International Journal of Innovations & Research Analysis (IJIRA)
ISSN : 2583-0295, Impact Factor: 5.449, Volume 02, No. 01, January - March, 2022, pp 61-65

IMPACT OF MERGERS AND ACQUISITION IN BANKING SECTOR

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ABSTRACT

Since 1990s, liberalization and financial sector reforms, which are the merchandise of globalization have resulted in bringing to the fore the problem of profitability and efficiency of the banks. The extraordinary competition among the banks and therefore the simultaneous decrease in the interest margin has created an immense pressure on the profitability of the banks. With entry of personal and foreign banks, deregulation of interest rates and a high level of competition, the business of the banks are not any longer confined thereto of merely accepting deposits and lending them at administered rates. In such a changed economic scenario as this, only those banks which are able to adopt appropriate cost control mechanism and customer oriented approach would be able to survive. This deregulated environment demand an increased use of recent risk management tools, exploration of avenues of enhancing the non-fund based income, control of the expenses and increased use of knowledge and communication technology to make sure viability and survival in an environment of intense competition. It's precisely during this context of a highly competitive business environment that mergers and acquisitions have assumed a particularly vital role as a crucial corporate strategic instrument for increasing the competitiveness of the banks. In recent times, the banks in India have adopted mergers and acquisitions (M&A) as a business restructuring strategy with the expectation to enjoy the efficiency gains brought in by such mechanism. The crucial role of M&As in shaping the restructuring strategy of the Indian industry in future is the main motivation for the current study. There are some studies conducted to look at the impact of bank mergers by employing either an accounting based or market based approach, with all having its own strengths and limitations.

Keywords: *Economic Scenario, Risk Management, Mergers, Acquisition, Efficiency, Strength.*

Introduction

The present globalised economy encourages mergers and acquisitions (M&As) of the company entities everywhere the planet to boost the competitive attitude of the enterprises by exploiting the economies of scale to extend their market share, expanding the investment portfolio to attenuate their business risk and also enter new markets and geographies. Though remaining small could also be beautiful during a poetic sense, becoming big carries sense from an economic standpoint. Increase in volume would harness the economies of scale and thus would cause increased cost effectiveness. Thus bigness for increased power is the underlying principle behind the company restructuring strategy of mergers and acquisitions. In this current scenario of emphasis on core competency, every organisation is struggling hard for survival and thus M&As are considered as a crucial mode of growth. This phenomenon has been gaining momentum in both developed and developing economies of the planet. The financial sector reforms initiated by the government of India in 1991 have led to a large transformation and structural change within the Indian economy. The company entities have taken recourse to the current restructuring strategy to unload their noncore units

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and to say significant presence in their main areas of business interest. M&As have thus resulted in being one in every of the foremost effective methods of the business restructuring process and also becoming an integral a part of the longer term business strategy of corporate India. Grant Thornton in 2006 conducted a survey to focus on the objectives of M & As of the Indian corporate and his findings suggest that majority of the units 4 had the first objective of levy or profitability behind their venture for M&As.

Objective of the Study

The specific objectives of this study are outlined in what follows:

- To discuss the theoretical underpinnings of M & As, especially within the context of the financial service sector,
- To discuss the recent trends within the M & As within the Indian banking sector,
- To judge the performance of the chosen commercial banks in India before and after merger, with the utilization of CAMEL ratio analysis approach,
- To find out the reaction of security prices to announcement of mergers/acquisitions decision of the chosen commercial banks in India using the quality Event Study methodology.

Review of Literature

Smith (1969) analysed the motivating factors for mergers between banks and recommended that banks merge with the intention to boost their size and hence their market power, vis-à-vis their competitors. His study failed to approve of the normal factors often cited for bank consolidation like management- succession problems, restrictive lending limits or the profit motive.

Berger and Humphrey (1994) investigated the impact of consolidation strategy on the European Banks. Their study recommended absence of great cost efficiency gains of merged European banks post-merger. The most motive for this is often that the larger banks that resorted to consolidation in Europe didn't enjoy lower average costs and experienced almost negligible scale and scope economies as they grew further. They also didn't realize how the X-efficiency improvement can help within the minimization of 20 overall costs.

Khavein et al. (1996) suggested that the rise in value creation of the banks post-merger in the course of improved profit efficiency is due to the diversified portfolios of the banks post-merger. They concluded that the merged banks experienced a statistically significant profit efficiency rank compared to the opposite banks. It absolutely was also found that the banks which showed the smallest amount efficiency scores in the pre-merger period experienced greater improvements within the post-merger period as they enjoyed excess capacity and scope for improvements. Transformation of the market power due to mergers was relatively very small and statistically not significant.

