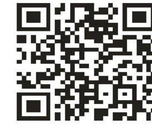
Review Of Research
Vol. 2 | Issue. 11 | August 2013
ISSN:-2249-894X Available online at www.lbp.world

ORIGINAL ARTICLE



A STUDY OF THE MERGERS AND ACQUISITIONS PROSPECTS IN INDIAN BANKING SECTOR

Dr. Ishtiaque Ahmed
Associate Professor, Dept. of Commerce, Purnea College, Purnia (Bihar).

ABSTRACT:
The paper examines M&A in the Indian banking industry to understand the results of these synergies and the long-term implications of mergers.. This paper examines M&A's. The paper also analyses future developments and recommends banks' future measures. In this paper, trends of M&A in the Indian banking sector were reviewed and the impact of M&A in three leading banks in India was examined. In the period 2000 to 2013, the study covers the area of performance evaluation of M&A in India.The paper compares financial performance before and after mergers of merged banks by using financial parameters such as the margin of net profit, operating profit margin, return on equity employed, return on equity, income per share, capital property ratio, dividend per share, etc.. Results suggest that M&A's in the Indian banking sector have been somewhat successful. Government and policymakers should not promote the fusion of strong and distressed banks as a means of supporting depositors' interests in distraught banks, as they will adversely impact the quality of assets of stronger banks.

KEYWORDS: Capital adequacy, Consolidation, Mergers, Strategic alliance, Ratios.

I. INTRODUCTION

Banking organisations have greatly expanded their operations' reach and complexity in the current world marketplace and face a regulatory environment that is constantly changing and increasingly complex. Globally it has been established that M&A can only gain competitive advantages domestically and internationally and, as a result, strategic acquisitions are sought in all industries both inside and outside India. The banking industry is nowadays one of India's fast-growing industries. The paradigm shift in banking industries has occurred in the last two decades. M&A is accelerating a relatively new aspect in the Indian banking industry. Consolidation of the Indian banking sector through M&A on business considerations and business strategies are essential pre-requisites to achieve economies of scale and also fight against unhealthy competitiveness. Consolidation has become a major strategic instrument and a global

phenomenon, driven by the advantages of economies of scale, geographical diversification and cost reductions through industry and personnel simplification, cross-border development and concentration of market shares. The new Basel II standards also resulted in banks considering M&A.

II. RESEARCH METHODOLOGY

Objectives:

1. Examine M&A trends in the Indian banking sector.
2. To investigate the banks' performance before and after the M&A.

Sample Selection:

The study analyses the fusions and acquisitions experienced by three major banking companies. These are these

1. BANK ICICI.
2. India's STATE BANK
3. HDFC

Sources of Data

The secondary data for the study is collected. The necessary data was collected and compiled from the CMIE Database and the banks' annual reports. The trial covers a period between 2000 -2013. Furthermore, additional information from various magazines and journals was collected.

Limitation

1. The study ignores the impact that the accounting methods of various companies may differ.
2. For all companies the factors affecting M&A performance may not be the same.
3. The cost of acquisition for mergers is not considered in the methodology.

Literature Review

Fusion or merger of two weaker banks with one healthy bank can be treated as the faster and less expensive way of improving profitability and stimulating internal growth (Franz, H. Khan 2007). Fusion also contributes to the product diversification that helps reduce risks. The impact of merger announcements made to five banks in the Indian banking sector has been studied in Anand Manoj and Singh Jagandeep (2008), which include the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank and ICICI Ltd, the Global Trust Bank merged with the East Banco del Comercio and the Punjab Bank, which merged to the Century Bank. Mehta Jay & Kakani Ram Kumar (2006) stated there are several reasons for M&A in the Indian Banking Sector and it simply has led to M&A waves in the banking sector and states that many reasons for M&A merger in the Indian Banking Sektor have been established by strict control regulations. Kuriakose Sony et al. (2009) focused on swap ratio valuation practises and adequacy that are fixed in the Indian Banking Sector for voluntary fusion and used for

bank valuations to use the swap ratio, but in the majority of cases the final swap ratio is not justified by financial resources.In their paper, Kuriakose Sony & Gireesh Kumar G.S (2010) assessed the strategic and financial parallels of the combined banks and assessed their relativity with the relevant financial variables of the respective banks. The study found that the voluntary merger wave in the Indian banking sector has only been promoted by private sector banks.

