International Journal of Advanced Research in Commerce, Management &Social Science (IJARCMSS)
ISSN :2581-7930, Impact Factor : 6.809, Volume 06, No. 03(I), July-September, 2023, pp 21-27

EFFECT OF MERGERS AND ACQUISITIONS ON FINANCIAL PERFORMANCE OF BANKS WITH SPECIAL REFERENCE TO CANARA BANK

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ABSTRACT

The study intends to explore the motivation behind the Merger and Acquisitions in the Indian banking sector. It compares and examines the pre and post merger financial performance of merged bank using financial parameters like Return on Capital Employed (ROCE), Net- Profit Margin, Gross-Profit Margin, Return on Equity (ROE), Operating Profit Margin and Debt-Equity Ratio. The study is conducted on Canara bank and the financial reports are collected for a set of various financial parameters. This study examines the changes occurring in the Canara Bank on the basis of financial ground and also the overall impact of Merger and acquisitions (M&As) on Canara bank. The Researcher used paired t-test for testing the statistical significance and this test is applied not only for the ratio analysis but also to test the effect of Merger and Acquisitions on the performance of banks. The performance is being tested considering before and after effects i.e. Pre- merger and Post- merger. The evidence indicates that the bank has been positively affected by the event of M&As but no strong statistical evidence is seen. However, the merged bank can gain and obtain efficiency through this restructuring and pass the benefits to their equity shareholders.

***KEYWORDS**: Merger & Acquisitions, Banking, Financial performance, Efficiency.*

Introduction

Mergers and Acquisitions ("**M&A**") is one of the most effective way to expedite the process of implementation of a business plan in order to grow rapidly. Due to M&A strategy, majority of the sectors and companies under them such as telecommunication, automobile, food and beverages, pharmaceutical and others have grown at lightning speed. M&A refers to transactions between two companies combining for better prospects. An acquisition is where a larger company acquires a smaller company, thereby absorbing the business of the smaller company. On the other hand, a merger describes two firms, of usually the same size, that combines to become a single new entity, rather than remain separately owned and operated.

In India, usually the government agencies and the financial institutions arrange for the M&A within the regulatory framework of M&A transactions. However, as years passed, Indian industries have been increasingly exposed to both domestic and international competition. The competitiveness has become the real need for survival. Due to increased competition among the companies in both the domestic and international markets, majority of the firms in India have opted for M&A transactions in order to grow in today's market. M&A has shown to be a comprehensive means for expanding portfolios, gaining knowledge, , entering new markets, expanding access to research and development and also to gain access to the assets that allow a firm to operate on a worldwide scale.

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The main motive for M&A is to create synergies in which the combined company is worth more than two individual companies. Synergies can be cost reduction or higher revenues. Cost synergies are created due to economies of scale, while revenue synergies are typically created by cross-selling, increasing market share, or higher prices. Among the two, cost synergies are easily quantifiable and calculated.

M&A enables a company to achieve better revenues and attain faster growth inorganically when compared to organic growth. It means merging with or acquiring another company leads to faster growth than saving itself from the cost and risk to develop internally.

M&A help companies in diversifying the company's risk by having more than one revenue streams and also leads to tax benefits if the target company is in a strategic industry or a country with a favourable tax regime. Further, acquiring a company with net tax losses enables the acquiring company to use the tax losses to lower its tax liability. The firm's earnings outcomes, their stock price over time, the company new sales opportunities and new areas to explore are the enhanced with the M &A strategy.

Though M&A are pursued globally by large number of firms, many a times management decisions go wrong in terms of valuation, choice of industry, mode of financing, regulatory compliances, issues involving stakeholders, expected returns and risks, etc. Despite several challenges and issues, firms look to use M&A as a key strategy for business growth. In certain cases, there has been less than expected short and long term performances, whereas in other cases, M&A have proved very fruitful for the acquirer companies. Even so, there have been win-win situations for both acquirers and target companies.

Canara Bank is a public sector bank of India based in Bangalore. It was established in 1906 at Mangalore by Ammembal Subba Rao Pai. It was nationalized in 1969. Outside India, it has offices in London, Dubai and New York. In 2020, Syndicate Bank was merged with Canara Bank to become the fourth largest public sector bank in the country with total business of ₹15.20 lakh crore (US$190 billion) with 10,324 branches. The merger was completed on 1st April 2020 with Syndicate Bank shareholders receiving 158 equity shares in the former for every 1,000 shares they hold. The study has taken Canara bank as the sample for research to examine the impact of merger on banks.

There are many firms which pursue of M&A for attaining related or unrelated diversification. Earlier, we used to find only firms from developed countries engaging in it. But recently, several firms from developing countries have started pursuing M&A deals. It forces us to think and ponder whether M&A will be beneficial. This study seeks to deal with the cause and effect of such M&A deals by an Indian Public Sector Bank. The research focuses on the performance analysis on the effect of a M&A deal on the financial performance of an Indian acquiring company. The long term performance is assessed by analysing different ratios during the pre- and post-acquisition periods.