Pillof and Santomero (1996) made an endeavor to review the sources of import creation or value destruction in mergers and acquisitions strategy. in step with them, restructuring mechanism is profitable through reduction of expenses, enhancement of market power, reduction in the volatility of the earnings and increase of scale and scope economies while it may end up in value destruction through self-delusion of the managers of acquiring firms about the success of the deal or because of the look for the widening their own power base and compensation. But it failed to result in any concrete conclusion by them and they suggested that there's a requirement for further evaluation of bank mergers.

Girija (2003) analysed the impact of mergers on the efficiency of the banks in Sweden and located that post-merger banks enjoy substantial improvement within their efficiency in the variety of decreased operating costs, risk diversification and improved quality of management, but a substantial number of the merged banks didn't achieve realizing the efficiency gains due to the actual fact that the acquirers underestimated the post-acquisition challenges for example the task of integrating 22 systems, shutting down of branches, retraining staff then on and then forth. Also, the difficulties and also the cost related to the restructuring of various corporate cultures disturb the management of the new enterprise and causes disappointing results.

Prasad and Chari (2011) studied the performance of both Indian public and personal sector banks in financial terms. This study also includes a comparison of the financial performance of top four banks in India viz., Reserve Bank of India, Punjab National bank, ICICI Bank and HDFC Bank and located that HDFC Bank obtained the very best position on an overall basis. Reddy and Prasad (2011) made a study by adopting CAMEL Model to analyse the performance of regional rural banks in India.

Merger's & Acquisition's in the Indian Banking Sector

The Indian banking sector which plays a dominant role in the economic development of the country has been witnessing major changes in functioning in addition as approach. M&A's are considered to be a very important avenue of restructuring adopted by the banks to confirm a faster growth track. a number of the crucial reasons for this growing tendency of resorting to M&As in the financial service sector are as follows

- To harness the benefits of the massive scale economies
- To aid the event of the brand
- To increase the bank branch network with the target of ensuring its presence during a wide geographic region
- To minimise or eliminate, if possible, the negative impact of the nonperforming assets
- To realise the synergistic benefit created by the expert management and resolve the issues related to the upkeep of proper capital adequacy norms.

Since 1991, with the adoption of liberalization, privatization, marketization and increased competition within the wake of globalization in India, the banking system has been made an integral a part of the method of transformation and consolidation. Considering the requirement for the delicate technological changes and also to reinforce the efficiency of banks in India, Narasimaham Committee – II suggested mergers and acquisitions because the only feasible choice to restructure and strengthen the banks in the emerging scenario. Since then mergers and acquisitions have constituted a major strategy for the industry of our country and also the banks are making a shot to extend their sizes with a view to magnify their asset bases and thereby the profits. These attempts would help them to enhance their performance and match the worldwide benchmarks. While insisting the justification of mergers and acquisitions in the banking sector in India, the then Finance minister Mr. P Chidambaram often said that within the present emerging scenario the banks should try and think and act big in a very way since the scale of the banks are important together with efficiency and every bank should make a trial to convert itself into a giant powerhouse.

The M&A scenario of the Indian banking sector in the last decade has been quite significant with a minimum of one bank involved in the restructuring process each year. During this context, it's worth mentioning that HDFC, ICICI and SBI are the banks that appear to be highly interested on enjoying the gains of M&A friendly environment witnessed by the banking system. Also it's observed that before 1999, M&As were adopted only by the financially weaker banks. It absolutely was only during the second decade of the reforms that the Indian industry witnessed M&A even between the financially sound banks.

Rational of the Study

The present work is a trial to review and analyze the trends of mergers and acquisitions (M&As) within the Indian banking sector and also to judge the efficiency of M&As in this sector. The financial service sector normally and therefore the industry specifically in many developing countries have undergone fundamental changes not to mention a big change in approach, with the target of achieving an efficient functioning of the system. One important aspect of this financial service sector reform is that the entry of recent private sector banks, which incorporates foreign banks and also the adoption of a more liberal attitude towards these foreign banks. It's generally observed that these banks hold out a better level of productivity due to their sophisticated technology and efficient human resource planning, which enable them to boost their total banking business per unit of capital. This can be markedly reflected in their competitive edge over their Indian counterparts.

Hypothesis for Study

$H_0$1: There is no Significant Impact of Merger's and Acquisition on the efficiency of the Banks.

$H_0$2: The Technical efficiency of the acquiring banks has not improved in the post-merger scenario.

