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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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POST-MERGER PROFITABILITY OF SELECTED BANKS IN INDIA

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ABSTRACT

The present study aims to shed some light on the gains from consolidation exercise in terms of profitability of banks. Through the application of paired t-test, we arrived at the result that the consolidation of banks did improve the profitability of banks in India. The increase in profitability of banks under study is due to an increase in employee turnover and the subsequent reduction in operating expenses. Merger and acquisition programmes in Indian banks cannot be regarded as a false step if the benefits of it accrue to all stakeholders.

KEYWORDS

Banks, Merger, Profitability.

INTRODUCTION

The corporate world is so fond of merger and acquisition (M&A) activity for instantaneous growth, survival and sustenance. Being a high-born US phenomenon, global demonstration effect and the linkage between various sectors of the economy has helped spread the inorganic growth strategy the world over. Bank mergers in India are as old as the colonial period when the Bank of Bengal, Bank of Bombay and Bank of Madras with their 70 branches merged to constitute a single entity namely the Imperial Bank of India. The horizontal merger did not stop there. Of recent, Bank of Rajastan was merged with ICICI Bank, acceding to a deal value of around Rs.3000 crores. The recommendations of successive Narasimham Committees paved the way for reshaping the structure of Indian banking industry according to size of banks. Their policy prescription was to have an enormous size for Indian banks, although the recent experience shows that internal financial management will be at bay without controlling for size. This has culminated with the merger of banks when Basel-II norms have been put into practice. While industries in India have undergone three distinct merger waves, the Indian banking industry is yet to complete two consolidation phases, according to a report by Dolat Capital. Against this backdrop, the paper aims to shed some light on the gains from consolidation exercise in terms of profitability of banks.

REVIEW OF PREVIOUS STUDIES

Mylonidis and Kelnikola (2005) focused on the merging activity in the Greek banking system over the period 1999-2000. They took a sample of four acquirers and five target banks that are of relatively the same size and the non-merging banks that comprises of two large banks and two small banks are referred to as the control group. One of the major findings emerged from the study is that profit, operating efficiency and labour productivity ratios of the acquirer and acquired banks do not show any post-merger improvement, if the comparison has not been made with the corresponding ratios of the control group.

Cabanda and Pajara-Pascual (2007) made a comparison between short-run and long-run analysis of mergers in the corporate performance for shipping companies in the Philippines. The different measures of profitability used are net income, return on sales, return on assets and return on equity. Unlike the short-run, the long-run analysis using parametric t-test showed significant improvements in profitability of the merged shipping entity.

According to Mantravadi and Reddy (2008), mergers exerted a positive impact on the profitability of firms in the banking and finance industry in India. They took a sample of firms in the period of 1991 to 2003. The average pre-merger and post-merger performance of a set of financial ratios such as operating profit margin, gross profit margin, net profit margin, return on net worth, return on capital employed and debt-equity ratio were compared with the help of t-test for two-samples. However, the statistical test could not find any significant change in the operating performance of these financial ratios.

Badreldin and Kalhoefer (2009) studied the merger and acquisition activity in the Egyptian banking sector through the magnifier of reforms. The study concluded that merger and acquisition during 2002-07 had no clear impact on the profitability of acquirer banks, whether they are involved in domestic or cross-border transactions.

Ullah et al (2010) found a positive impact of mergers on the performance of banks in Pakistan. They selected a sample of four banks that have undergone the merger process in 2002. Using t-test on the measures of profitability, capital adequacy and solvency ratios, they recommended merger and acquisition for improved management and technology.

Kemal (2011) undertook a case study of Royal Bank of Scotland for analysing the post-merger profitability in Pakistan. He calculated the average of a set of financial ratios and affirmed the negative impact of mergers and acquisitions on profitability.