Review of Literature

Mergers & Acquisitions are considered as inorganic growth strategy for a firm, much research has been done in developed as well as developing economies. In developed economies, the studies are diverse starting from research by Kogut and Singh (1988), acquisition having certain determinants is a means to go global (Bhagat et al. (2002), Bhagat and Bolton (2019) .On the other hand, studies by Gubbi et al., 2010, Contractor et al. (2014), Chittoor (2009) which was conducted for developing economies concluded that the strategic asset seeking is the major motive of Mergers & Acquisitions, though there are other reasons also for going global. Pandya and Sisombat(2017) stated that M & A fastens firms to realize gains of market share and decrease in cost which leads to improvement after merger, Pandya and Sisombat (2017). Pandya (2018) also confirmed that after 1990s, the mergers and acquisition activities have increased in India but the non-manufacturing sector role in mergers and acquisitions have decreased. According to UNCTAD and IMAA, the number of M & A deals in India has increased as well as value of M & A has also increased to a significant extent. According to Dhingra and Kapil (2019), studied motives behind merger and found that resource and asset seeking was the reason for tech based firms to merge. Also FMCG for resource and market entry, Pharma Sector and Healthcare sector by resource, market and strategic asset motive, Banking or Finance Sector for Institutional Theory and resource seeking. Their study in 2020 concluded Indian firms have succeeded after their merger with foreign firms thereby creating value and synergistic benefits for both the firms.

In India, Srivassan et al., (2009) examined the financial implications and problems occurring in M&As and discussed the synergy based merger and found that maximum profit is not promised post

merger for most of the firms and emphasized that for sustainability, there is always the risk of improving performance. Bhan,A (2011) has made an attempt to study the insight into the motives and benefits of the mergers in Indian banking sector by examining the eight merger deals of the banks in India during the period of reforms from 1999 to 2006 . Through the empirical methods by applying t-test and EVA value calculations the potential of the mergers has been evaluate to study the efficiencies or benefits achieved due to the merger and concluded that the mergers in the banking sector in the post reform period possessed considerable gains which was justified by the EVA of the banks in the post merger period. Shobhana and Deepa (2011) made a probe into the fulfilment of motives as vowed in the merger deals of the nine select merged banks. The study uses both parametric and non parametric tests for analysis for five years pre and post merger. The result indicates that there has been only partial fulfilment of the motives. Duksait and Rima Tamosiunien (2009) assessed the motives for mergers and found synergy, growth, access to intangible assets and diversification which serve as means of reshaping competitive advantage within their respective industries. Dewan,A., (2007) focused on the financial performance of the acquirer companies post merger in Indian industry. The merger cases for the year 2003 are analysed using the financial data for six years from 2000-06. The financial ratios have been examined using paired sample t test and results of the pre and post merger analysis revealed that there is significant difference between the financial performance of the companies before and after the merger..

It is seen that, most of the study have been done on trends, policies and their framework whereas analysis of profitability and managerial efficiency of the mergers have not given due importance. The present study would go to investigate the detail of Merger and Acquisitions (M&As) with greater focus on the Indian banking sector in post and pre merger. The study will discuss the pre and the post merger performance of Canara bank in particular and evaluate its performance.

Research Methodology

Objectives of the Study

The primary objective of the study is to analyse whether M&A deals have resulted in to positive improvement in financial performance of such acquirer Canara Bank in India. It becomes significant to check whether the M&A is the most preferred strategy to explore the opportunities for growth and expansion of business.

Data and Methodology

The study is undertaken to assess the effect of mergers and acquisitions on a long term basis. The financial and accounting data of banks is collected from the Annual Reports to examine the impact of M&As on the performance of Canara bank. The financial performance of the acquiring bank is evaluated by considering Its Liquidity, Profitability, Long-Term Solvency and Management Efficiency position ratios.

Pre merger two different banks were carrying out the operations and other business activities in the market and after the merger the bidder bank carries out the business of both the banks. Keeping in view the purpose & objectives of the study, paired t- test is being used as a statistical tool for this study. The year of merger is considered as a base year and denoted as 0 and it is excluded from the evaluation. For the pre merger (3 years before) , the combined financial ratios of both banks are considered and for the post merger (after 3 years) the ratios of acquiring bank is used for the study. For analysis, The year of deal being 2019-20. Three years preceding- Pre M&A deal period (2016-17,2017-18 and 2018-19 whereas, Post Merger period (2020-21,2021-22 and 2022-23) for the purpose of this study.

