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MERGERS AND ACQUISITIONS PROSPECTS: INDIAN BANKS STUDY

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Abstract: **This research paper looks at Mergers and Acquisitions (M&A's) that have happened in Indian banking sector to understand the resulting synergies and the long term implications of the merger. The paper also analyses emerging future trends and recommends steps that banks should consider for future. The paper reviews the trends in M&A's in Indian banking and then impact of M&A's has been studied in three leading banks of India. The study covers the area of performance evaluation of M&A's in Indian banking sector during the period from 2000 to 2013. The paper compares pre and post merger financial performance of merged banks with the help of financial parameters like, Net Profit margin, operating Profit margin, Return on Capital Employed, Return on Equity, earnings per share, capital adequacy ratio, dividend per share etc. The findings suggest that to some extent M&A's has been successful in Indian banking sector. The Government and Policy makers should not promote merger between strong and distressed banks as a way to promote the interest of the depositors of distressed banks, as it will have adverse effect upon the asset quality of the stronger banks.**

Keywords: **Strategic alliance, Capital adequacy, Mergers, Consolidation, Ratios.**

I. INTRODUCTION

In today's global marketplace, banking organizations have greatly expanded the scope and complexity of their activities and face an ever changing and increasingly complex regulatory environment. It has been realized globally that M&A is only way for gaining competitive advantage domestically and internationally and as such the whole range of industries are looking for strategic acquisitions within India and abroad. Today, the banking industry is counted among the rapidly growing industries in India. In the last two decades, there has been paradigm shift in banking industries. A relatively new dimension in the Indian banking industry is accelerated through M&A. In order to attain the economies of scale and also to combat the unhealthy competition Consolidation of Indian banking sector through M&A's on commercial considerations and business strategies are the essential pre-requisite. Consolidation has been a significant strategic tool and has become a worldwide phenomenon, driven by advantages of scale-economies, geographical diversification, and lower costs through branch and staff rationalization, cross-border expansion and market share concentration. The new Basel II norms have also led banks to consider M&As.

II. RESEARCH METHODOLOGY

Objectives:

1. To study the trends of M&A's in Indian banking sector.

2. To study the performance of the banks in the pre and post M & A.

Sample Selection:

The study analyses three major Banks undergone Mergers and acquisition. These are –

1. ICICI BANK

2. STATE BANK OF INDIA

3. HDFC

Sources of Data

The secondary data is collected for the study. The required data for the study were collected and compiled from the CMIE data base and the annual reports of the banks. The study covers a period from 2000-2013. In addition, the other required data were collected from various journals and magazines.

Limitation

1. The study ignores the impact of possible differences in the accounting methods adopted by different companies.

2. The factors which effect the M & A performance may not be same for all companies.

3. The cost of acquisition for mergers is not considered in the methodology.

Literature Review

Merger of two weaker banks or merger of one healthy Bank with one weak bank can be treated as the faster and less costly way to improve profitability then spurring internal growth (Franz, H. Khan 2007). Mergers also help in the diversification of the products, which help to reduce the risk. Anand Manoj & Singh Jagandeep (2008) studied the impact of merger announcements of five banks in the Indian Banking Sector these mergers were the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank, the ICICI Ltd with the ICICI Bank, the Global Trust Bank merged with the Oriental Bank of commerce and the Bank of Punjab merged with the centurion Bank. Mehta Jay & Kakani Ram Kumar (2006) stated that there were multiple reasons for M&A's in the Indian Banking Sector and its simply because of the strict control regulations had led to a wave of M&A's in the Banking industry and states many reason for merger in the Indian Banking sector. Kuriakose Sony et al., (2009), focused on the valuation practices and adequacy of swap ratio fixed in voluntary amalgamation in the Indian Banking Sector and used swap ratio for valuation of banks, but in most of the cases the final swap ratio is not justified to their financials. Kuriakose Sony & Gireesh Kumar G. S (2010) in their paper, assessed the strategic and financial similarities of merged Banks, and relevant financial variables of respective Banks were considered to assess their relatedness. The result of the study found that only private sector banks are in favour of the voluntary merger wave in the Indian Banking Sector.

III. IMPACTS OF MERGER & ACQUISITIONS

1. Growth: Companies that desire rapid growth in size or market share or diversification in the range of their products may find that a merger can be used to fulfill the objective instead of going through the time consuming process of internal growth or diversification. The firm may achieve the same objective in a short period of time by merging with an existing firm.

2. Synergy: The merged entity has better ability in terms of both revenue enhancement and cost reduction. Mergers and Acquisition allows firms to obtain efficiency gains through cost reductions(cost synergies) & revenue increases(revenue synergies).