OVERVIEW OF BANKING REFORMS

Dobson (2007) stated that the financial system of India is more developed than that of China. This was due to the banking reforms initiated in 1992 and the stringent banking policies adopted by the Reserve Bank of India from time to time. The market-driven banking reforms laid emphasis on the gradual reduction of cash reserve ratio and statutory liquidity ratio to make up the poor profitability of banks. The sluggish liberalization policies in India helped to increase the overall operational efficiency of financial intermediaries. Evidently, the entry of foreign banks opened the floodgates of competition in India. Of late, there have been some notable changes in the modus operandi of public sector banks in terms of competitiveness and profitability. All credit goes to the Narasimham Committees that speeded up the reform process in India and transformed the banking sector into an 'engine of economic growth'.

OBJECTIVES AND METHODOLOGY

Objectives of the Present Paper: The present study aims to explore the impact of mergers and acquisitions on profitability of selected banks in India.

Collection of Data: The present paper is entirely based on secondary data. RBI Publications of 'A Profile of Banks' and 'Statistical Tables Relating to Banks in India' have been used throughout the study to calculate various ratios of profitability.

METHODOLOGY: The study examines the impact of the banks merged in India from 1999 to 2011. Between 1999 and 2011, around 18 amalgamations took place in Indian banking sector. Out of these 6 banks were selected as samples which constitute 1/3 of the population. The samples were selected on a random sampling basis through lottery method. Among the six acquirer banks selected, three of them are public sector banks and the remaining are private sector banks.

RESULTS AND DISCUSSIONS

VARIOUS RATIOS OF PROFITABILTY

The aim of any organization is to earn profit and to survive in the long run. An understanding of what happens to different ratios of profitability is useful not only to the firms, but to the government as well, to decide whether they should go for merger strategy or not. Before examining various ratios of profitability, it is necessary to have a clear understanding of the changes in growth of total assets and net profits of selected banks.

TABLE 1: CHANGES IN GROWTH OF TOTAL ASSETS (in Rs. Crore)

Name of the bank	Pre-merger Average	Post-merger Average	Growth Rate
Punjab National Bank	79568.5	114286.5	43.63
Bank of Baroda	80767	104028.5	28.80
Oriental Bank of Commerce	37503	56503	50.66
Federal Bank	18732	28798	53.74
ICICI Bank	298358.5	389548	30.56
HDFC Bank	112206.5	203175	81.07

Source: Computed from RBI Statistical Tables Relating to Banks in India and Annual Reports of Banks

As per the table, the average total assets of merged banks taken for this study during post-merger period was higher than the total assets during pre-merger period. It was also evident from the table that HDFC Bank achieved 81.07 highest growth rates in respect of total assets among sample banks followed by Federal Bank, Oriental Bank of Commerce and Punjab National Bank. The lowest growth rates are recorded in Bank of Baroda and ICICI Bank.

Net profit after the payment of taxes was increased by Rs.4864 crores in public sector banks while the increase was only Rs. 2243 crores for private banks during 2009-10 as compared to the previous period 2008-09.

TABLE 2: CHANGES IN GROWTH OF NET PROFIT (in Rs. Crores)

Name of the bank	Pre-merger Average	Post-merger Average	Growth Rate
Punjab National Bank	702	1259.5	79.42
Bank of Baroda	870	752	-13.56
Oriental Bank of Commerce	571.5	659	15.31
Federal Bank	157.5	330.5	109.84
ICICI Bank	2825	3958	40.11
HDFC Bank	1365.5	2597	90.19

Source: Computed from RBI Statistical Tables Relating to Banks in India and Annual Reports of Banks

As per the table, the average net profits earned by merged banks increased in the post-merger period except for Bank of Baroda. Clearly, Federal Bank and HDFC Bank achieved the growth rate of more than 80 per cent. Oriental Bank of Commerce and Bank of Baroda lags behind any other bank in respect of net profits.

The various ratios of profitability examined in the study are return on assets, return on equity and net interest margin. Now let's briefly touch upon them.