Long-term performance of a firm before and after an event is measured by the change in financial performance. Financial Performance of the acquiring firm is evaluated by considering their Liquidity, Profitability, Long-term solvency and Management efficiency position ratios. The following table provides the list of ratios taken into consideration to evaluate the financial performance of the selected firms for the study. Long-term performance of a firm before and after an event is measured by the change in financial performance. Financial Performance of the acquiring firm is evaluated by considering their Liquidity, Profitability, Long-term solvency and Management efficiency position.

Research Hypotheses

Testing the significance difference between Pre and Post merger Financial Performance ratios

H_0 (Null Hypothesis): There is no significance difference between the pre and post merger Financial Performance ratios.

H_1 (Alternative Hypothesis): There is significance difference between the pre and post merger Financial Performance ratios.

Results & Discussions

- **Liquidity Ratios**

The first set of financial parameters to be analysed are the current ratio and quick ratio. These financial parameters help us know if there is any improvement in the liquidity measure of this acquiring firm during the post- acquisition period when compared to the pre- acquisition period. The data for three years before and after the acquisition year are collected from annual reports of the bank. A paired – sample t-test is conducted to find if there is any difference in the liquidity position of this acquiring firm after the acquisition.

Table 1: showing Paired two sample t-test for Current Ratio and Quick –Ratio

Financial Parameter	Mean Value	t-value	Significance (Two-Tailed)
Current Ratio (Post)	6.87		
Current Ratio(Pre)	5.29	-1.38	0.30
Quick Ratio (Post)	5.26050188		
Quick Ratio(Pre)	3.405619	-1.88	0.199

Source: Authors own calculation based on Annual reports
* represents significance at 10% level
** represents significance at 5% level

From the table 1, it can be seen that there is an improvement in the current ratio for a three-year period after acquisition when compared to the three- year pre-acquisition period. The mean difference is 1.58 with a t-value of -1.88, which is not statistically significant.

Thus, it can be concluded that there has been no significant improvement in the firm's current ratio from the pre-acquisition period. Similarly, in the case of the Quick ratio (revealing firm's short term liquidity position), the mean value for the post- acquisition period is 5.26 as compared to 3.40 in the pre-acquisition period. Quick ration deals with firm's ability to honour its short-term liabilities with the help of its most liquid assets. As a result of rise in current assets in comparison with change in current liabilities post M&A deal, there has been improvement in the ratio. However the null hypothesis is accepted in both the cases and said that there is no significant improvement in liquidity ratios. However the firm has become more liquid and it has generated cash more quickly.

Overall, it can be concluded that the Liquidity position of the firm has improved after the acquisition, as there is an improvement in the average current ratio and average quick ratio for a three-year post- acquisition period when compared to the pre- acquisition period.

- **Management Efficiency Ratios**

The next set of financial parameters is related to Management efficiency. The ratios analysed are the Debtor turnover ratio, Fixed asset turnover ratio and Total asset turnover ratio. These financial parameters measure the management efficiency and are hence analysed to know whether there is an improvement in the efficiency ratios of the firm during the post- acquisition period of three years when compared to the pre-acquisition period of three years.

Table 2: Showing Paired Two Sample t-test for Debtors Turnover Ratio, Fixed Assets Turnover Ratio and Total Assets Turnover Ratio

Financial Parameter	Mean Value	t-value	Significance (Two-Tailed)
Fixed Assets turnover ratio(Post)	0.085505		
Fixed Assets turnover ratio(Pre)	0.08868	1.518478	1.518478
Total Assets turnover ratio(Post)	0.072021		
Total Assets turnover ratio(Pre)	0.084891	8.578667	0.013317**

Source: Authors own calculation based on Annual reports
** represents significance at 5% level

From the above table, there is a decrease in the Total Asset turnover ratio. The mean difference is -0.012.The t value is 8.578 with a p value (two tails) of 0.0133, which is statistically significant at 5% level. Thus, we can say that there is a significant difference in the pre- and post total asset turnover ratio.

The same holds true in the case of the Fixed Assets turnover ratio, where the mean difference of -0.012, which is statistically insignificant and hence it can be said that there is no significant difference in the pre- and post fixed assets turnover ratio.

- **Long Term Solvency Ratios:**

The long term solvency position is analysed by taking into consideration the debt-equity ratio which will give the relative proportion of shareholders' equity and debt used to finance company's assets.

Table 3: Showing Paired Two Sample t-test for Debt-Equity Ratio

Financial Parameter	Mean Value	t-value	Significance (two-Tailed)
Debt-equity ratio Ratio (Post)	19.77934		
Debt-equity ratio (Pre)	19.93247	-0.10708	0.924496

Source: Authors own calculation based on Annual reports
* represents significance at 5% level

The results of the long-term solvency position of the company are measured for a period of three years before and three years after the acquisition year. It can be observed that the debt- equity ratio has reduced for the post-acquisition period. This shows that the long-term debt capital has reduced during the post-acquisition period. However, the results are not statistically significant. Thus, it can be said that there is no significant difference in the debt-to-equity ratio before and after the acquisition. It was highest during 2019-20 for which the reason could be the use of debt to finance this acquisition.

