32760.97 | 12.24 | 216.77 | 2565.91 | 11.84 |
| ICICI | 4128.70 | 82652.99 | 20.02 | 1653.54 | 80067.04 | 48.42 | 5054.57 | 151872.67 | 30.05 | 481.26 | 11936.56 | 24.80 |
| **Private Sector Foreign Banks** | | | | | | | | | | | | |
| HSBC | 4727.64 | 13675.27 | 2.89 | 2193.73 | 7761.84 | 3.54 | 6396.60 | 21845.63 | 3.42 | 749.25 | 2058.63 | 2.75 |
| SCB | 4420.17 | 19235.47 | 4.35 | 2884.28 | 15559.55 | 5.39 | 6712.16 | 33141.37 | 4.94 | 908.09 | 3202.58 | 3.53 |

The private sector foreign banks involved in mergers could achieve three to five fold increase in terms of the various growth parameters. The public sector banks involved in M & A activity achieved two to three-fold increase in the growth indicators barring total income which increased around 2 times only. This growth in all the indicators were also tested through't' test and given in Table 5.

**TABLE 5: RESULTS OF 'T' TEST (GROWTH VARIABLES)** Rs. in crores

| Sl.No. | Growth indicators | Pre Merger Period | | Post Merger Period | | t-value |
|---|---|---|---|---|---|---|
| | | Mean (Rs.) | S.D | Mean (Rs.) | S.D | |
| 1 | Deposits | 25562.63 | 24569.81 | 73848.65 | 53252.73 | 4.44* |
| 2 | Advances | 13497.30 | 14611.25 | 47571.11 | 31573.42 | 4.27* |
| 3 | Total Assets | 32274.08 | 33422.70 | 98115.34 | 69768.23 | 4.21* |
| 4 | Total Income | 3455.25 | 3552.16 | 8662.30 | 6724.62 | 3.82* |

* Significant at 5% level of significance (Table Value is 1.860, DF - 8)

It is observed from the results of 't' test given in Table 5 that the impact of merger on growth is found to be significant in all the merger deals, in terms of all the growth indicators. Hence, the null hypothesis that there is no significant difference in the growth between pre and post merger period is rejected.

## EFFECT ON LEVERAGE

Leverage imbalance being a cause of merger, mean of the leverage ratios for merged bank in the pre-merger has been compared with the leverage ratios in the post-merger period. Capital Adequacy Ratio (CAR) and Debt-Equity Ratio (DER) have been used to analyse the effect of leverage on mergers and the resultant mean ratios are specified in Table 6.

**TABLE 6: EFFECT OF MERGERS ON LEVERAGE** (Mean Ratios in percentages)

| Banks | CAR | | DER | |
|---|---|---|---|---|
| | Pre | Post | Pre | Post |
| **Public Sector Banks** | | | | |
| BOB | 12.31 | 12.98 | 17.15 | 15.13 |
| OBC | 12.81 | 12.16 | 16.20 | 13.44 |
| PNB | 10.17 | 13.02 | 22.45 | 15.63 |
| SBI | 12.32 | 12.71 | 46.41 | 19.94 |
| UBI | 10.25 | 11.75 | 18.26 | 19.19 |
| **Private Sector Indian Banks** | | | | |
| HDFC | 12.86 | 11.99 | 6.19 | 12.90 |
| ICICI | 14.95 | 11.61 | 11.52 | 13.01 |
| **Private Sector Foreign Banks** | | | | |
| HSBC | 10.85 | 13.99 | 8.76 | 10.47 |
| SCB | 10.26 | 10.22 | 9.30 | 10.41 |

Source: Compiled and calculated from the annual reports of the banks

According to the norms of the RBI, each bank in India has to maintain 9% of their risk-weighted assets as capital. All the sampled banks were able to maintain adequate capital adequacy ratio. However, it could be noted from Table 6 that growth of Capital Adequacy Ratio declined in the post-merger period in case of OBC, HDFC Bank, ICICI Bank and SCB. The Debt Equity Ratio (DER) of all select public sector banks except UBI got reduced during the post-merger period indicating lesser dependence on debt capital over the pre-merger period. Where as, the DER of both Indian and Foreign Private sector Banks indicated more dependence on debt capital by registering increased ratio in the post-merger period. In order to test this statistically, Wilcoxon Matched Pairs Signed Ranks' Test was applied and shown in Table 7.