Research Methodology

Different techniques are being employed by the researchers to analyse and evaluate the success of mergers and acquisitions, as a major corporate restructuring strategy. One important method applied by the financial economist is the accounting based study, which is additionally named because the operating performance based study, that's concerned with examining the changes over time (usually one to 5 years) with relevance the critical performance indicators like earnings, cash flow, margins or productivity. A crucial assumption that's being made in these studies is that the complete change is the outcome of mergers and acquisitions only and no other factors have made any contribution to the identical. Hence, the sole pertinent question raised by of these mergers related studies is that, whether the acquired organization shows an improvement in its performance after merger or not. The current study have adopted the CAMEL Model parameters i.e. Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality, Liquidity for evaluating the performance of the banks pre and post-merger.

Results and Analysis

The commercial banks throughout the globe have adopted mergers and acquisitions (M&As) as a company restructuring strategy under the cherished hope that it'll increase the efficiency of the banks through an enormous consolidation programme. It's assumed that several strategic advantages like cost efficiency, wealth maximization of the stakeholders and similar other benefits of economies of scale would result from the restructuring mechanism adopted. It's been observed in the recent past that the worldwide financial meltdown which was the immediate outcome of the subprime crisis has resulted in a very greater emphasis on the aspect of efficiency of the commercial banks. The subsequent table represents the pre and post- merger impact.

S. No.	Name of the Bank	Year of Merger	Pre-Merger Technical Efficiency	Post-Merger Technical Efficiency
1	**ICICI Bank**	2001	0.761	0.993
	Bank of Madura		0.581	
2	**Bank of Baroda**	2002	O.598	0.401
	Benares State Bank		0.493	
3	**Punjab National Bank**	2003	0.811	0.383
	Nedungadi Bank		0.798	
4	**Oriental Bank of Commerce**	2004	0.751	0.505
	Global Trust Bank		0.801	
5	**Bank of Punjab**	2005	0.897	0.632
	Centurion Bank		0.811	
6	**IDBI Bank**	2006	0.819	1.000
	United Western Bank		0.481	
7	**Federal Bank**	2006	0.451	0.658
	Ganesh Bank of Kurundwad		0.444	
8	**Centurion Bank of Punjab**	2006	0.651	0.681
	Lord Krishna Bank		0.491	
9	**ICICI Bank**	2007	0.819	1.003
	Sangli Bank		0.221	
10	**Indian Overseas Bank**	2007	0.393	0.761
	Bharat Overseas Bank		0.398	
11	**HDFC Bank**	2008	0.606	0.778
	Centurion Bank of Punjab		0.453	
12	**ICICI Bank**	2010	0.906	1.001
	Bank of Rajasthan		0.515	

From the above table it had been observed that out of the 12 bank M&A cases, in 8 cases there was an improvement within the technical efficiency score post restructuring exercise. A thorough study indicates that out of the 4 banks which didn't show a rise in their post M&A TE (TECHNICAL EFFCIENCY) score were before the year 2006. From this it should be inferred that in the later a part of the last decade, the banks had exhibited increased efficiency in their try to mobilize their deposits into loans advances. it's also revealed from the above table that out of the 4 unsuccessful M&As were the instances of the private sector banks being acquired by the public sector banks, which suggest that as their exist difference in the operational and cultural environment between these two groups, it would end in a negative impact on the post-merger performance of the PSBs. Further, it's also observed that in 9 of the 12 cases, the acquiring banks showed better technical efficiency than that of the acquired banks.

Conclusion

The banking system in India has undergone a motivating transformation and upgradation in the context of sophistication and advancement in technology, product innovation and sevice mix, customer satisfaction and then on, with the aim of tax together with cost optimization. The expectations of present day customers in reference to the banking services have also increased. With the entry of personal and foreign banks in the Indian banking sector, the competition has become severe and therefore the customers became the point of interest in the deciding process of the banks. Importance is now being given in designing the banking products and services in tune with the expectations of the shoppers. In the present era of globalization, banks will should be financially viable and competitive to beat these challenges. There has been a gradual shift in the revenue generation mechanism of the banks from traditional sources like loan creation to non traditional sources like fee based income, service charges and non-interest incomes. Also the recommendations of the Narasimham committee on the banking sector reforms compelled many banks to adopt consolidation exercise with the intention of improving their efficiency, profitability and competitive strength. Further, the policy initiatives introduced by the government of India in the recent years also focused on deregulation and encouraged mergers with the target of enhancing the profitability and financial strength of the Indian banks so they're ready to compete globally. It's for this reason that the industry in India embarked upon restructuring mechanism and it's expected to continue in the future and therefore the 3Cs, i.e. competition, convergence and consolidation are going to be the key words in the industry in the days to return.

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