- **Profitability Ratios**

The ratios analysed here are Net Profit Margin ratio, Profit Before Interest and Tax margin, Cash Profit margin, Return on Capital employed, Return on Net worth, Return on Assets and EPS. The results are depicted in the following table.

Table 4: Showing Paired Two sample t-test for Net Profit Margin ratio, Cash Profit margin, Return on Capital Employed, Return on Net Worth, Return on Assets and EPS.

Financial Parameter	Mean Value	t-value	Significance (Two-Tailed)
Net Profit Margin ratio(Post)	8.143333		
Net Profit Margin ratio(Pre)	-2.26	2.047408	0.177202
Cash Profit margin(Post)	-14.54		
Cash Profit margin (Pre)	-18.6333	0.988718885	0.427016387
Return on Capital employed(Post)	1.936667		
Return on Capital employed(Pre)	1.57	3.779645	0.063414*
Return on Net Worth(Post)	-3.13		
Return on Net Worth(Pre)	10.31	1.989515	0.184938
Return on Assets (Post)	0.486667		
Return on Assets (Pre)	-0.15	1.961581	0.188834
Basic EPS(Post)	35.95		
Basic EPS(Pre)	-15.043	1.654206	0.239909

Source: Authors own calculation based on Annual reports
* represents significance at 10% level

Net-profit margin assesses how much net income or profit is generated as a percentage of revenue. The net profit margin has increased by 10.4% in the post- in the acquisition period of three years for the company, which indicates that there is an improvement in the overall profitability position of the company. The efforts by the company to cut costs and increase in the revenue was also witnessed. The profitability ratios have shown a increase but a significant improvement is seen only in Return on capital employed. The performance of the company has declined during the post-acquisition period. Though increase in revenue recorded, there is increase in expenses due to unforeseen rise in inflation.

Even though we can see that there is an increase in the net profit margin, which is a measure of operating performance, the significant improvement is not seen after the merger. Therefore, the increase in net profit margin can be attributed to an increase in non- operating incomes as dividend earnings and profits have resulted in increased earnings. This included gains from foreign exchange as dollar strengthened against rupee.

- **Cash Profit Margins**

Cash Profit ratio that measures cash from operating activities as a percentage of total sales revenue in a given period. The cash profit margin is a good indicator of earnings quality, has slightly improved during the post-acquisition period, indicating improvement in the firm's ability to convert sales into cash. However, these results are statistically insignificant, concluding that there is no significant difference in the pre- and post-acquisition ratios of Net Profit margin and cash profit margin.

Return on Capital Employed (ROCE) is a better indicator of the efficient utilization of capital, provided by both equity and long-term debt. A higher ROCE is considered to be better for a company. The ROCE for the said company has slightly increased by 0.36%. Return on capital employed is a financial ratio that measures a company's profitability in terms of all of its capital. It is statistically significant at 10% level which means there is significant improvement in return on capital employed.

The Return on Net worth (RONW) represents the profits generated based on the strength of its shareholders' equity. RONW has improved at around 10% after the acquisition, indicating the firm's ability to generate profits from its shareholders' equity. It reveals how much profit a company generates with the money that the equity shareholders have invested. Return on Net Worth (RONW) is used in finance as a measure of a company's profitability.

Basic EPS has increased which means there is an increase in earnings per share. However, these results are not statistically significant. Hence, it can be concluded that there is no significant difference in the pre- and post- acquisition ratios of ROCE, ROA and basic EPS.

Since most of the ratios have increased but have not shown any significant difference, it can be concluded that there is no significant improvement in the post merger financial performance of Canara Bank.

Conclusion

The financial parameters of the bank performance have improved after the merger but have found no much change in some of the parameters. It may be because the improvement in post performance may be found in later years. The ratios does not give better picture because we compared only three years financial ratios, it may be possible that profit and efficiency will be seen in future. The size may increase but the profitability will not increase or not may not be guaranteed after merger. The success of merger is dependent upon synergy gains created after the merger and overall performance of bank, the financial performance of the Canara Bank have been improved after the merger and was affected positively in terms of Net Profit Margin , Return on Equity , Return on Capital Employed and Debt Equity Ratio. However, statistically most of the ratios have not shown significant relationship. However, it serves as a tool to grow, expand and for global recognition in the Indian Banking sector.

This study shows the impact of M&As in the Indian banking sector and examined whether the Canara Bank merger led to a profitable situation or not. The results suggest that after the merger, the efficiency and performance of banks have increased. Further research could be to study more banks and a comparative analysis taking into consideration concerning a longer time period for the study which will give better results.

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