**TABLE 7: RESULTS OF WILCOXON MATCHED PAIRS SIGNED RANKS' TEST (LEVERAGE)**

| Sl.No. | Select Ratios | Z Statistic | Increased after Merger | | Decreased after Merger | |
|---|---|---|---|---|---|---|
| | | | No.of Banks | Percent (%) | No.of Banks | Percent (%) |
| 1 | Capital Adequacy Ratio | -0.42 (-0.674) | 4 | 50 | 4 | 50 |
| 2 | Debt Equity Ratio | -0.652 (-0.515) | 5 | 56 | 4 | 44 |

* denotes significance at 5% level. ** denotes significance at 1% level.

Note: The figures in parenthesis are estimated probabilities.

The Results of Wilcoxon Matched Pairs Signed Ranks' Test in Table 7 revealed insignificance for both the ratios taken for analyzing leverage. But this is not an adverse effect; rather it indicates greater protection to the creditors and depositors.

**EFFECT ON TAX CONSIDERATION AND RISK REDUCTION**

The effect of tax variable on merger is measured as difference between pre-merger and post-merger effective tax rate of the merged firm. The effective tax rate is calculated as the ratio of tax paid to profit before tax. Variation in profits is a commonly used estimate of risk of profits. The measure of risk for the purpose of this analysis has been taken as coefficient of variation of gross operating profit. The results of these measures are put into Table 8.

**TABLE 8: EFFECTS OF MERGER ON TAX CONSIDERATION AND RISK REDUCTION** (Mean Ratios in Percentages)

| Banks | Effective Tax Rate | | Risk Reduction | |
|---|---|---|---|---|
| | Pre | Post | Pre | Post |
| **Public Sector Banks** | | | | |
| BOB | 33.97 | 31.44 | 23.36 | 21.83 |
| OBC | 36.50 | 31.84 | 45.68 | 23.92 |
| PNB | 26.69 | 32.91 | 28.39 | 17.91 |
| SBI | 35.53 | 38.09 | 27.03 | 16.45 |
| UBI | 20.72 | 22.21 | 25.28 | 39.06 |
| **Private Sector Indian Banks** | | | | |
| HDFC | 30.94 | 31.40 | 78.62 | 41.88 |
| ICICI | 21.29 | 11.77 | 69.93 | 48.61 |
| **Private Sector Foreign Banks** | | | | |
| HSBC | 59.28 | 53.20 | 13.85 | 33.21 |
| SCB | 20.68 | 32.89 | 44.90 | 29.15 |

Source: Compiled and calculated from the annual reports of the banks

An examination of the figures given in Table 8 shows that the risk in terms of variations in operating profit has been reduced for all the select acquirer banks except for UBI and HSBC which witnessed higher percentage variations in operating profit during the post-merger period over the pre-merger period. Likewise, many of the select acquirer banks like BOB, OBC, ICICI and HSBC had reduced tax burden in the post-merger period as is evidenced from their effective tax rate, revealing tax benefits. Further, the significance of the variations are statistically tested and presented in Table 9.

**TABLE 9: RESULTS OF WILCOXON TEST (TAX CONSIDERATION AND RISK REDUCTION)**

| Sl. No. | Select Variables | Z Statistic | Increased after Merger | | Decreased after Merger | |
|---|---|---|---|---|---|---|
| | | | No. of Banks | Percent (%) | No. of Banks | Percent (%) |
| 1 | Effective Tax Rate | -0.28 (-0.779) | 4 | 50 | 4 | 50 |
| 2 | Risk Reduction | -1.481 (-0.139) | 2 | 22 | 7 | 78 |

As per the results of Wilcoxon Matched Pairs Signed Ranks' Test shown in Table 9, differences in the mean ratios between the periods before and after merger as regards risk reduction and tax advantages were insignificant, proving the hypothesis.

## CONCLUSIONS AND POLICY RECOMMENDATIONS

As regards fulfillment of merger motives, all the select merged private sector banks achieved manifold increase in deposits, advances and size of assets. As regards profitability, the post merger performance of all the select acquirer banks was dismal with a decline in ROA and ROCE except for SBI. However, return on networth improved in the case of all the merged banks other than BOB, OBC, PNB and ICICI. Stability of the banks as reflected by leverage ratios exhibited required capital adequacy, and Debt-Equity Ratio declined for BOB, OBC, PNB, and SBI. HSBC could reduce tax burden and risk reduction motive was achieved by all the select banks except UBI and HSBC. Hence, it could be concluded that there has been partial fulfillment of merger motives in case of select merger deals.

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