RETURN ON ASSET

Return on Asset (ROA) the ratio of net profit to total assets is widely used among financial institutions to measure how profitably the bank carries out its operations. The higher the ratio, the higher will be the managerial efficiency and vice-versa.

TABLE 3: RETURN ON ASSETS

Name of the bank	Pre-Merger Average	Post-Merger Average
Punjab National Bank	0.88	1.10
Bank of Baroda	1.13	0.77
Oriental Bank of Commerce	1.50	1.40
Federal Bank	0.91	1.36
ICICI Bank	1.20	1.05
HDFC Bank	1.33	1.41

Source: Computed from RBI, Statistical Tables Relating to Banks in India and A Profile of Banks, Various Issues.

Table 3 shows that Punjab National Bank is the only public sector bank that achieved higher return on assets when the merger and acquisition programme came to an end. The mean return on asset of two private banks slightly improved. On an average, the private banks outperform that of public sector banks in the field of return on assets.

RETURN ON EQUITY

Return on Equity (ROE) which shows the return to the shareholders can be computed as a ratio of net profit to the total sum of capital, reserves and surplus. Higher value of the ratio is indicative of higher profitability.

TABLE 4: RETURN ON EQUITY

Name of the bank	Pre-Merger Average	Post-Merger Average
Punjab National Bank	19.18	19.71
Bank of Baroda	18.24	11.29
Oriental Bank of Commerce	23.65	16.82
Federal Bank	15.22	14.44
ICICI Bank	11.94	8.24
HDFC Bank	15.79	14.51

Source: Computed from RBI, Statistical Tables Relating to Banks in India and A Profile of Banks, Various Issues.

All but Punjab National Bank showed a decrease in average return on equity. Table 4 illustrates this trend. The average return on equity of both public sector and private banks came down in the post-merger period.

NET INTEREST MARGIN

Net Interest Margin (NIM) is the ratio of spread to total assets. Spread can be calculated as the difference between interest earned and interest expended. For net interest margin, Bank of Baroda and HDFC Bank are the successful banks in terms of profitability.

TABLE 5: NET INTEREST MARGIN

Name of the bank	Pre-Merger Average	Post-Merger Average
Punjab National Bank	3.39	3.34
Bank of Baroda	2.89	2.98
Oriental Bank of Commerce	3.56	2.77
Federal Bank	2.95	2.76
ICICI Bank	1.76	2.02
HDFC Bank	3.87	3.91

Source: Calculated from A Profile of Banks, RBI, Various Issues.

The average net interest margin of public sector banks showed a declining trend, but the trend is a good sign so far as the profitability criterion is concerned. On the contrary, an increasing trend is discernible in case of private banks. This might be due to a decrease in competition when the public sector banks adhered to the profit-making goal along with social banking.

TABLE 6: T-STATISTICAL ANALYSIS FOR THE SELECTED BANKS

Sl. No.	Ratios	Pre-Merger Mean	Post-Merger Mean	SD	T-value
1	Return on Assets	1.158	1.182	0.288	-0.20 (0.851)
2	Return on Equity	17.34	14.17	3.19	2.43 (0.059)
3	Net Interest Margin	3.070	2.963	0.367	0.71 (0.508)

Source: Author's Calculations

Note: Figures in parenthesis show the p-values.

Table 6 shows the paired t-test for the combined banks during pre-and post-merger periods. The average return on assets showed an improvement though it was not statistically significant. The average return on equity decreased but it was not statistically significant as evidenced by the higher p-values. Similarly, the average net interest margin declined insignificantly.

CONCLUSION

An attempt has been made to analyse the financial performance of banks in the wake of consolidation exercise. The results emerged from the profitability ratios, on an average, showed a significant difference between the profitability of banks in post-merger scenario. The increase in profitability of banks under study is due to an increase in employee turnover and the subsequent reduction in operating expenses. Merger and acquisition programmes in Indian banks cannot be regarded as a false step if the benefits of it accrue to all stakeholders.

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