3. Purchase Of Assets At Bargain Prices: M&A'S have the opportunity to acquire assets, particularly land mineral rights, plant and equipment, at lower cost than would be incurred if they were purchased or constructed at the current market prices.

4. Enhanced Managerial Skills: Occasionally a firm with good potential finds it unable to develop fully because of deficiencies in certain areas of management or an absence of needed product or production technology. If the firm cannot hire the management or the technology it needs, it might combine with a compatible firm that has needed managerial, personnel or technical expertise.

5. Acquiring New Technology: To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

6. Broader Array Of Products: When two firms merge they have diversified variety of products and after the merger each consumer in both the firms will be benefited with the range of products or services to choose from M&A's helps firms to widen its consumer portfolio but it also leads to a more diversified range of services .

7. Income Tax Advantages: In some cases, income tax consideration may provide the financial synergy motivating a merger. Tax concessions act as a catalyst for a strong bank to acquire distressed banks that have accumulated losses and unclaimed depreciation benefits in their books.

8. Own Developmental Plans: The purpose of acquisition is backed by the acquirer companies own developmental plans. A company thinks in terms of acquiring the other company only when it has arrived at its own development plan to expand its operation having examined its own internal strength. It has to aim at suitable combination where it could have opportunities to supplement its funds by issuance of securities; secure additional financial facilities eliminate competition and strengthen its market position.

9. Strategic Purpose: The Acquirer Company view the merger to achieve strategic objectives through alternative type of combinations which may be horizontal, vertical, product expansion, market extensional or other specified unrelated objectives depending upon the corporate strategies.

10. Corporate Friendliness: Although it is rare but it is true that business houses exhibit degrees of cooperative spirit despite competitiveness in providing rescues to each other from hostile takeovers and cultivate situations of collaborations sharing goodwill of each other to achieve performance heights through business combinations.

IV. MERGER AND ACQUISITION IN INDIAN BANKING – PRESENT SCENARIO

In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's banking growth story. The first banks were Bank of Hindustan (1770-1829) and The General Bank of India, established 1786 and since defunct. The largest bank, and the oldest still in existence, is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955. The Government of India issued an ordinance and nationalised the 14 largest commercial banks in 1969. These banks have 85 per cent of bank deposits in the country. A second round of nationalisation of 6 more commercial banks took place in 1980. Nationalisation took place so that government get more control of credit delivery. With the second round of nationalisation, 91% of banking business was held by the Government of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank.

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

Phase I (1786- 1969) - Initial phase of banking in India when many small banks were set up

Phase II (1969- 1991) - Nationalisation, regularisation and growth

Phase III (1991 onwards) - Liberalisation and its aftermath

Reasons for Bank Merger

1) Merger of weak banks: Practice of merger of weak banks with strong banks was going on in order to provide stability to weak banks but Narsimhan committee opposed this practice. Mergers can diversify risk management.

2) Increase market competition: Innovation of new financial products and consolidation of regional financial system are the reasons for merger. Markets developed and became more competitive and because of this market share of all individual firm reduced so mergers and acquisition started.

3) Economies of scale: Capability of generating economies of scale when firms are merged.

4) Skill & Talent: Transfer of skill takes place between two organisation takes place which helps them to improve and become more competitive.

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5) Technology, New services and Products: Introduction of e- banking and some financial instruments / Derivatives. Removal of entry barrier opened the gate for new banks with high technology and old banks can't compete with them so they decide to merge.

6) Positive Synergies: When two firms merge their sole motive are to create a positive effect which is higher than the combined effect of two individual firms working alone. Two aspects of it are cost synergy and revenue synergy.

Few other reasons

• Sick banks survived after merger & Enhanced branch network geographically.

• Larger customer base (rural reach)& Increased market share.

• Attainment of infrastructure & restrict competition and prevent overcrowding of banks & utilize under and unutilized resources so that the banks can compete the foreign banks in global era.

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 Bank td.	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	ICICI Limited	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 Area bank	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 Report on Trend and Progress of Banking in India, RBI, various issues.

ICICI BANK

ICICI Bank was originally promoted in 1994 by ICICI Limited, an Indian financial institution, and was its wholly-owned subsidiary. ICICI's shareholding in ICICI Bank was reduced to 46% through a public offering of shares in India in fiscal 1998, an equity offering in the form of ADRs listed on the NYSE in fiscal 2000, ICICI Bank's acquisition of Bank of Madura Limited in an all-stock amalgamation in fiscal 2001, and secondary market sales by ICICI to institutional investors in fiscal 2001 and fiscal 2002. ICICI was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian industry. The principal objective was to create a development financial institution for providing medium-term and long-term project financing to Indian businesses. In the 1990s, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group offering a wide variety of products and services, both directly and through a number of subsidiaries and affiliates like ICICI Bank.