III. IMPACTS OF MERGER & ACQUISITIONS

1. Growth: Companies wishing for rapid growth in market share or size or diversification in their products' spectrum might find a merger useful for meeting the goal rather than going into an internal growth or diversification process that takes time. In a short period of time the company can achieve the same goal by merging with an existing company.

2.Synergy: The merged entity is better capable of both increasing revenues and reducing costs. Fusion and procurement allows companies to achieve efficiency benefits by cutting costs (costs synergies) and increasing revenue (revenue synergies).

3.Purchase Of Assets At Bargain Prices: M&A'S is entitled to acquire assets at lower costs than they might have been if the assets were purchased or constructed at current market prices, particularly the rights to land minerals, plants and equipment.

4.Enhanced Managerial Skills: Sometimes a company with good potential finds that it cannot fully develop due to weaknesses in certain management areas or a lack of required product or production technology. If the company cannot hire the management or technology it needs, the company could combine the management, the personnel or technical expertise it needs with a compatible company.

5. Acquiring New Technology: Companies have to keep up with technological developments and business applications in order to remain competitive. A large company can maintain or develop a competitive edge by purchasing a smaller company with unique technologies.

6. Broader Array of Products: When two companies merge, they have a variety of products and each consumer in both companies after the merger will benefit from the range of products and services to choose from which M&A helps firms to broaden their consumer portfolio, but also leads to a more diverse range of services.

7. Income Tax Advantages: In some cases, the financial synergy that may lead to merger could be provided by income tax consideration. Tax concessions serve as a catalyst to a strong bank to acquire distressed banks with unclaimed book profits accumulated and loss accrued.

8. Own Developmental Plans: The acquisition purpose is supported by own development plans by the acquirer companies. A company only thinks when it has reached its own development plan to expand its operation by looking at its own internal strength when acquires the other company. It must strive for an appropriate combination in which it can supplement its funds by issuing security funds; safeguarding additional financial facilities eliminates competition and strengthens its position on the market.

9. Strategic Purpose: The acquired company considers the merger to reach strategic targets by means of alternative combinations which, depending on the corporate

strategy, can be horizontal, vertical, product expansion, market extension or any other unrelated objectives.

10. Corporate Friendliness: While it is rare, business companies exhibit levels of cooperation despite their competitiveness in rescuing each other from hostile takeovers and in cultivating collaborative conditions which share goodwill to achieve high performance by means of business combinations.

IV. MERGER AND ACQUISITION IN INDIAN BANKING – PRESENT SCENARIO

The Indian banking system has achieved several exceptional accomplishments in recent decades. Its extensive reach is the most striking. It is no longer confined to Indian cities or metropolises. Indeed, India's banking system is even reaching far-flung corners. This is one of India's main aspects of banking growth. The first banking companies, which were created in 1786 and late afterwards were Bank of Hindustan (1770-1829) and General Bank of India. The largest and the oldest bank still in existence is the Bank of India that was founded in June of 1806 at the Bank of Calcutta which became the Bank of Bengal almost immediately.The Bank of Mumbai and the Bank of Madras were one of the three banks of the presidency, and the other two were created under charters from the British East Indian Company. The three banks merged into the Imperial Bank of India in 1921, which became the State Bank of India in 1955 after India's independence. In 1969 the Indian government issued an order nationalising the 14 major trading banks. These banks are responsible for 85per of the country's bank deposits. A second nationalisation round was conducted in 1980 for 6 more commercial banks. Nationalization has been carried out to enhance government control of the provision of credit.91% of the banking business was held by the Government of India with the second round of nationalisation. In 1993, New Bank of India and the Punjab National Bank were subsequently joined by the Government.

The Indian Banking Sector: Indian banking history can be divided into three principal phases:

Phase I (1786-1969) – Initial stage of Indian banking with the establishment of many small banks

Phase II Phase II (1969- 1991) - Nationalising, regulating and growing

Phase III (from 1991 on) - Post-liberalization

Reasons for Bank Merger

1) Merger of weak banks: Weak banks were fused with strong banks in order to give weak banks stability, but the Narsimhan Committee opposed the practise. Fusion can diversify the management of risk.

2) Increase market competition: The reasons for fusion are innovative new financial products and regional financial system consolidation. Markets have grown more competitive, which has reduced fusions and acquisitions as a result of this market share of every single company.

3) Economies of scale: The ability to generate economies of scale by merging companies.

4) Skill & Talent: Skills are transferred between two organisations, helping them improve and become more competitive.
5) Technology, New services and Products: E-Banking and certain financial instruments / derivatives are introduced. Entry barrier removal paved the way for new high-tech banks and old banks cannot compete with them to decide to merge.
6) Positive Synergies: When two companies combine, the only motive is to produce a positive effect that is higher than the combined effect of two companies alone. Cost synergy and income synergy are two aspects of it.

There are few other reasons
- Geographical survival of sick banks following merger and enhanced branch network.
- Larger client basis (rural reach) & Market share increased.
- Infrastructure attainment, and competition restricted, and banking overcrowded and unused resources are used, so that banks can compete in the international age against foreign banks.

Table-1: LIST OF M&A'S IN INDIAN BANKING INDUSTRY SINCE POSR LIBERALIZATION REGIME

YEAR	ACQUIRER	TARGET	TYPE/MOTIVE
1993	Punjab National Bank	New Bank of India	Forced Merger
1993	Bank of India	Bank of Karad Ltd.	Forced Merger
1996	State Bank of India	Kashinath Seth Bank	Forced Merger
1997	Oriental Bank of Commerce	Punjab Co-operative Banktd.	Forced Merger
1997	Oriental Bank of Commerce	Bari Doab Bank Ltd.	Forced Merger
1999	Union Bank of India	Sikkim Bank Ltd.	Forced Merger
2000	HDFC Bank Ltd.	Times Bank	Voluntary Merger
2001	ICICI Bank	Bank of Madura	Voluntary Merger
2002	ICICI Bank	ICICILimited	Voluntary Merger
2002	Bank of Baroda	Benaras State Bank Ltd.	Forced Merger
2003	Punjab National Bank	Nedungadi Bank Ltd.	Forced Merger
2004	Bank of Baroda	South Gujarat Local Areabank	Forced Merger
2004	Oriental Bank of Commerce	Global Trust Bank	Forced Merger
2005	Centurion Bank	Bank of Punjab	Voluntary merger
2006	Federal Bank	Ganesh Bank of Kurandwad	Forced merger
2006	IDBI Bank	United Western Bank	Forced merger
2006	Centurion Bank of Punjab	Lord Krishna Bank	Voluntary merger
2007	ICICI Bank	Sangli Bank	Voluntary merger
2007	Indian Overseas Bank	Bharat overseas Bank	Compulsory merger
2008	HDFC Bank Centurion	Bank of Punjab	Voluntary merger

2008	State Bank of India	State bank of saurastra	Voluntary merger
2010	ICICI Bank Ltd	The Bank of Rajasthan	acquisition
2010	State Bank of India	State bank of Indore	acquisition

Source: Compiled from the Indian Trend and Progress Report, RBI, a series of issues.

ICICI BANK

ICICI Bank was promoted in 1994 and its wholly-owned subsidiary was ICICI Limited, an Indian financial institution. ICICI's equity holdings in ICICI Bank have been reduced to 46% via publicly offered stocks in India in the financial year 1998, equity bids as ADRs as indicated in the New York City in fiscal year 2000, ICICI's acquisition by the ICICI Bank to the Bank of Madura in the full stock in fiscal 2001, and ICICI sales secondary market in financial 2001 and 2002 to institutional investors. In 1955, ICICI was founded on an initiative of the World Bank, the State of India and the Indian industry representatives.The main objective was the creation of a financial development institution to finance Indian businesses for the medium and long term. In the 1990s ICICI transformed its business from a financial development institution offering project financing only to a diversified group of financial services providing a variety of products and services, both directly and via a variety of subsidiaries and affiliates, such as ICICI Bank.

In 1999, ICICI was the first Indian company to be listed in NYSE and the second largest bank or financial institution in non-Japanese Asia.

Table -2: Key financial indicators of ICICI BANK

ICICI BANK	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Netinterest income	21.85	29.32	39.07	56.37	73.04	83.67	81.14	90.17	107.34	138.66
Earnings per share (Basic)	26.66	27.55	32.49	34.84	39.39	33.76	36.14	45.27	56.11	72.20
Earnings per share (Diluted)	26.44	27.33	32.15	34.64	39.15	33.70	35.99	45.06	55.95	71.93
Total assets	1,252.29	1,676.59	2,513.89	3,446.58	3,997.95	3,793.01	3,634.00	4,062.34	4,890.69	5,367.95
Equity capital &Reserves	80.1	125.50	222.06	243.13	464.71	495.33	516.18	604.05	604.05	667.06
Total capital adequacy ratio	10.4%	11.8%	13.4%	11.7%	14.0%	15.5%	19.4%	19.5%	18.5%	18.7%
Profit after tax	16.37	20.05	25.40	31.10	41.58	37.58	40.25	51.51	64.65	83.25
Dividend per share	7.5	8.5	8.5	10	11	11	12	14	16.5	20
Deposits	681.09	998.19	1,650.83	2,305.10	2,444.31	2,183.48	2,020.17	2,256.02	2,555.0	2,926.13
Advances	626.48	914.05	1,461.63	1,958.66	2,256.16	2,183.11	1,812.06	2,163.66	2,537.28	2,902.49