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In 1999, ICICI become the first Indian company and the first bank or financial institution from non-Japan Asia to be listed on the NYSE.

Table -2: Key financial indicators of ICICI BANK

(In billion except per share data)

ICICI BANK	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Net interest 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 had undergone M&A four times and is now one of the leading bank in India with increasing financial status.Net interest income ,earnings per share, total assets ,equity capital & reserves, total capital adequacy ratio ,profits after tax are showing a continuous increasing trend throughout ten years. Deposits reduced marginally from year 2009-2011 but again increased in 2013.similarly advances also showed declining trend for year 2009-2011,but again increased in year 2013. Performance Review – Quarter ended March 31, 2014

Consolidated profit after tax crosses the ₹ 10,000 crore milestone

18% year-on-year increase in standalone profit after tax to ₹ 9,810 crore (US$ 1.6 billion) for the year ended March 31, 2014 (FY2014) from ₹ 8,325 crore (US$ 1.4 billion) for the year ended March 31, 2013 (FY2013)

15% year-on-year increase in standalone profit after tax to ₹ 2,652 crore (US$ 443 million) for the quarter ended March 31, 2014 (Q4-2014) from ₹ 2,304 crore (US$ 385 million) for the quarter ended March 31, 2013 (Q4-2013)

15% year-on-year increase in consolidated profit after tax to ₹ 11,041 crore (US$ 1.8 billion) for FY2014 from ₹ 9,604 crore (US$ 1.6 billion) for FY2013

Operating profit increased by 24% to ₹ 4,454 crore (US$ 743 million) for Q4-2014 from ₹ 3,605 crore (US$ 602 million) for Q4-2013

23% year-on-year increase in retail advances at March 31, 2014

Current and savings account (CASA) ratio at 42.9% at March 31, 2014; year-on-year growth of 16% in CASA deposits

Net interest margin improved to 3.33% in FY2014 compared to 3.11% in FY2013; Q4-2014 NIM at 3.35%

Total capital adequacy of 17.70% and Tier-1 capital adequacy of 12.78% as per Reserve Bank of India's guidelines on Basel III norms

STATE BANK OF INDIA

The roots of the State Bank of India lie in the first decade of the 19th century, when the Bank of Calcutta, later renamed the Bank of Bengal, was established on 2 June 1806. The Bank of Bengal was one of three Presidency banks, the other two being the Bank of Bombay (incorporated on 15 April 1840) and the Bank of Madras(incorporated on 1 July 1843). All three Presidency banks were incorporated as joint stock companies and were the result of royal charters. These three banks received the exclusive right to issue paper currency till 1861 when, with the Paper Currency Act, the right was taken over by the Government of India. The Presidency banks amalgamated on 27 January 1921, and the re-organised banking entity took as its name Imperial Bank of India. The Imperial Bank of India remained a joint stock company but without Government participation. Pursuant to the provisions of the State Bank of India Act of 1955, the Reserve Bank of India, which is India's central bank, acquired a controlling interest in the Imperial Bank of India. On 1 July 1955, the Imperial Bank of India became the State Bank of India.

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	2013-14
Net Interest income	13,945	15,589	15,058	17,021	20,873	23,671	32,526	43,291	44,329	49,282
Net Profit	4,305	4,407	4,541	6,729	9,121	9,166	8,265	11,707	14,105	10,891
Return on Average Assets	0.99	0.89	0.84	1.01	1.04	0.88	0.71	0.88	0.97	0.65
Return on equity(%)	18.10	15.47	14.24	17.82	15.07	14.04	12.84	14.36	15.94	10.49
Earnings Per Share	81.79	83.73	86.10	126.62	143.77	144.37	130.16	184.31	210.06	156.76
Dividend Per Share	12.50	14.00	14.00	21.50	29.00	30.00	30.00	35.00	41.50	30.00
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	1,917.70
CapitalAdequacy Ratio	--	-	-	-	85,393	90,975	98,530	1,16,325	1,29,362	1,45,845

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

ANALYSIS AND INTERPRETATION

SBI is the first leading bank in India.The financial indicators like net interest income,earnings per share ,net profit were on increasing trend till year 2009-10 then it declined marginally during 2010-11.But after 2011-12 it shows a rising trend.The decline may be due to the cost of M&A during the year 2008 and 2010. FY14 OVER FY13- Operating Profit increased from Rs.40, 922 crores in FY13 to Rs.42, 097 crores in FY14 (2.87% YoY growth). Net Profit (after minority interest) decreased from Rs.17,916 ccrores in FY13 to Rs.14,174 crs in FY14(-20.89% YOY growth). Earnings per Share declined by 23.54% from Rs.267 in FY13 to o Rs.204 in FY 14.