(SOURCE- BANK ANNUAL REPORT)

ANALYSIS AND INTERPRETATION

The ICICI Bank has been M&A four times and is now one of India's leading banks with a growing financial status. Net interest income, earnings per share, total assets, equity capital and reserves, the overall capital adequacy ratio, tax profit, all show a steadily increasing trend over 10 years. Deposits marginally decreased from 2009-2011, but increased again in 2013. Declining trend for 2009-2011 also demonstrated similar advances. Similarly.

STATE BANK OF INDIA

The State bank of India had its roots in the first decade of the 19th century when it was founded on 2 June 1806, after which it was renamed the Bank of Bengal. The Bengal bank was one of three banks of the Presidency, two the Bombay Bank (incorporated on 15 April 1840) and the Madras Bank (incorporated on 1 July 1843). All three banks of the Presidency were incorporated as joint shareholders and resulted from Royal Charters. The three banks had the sole right to issue paper currency until 1861, when the government of India took over the right under the Paper Currency Act.On 27 January 1921, the banks of the presidency amalgamated and the bank was reorganised under its name Imperial Bank of India. The Imperial Bank of India remained a joint venture without participation by the Government. The Reserve Bank of India, which is the central bank of India, acquired the controlled interests of the Imperial Bank of India in accordance with the provisions of the State Bank of India Act of 1955. The Imperial Bank of India was made the State Bank of India on 1 July 1955.

Table-3: Key financial indicators of state bank of India

SBI	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
Net Interest income	13,945	15,589	15,058	17,021	20,873	23,671	32,526	43,291	44,329
Net Profit	4,305	4,407	4,541	6,729	9,121	9,166	8,265	11,707	14,105
Return on Average Assets	0.99	0.89	0.84	1.01	1.04	0.88	0.71	0.88	0.97
Return on equity (%)	18.10	15.47	14.24	17.82	15.07	14.04	12.84	14.36	15.94
Earnings Per Share	81.79	83.73	86.10	126.62	143.77	144.37	130.16	184.31	210.06
Dividend Per Share	12.50	14.00	14.00	21.50	29.00	30.00	30.00	35.00	41.50
SBI Share (Price)	654.80	968.50	994.45	1,600.25	1,067.10	2,078.20	2,765.30	2,096.35	2,072.75
Capital Adequacy Ratio	--	-	-	-	85,393	90,975	98,530	1,16,325	1,29,362

(source-bank annual reports) In crores except % and share price

ANALYSIS AND INTERPRETATION

SBI is India's first largest bank. Financial indicators such as net interest income, income per share and profit grew until 2009-10 and slightly declined in 2010-11. It shows a growing trend after 2011-12.

HDFC BANK

HDFC Bank, founded in 1994, is the fifth largest asset bank in India. As of 24 February 2014 it was India's largest bank with market capitalization. HDFC was approximately USD 26.88B as of 2 Jan 2014, compared with USD 47.63B as a Credit Suisse Group. The Housing Development Finance Corporation, India's leading housing finance company (established in 1 977), promoted the bank. The bank's assets were INR 4,08 trillion as of 31 March 2013. The bank has shown net income of INR 69 billion for fiscal year 2012-13, up 31% from the previous fiscal year. On 31 March 2013, its client base reached 28.7 million customers.

Table -4: Key financial indicators of HDFC BANK

HDFCBANK	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013
Earnings per share	11.01	13.75	17.95	22.92	27.92	36.29	46.22	52.85	67.56	85.02	22.11	28.49
Return on Average Net worth	18.30 %	18.10 %	20.14 %	20.44 %	17.47 %	19.40 %	16.05 %	16.12 %	16.80 %	16.52 %	18.37 %	20.07 %
Tier 1 Capital Ratio	10.81 %	9.49 %	8.03 %	9.60 %	8.55 %	8.58 %	10.30 %	10.58 %	13.26 %	12.23 %	11.60 %	11.08 %
Total Capital Ratio	13.93 %	11.12 %	11.66 %	12.16 %	11.41 %	13.08 %	13.60 %	15.69 %	17.44 %	16.22 %	16.52 %	16.80 %
Dividend per share	2.50	3.00	3.50	4.50	5.50	7.00	8.50	10.00	12.00	16.50	4.30	5.50
Dividend payoutratio	23.68 %	24.72 %	22.15 %	24.00 %	22.55 %	22.92 %	22.17 %	22.17 %	21.72 %	22.72 %	22.70 %	22.77 %
Book value per share	69.00	79.60	94.52	145.86	169.24	201.42	324.39	344.31	470.12	545.46	127.52	152.20
Market price pershare	236.60	234.55	378.75	573.64	774.25	954.15	1,331.25	973.40	1,933.50	2,345.85	519.85	625.35
Price to Earnings Ratio	21.50	17.06	21.10	25.03	27.74	26.29	28.80	18.42	28.62	27.59	23.51	21.95

(SOURCE- BANK ANNUAL REPORT)

ANALYSIS AND INTERPRETATION

Based on ten years of data per share, the average net return per share is reflected in the trend up to the year 2010-11 but then in 2011-13 the rate was declining in terms of capital ratio, dividend per share, the book value per share and market prices per share. Centurion Bank of Punjab ltd. in 2008-09 may or may not be the reason for this

decline In the July-September quarter of FY 14, HDFC bank experienced net profit increase of 27 percent at Rs. 1,982 crore in the same quarter last year compared to Rs. 1,560 cros.The second largest private sector lender in the country broke its own record of posting net profit growth of 30 percent over 54 quarters consecutively. The marginal decrease was due to net interest income and margin lower than expected.

During the quarter, the net interest margin declined to 4.3per, from 4.4per. This was because of the close measures of liquidity taken in July by RBI. Net interest income grew by 15 per cent in the same quarter of last year at the rate of Rs. 4476,5 crore, out of Rs. 3882 crore. In Q2 FY '13, non-interest revenues increased by 25 per cent from Rs. 1,472 to Rs. 1,844 crore. Gross non-performing assets (NPAs) rose at 0.9per cent in the second quarter of last year to 1.1per cent of the total advances.. Net assets that did not perform were up from 0.2per cent by 0.3per cent.

Total annual advances were increased to Rs. 2.69 lakh crore by 16 per cent on June 30, 2013. The segment of retail lending grew 17per cent with wholesale lending increasing by 15per cent leading to retail: wholesale loan mix of 53:47. At 3.13 crore, total deposits were at Rs. 30 September 2013, up 14per cent over the 30 September 2012 period. Deposits from savings accounts grew 18per cent.

V. SUGGESTIONS

1. Banks can work towards a synergy-based merger plan by minimising technology costs.
2. Fusion or large sizes are also needed as a facilitator, but no guarantee of improved profitability.
3. The goal should be to improve capacity for risk management, corporate governance and business strategic planning.

VI. CONCLUSION

The study shows that companies could not improve their performance even after ten years of merger. The corresponding companies show a similar decline in performance. Thus, only a fusion is not responsible for the decline in the results of fusion companies. However, the potential for improved profitability is strong in future.

REFERENCES

[1] Ghosal, (2010). “Consolidation of Banks”, the Indian Banker, Vol. V, No.2, p.p. 28-35.
[2] Aloke Ghosh (2001), “Does operating performance really improve following corporate Acquisition?” Journal of corporate finance, Vol 7, pp .151-178.
[3] Ansari, Muhammd Sadiq (2007) “An Empirical Investigation of Cost Efficiency in the Banking Sector of Pakistan,” SBP Research Bulletin , 3(2)
[4] Denizer CA, Dine M, Tarimcilar M (2007), “Financial Liberalization and Banking Efficiency: Evidence from Turkey Analysis,” Journal of Productivity, 27: 177-195.
[5] Goyal, K. A. and Joshi, V. (2011). Mergers in Banking Industry of India: Some Emerging Issues. Asian Journal of Business and Management Sciences, 1(2), 157-165.

[6] Murthy, G. K. (2007). Some Cases of Bank Mergers in India: A Study. In Bose, J. (Ed.), Bank Mergers: The Indian Scenario. (244-259). Hyderabad: The ICFAI University Press.