HDFC BANK

HDFC Bank is the fifth largest bank in India by assets, incorporated in 1994. It is the largest bank in India by market capitalization as of 24 February 2014. As on Jan 2 2014, the market cap value of HDFC was around USD 26.88B, as compared to Credit Suisse Group with USD 47.63B.The bank was promoted by the Housing Development Finance Corporation, a premier housing finance company (set up in 1 977) of India. As of 31 March 2013, the bank had assets of

INR 4.08 trillion. For the fiscal year 2012-13, the bank has reported net profit of INR 69 billion, up 31% from the previous fiscal year. Its customer base stood at 28.7 million customers on 31 March 2013.

Table -4: Key financial indicators of HDFC BANK

HDFC BANK	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 payout ratio	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 per share	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

As per the ten year data earnings per share, Return on average net worth, capital ratio, dividend per share, book value per share and market price per share are showing an upward trend upto the year 2010-11 but after that it showed a declining trend in 2011-13. The cause for this decline may be or may not be acquisition of centurion bank of Punjab ltd. in year 2008-09. HDFC Bank has showed a 27 per cent rise in net profit at Rs. 1,982 crore in the July-September quarter of FY'14 compared with Rs. 1,560 crore in the same quarter last year. The country's second largest private sector lender broke its own record of posting 30 per cent growth in net profit for 54 consecutive quarters. The marginal decline was due to lower-than-expected net interest income and margin.

Net interest margin during the quarter fell to 4.3 per cent from 4.4 per cent. This reduction was due to the RBI's tight liquidity measures taken in July. During the quarter, net interest income grew 15 per cent to Rs. 4,476.5 crore from Rs. 3,882 crore in the same quarter last year. Non-interest income increased 25 per cent to Rs. 1,844 crore from Rs. 1,472 crore in Q2 FY'13. Gross non-performing assets (NPAs) increased to 1.1 per cent of total advances against 0.9 per cent in the second quarter last year. Net non-performing assets were up at 0.3 per cent from 0.2 per cent.

As on June 30, 2013, total advances grew 16 per cent year-on-year to Rs. 2.69 lakh crore. Retail loan segment growth was 17 per cent, while wholesale loans grew 15 per cent resulting in a retail: wholesale loan mix of 53:47. Total deposits as of September 30, 2013 were at Rs. 3.13 crore, an increase of 14 per cent over September 30, 2012. Savings account deposits grew 18 per cent.

V. SUGGESTIONS

1. Banks can work towards a synergy based merger plan with minimisation of technology-related expenditure.

2. There is also a need that merger or large size is just a facilitator, but no guarantee for improved profitability.

3. The thrust should be on improving risk management capabilities, corporate governance and strategic business planning.

4. In the short run, attempt options like outsourcing, strategic alliances, etc. can be considered. Banks need to take advantage of this fast changing environment, where product life cycles are short, time to market is critical in deciding who wins in future.

5. The Government should not go for M&As as a means of bailing out of weak banks. The strong banks should not be merged with weak banks, as it will have adverse affect upon the asset quality of the stronger banks.

6. The strong banks should be merged with strong banks to compete with foreign banks and to enter in the global financial market.

VI. CONCLUSION

The banking industry has been undergoing major Mergers and Acquisitions in the recent years, with a number of global players emerging through successive .Mergers and Acquisitions in all sectors including banking. The present study indicates that the pre and post- Mergers and Acquisitions of selected banks in India have no greater changes in profitability ratio; a few banks are satisfactory during the study period. The study highlights that even after ten years of merger, the firms couldn't improve their performance. Similar decline in performance is observed matching firms. Thus, the decline in the performance of merging firms cannot be attributed to merger alone. But in future, there are strong prospects of improvements in profitability. But overall, results indicate that mergers led to higher level of cost efficiencies for the merging banks. Merger between distressed and strong banks did not yield any significant efficiency gains to participating banks. However, the forced merger among these banks succeeded in protecting the interest of depositors of weak banks but stakeholders of these banks have not exhibited any gains from mergers.
The empirical findings of this study suggest that trend of merger in Indian banking sector has so far been restricted to restructuring of weak and financially distressed banks. The Indian financial system requires very large banks to absorb various risks that have been emerged from operating in local and global market. The prime factors for future mergers in Indian banking industry included the Basel –II environment, challenges of free convertibility and requirement of large investment banks. Therefore, the Government and policy makers should be more cautious in promoting merger as a way to reap economies of scale and scope.

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