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MERGERS IN INDIAN BANKS: A STUDY ON MERGERS OF HDFC BANK LTD AND CENTURION BANK OF PUNJAB LTD.

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ABSTRACT

The purpose of the present paper is to explore various motives of merger in Indian banking industry. This includes various aspects of bank mergers. It also compares pre and post merger financial performance of merged banks with the helps of financial parameters like, Gross Profit margin, Net Profit margin, operating Profit margin, Return on Capital Employed, Return on Equity, and Debt Equity Ratio. Through literature Review it comes know that most of the work done high lightened the impact of merger and Acquisition on different companies. The data of Merger and Accusations since economic liberalization are collected for a set of various financial parameters. Independent T-test used for testing the statistical significance and this test is applied not only for ratio analysis but also effect of merger on the performance of banks. This performance being tested on the basis of two grounds i.e. , Pre-merger and Post- merger. Finally the study indicates that the banks have been positively affected by the event of merger.

KEYWORDS: Mergers & Acquisition, Banking, Financial Parameters, Profitability, Indian Banks.

INTRODUCTION

Bank in general terminology is referred to as an financial institute or a corporation which is authorized by the state or central government to deal with money by accepting deposits, giving out loan and investing in securities. The main roles of Banks are Economics growth, Expansion of the economy and provide funds for investment. In the resent times banking sector has been undergoing a lot of changes in terms of regulation and effects of globalization. These changes have affected this sector both structurally and strategically. With the changing Environment many different strategies have been adopted by this sector to remain efficient and to surge ahead in the global arena. One such strategy is through the process of consolidation of banks emerged as one of the most profitable strategy. There are several ways to consolidate the banking industry; the most commonly adopted by banks is merger.

Merger of two weaker banks or merger of one health 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).The main motive behind the merger and acquisition in the banking industry is to achieve economies of scale and scope. Mergers also help in the diversification of the products, which help to reduce the risk.

The Indian banking sector can be divided into two eras, the liberalization era and the post liberalization era. In the pre liberalization era government of India nationalized 14 banks as 19July 1965 and later on 6 more commercial Banks were nationalized as 15 April 1980. In the year 1993 government merged the new banks of India and Punjab National banks and this was the only merged between nationalized Banks after that the number of Nationalized Banks reduces from 20 to 19.In the post liberalization regime, government had initiated the policy of liberalization and licenses were issued to the private banks which lead to the growth of Indian banking sector. The Indian banking industry shows a sign of improvement in performance and efficiently after the global crises in 2008-2009. In the Indian banking industry having far better position than it was at the time of crises. Government has taken various initiatives to strengthen the financial system. The economic recovery gained strength on the bank of a variety of monetary policy initiatives taken by the RBI

THE INDIAN BANKING SYSTEM

At the top of the Indian banking system is the central bank of India known as Reserve Bank of India .the Reserve bank of India is responsible for the Indian banking system since 1935, the commercial banks in India are segregated into Public sector banks ,Private sector banks and Foreign banks .All these banks fall under Reserve Bank of India classification of scheduled commercial banks (SCBs).Public sector, Private sectors and Foreign banks as they are include in the second scheduled of the reserve bank of India Act 1934. The Public sector was wholly owned by the government of India before the reforms. The PSBs are the biggest player in the Indian banking system and they account for 70% of the assets of scheduled commercial banks in India

MERGER OF BANKS IN INDIA

Merger can be defined as a mean of unification of two players into single entity. Merger is a process of combining two business entities under common ownership.

According to Oxford Dictionary the expression “merger means combing two commercial companies into one”

Bank merger is an event of when previously distinct banks are consolidated into one institution (Pilloff and Santomerro, 1999).

A merger occurs when an independent bank loses its charter and becomes a part of an existing bank with one headquarter and unified branch network (Dario Farcarelli 2002)

Merger occurs by adding the active(bidder) bank assets and Liabilities to the target(Passive)banks balance sheet and acquiring the bidder’s bank name through a series of legal and Administrative measures.

Merger and Acquisition in Indian banking sectors have been initiated through the recommendations of Narasimham committee II. The committee recommended that “merger between strong bank / financial institutions would make for greater economic and commercial sense and would be case where the whole is greater than the sum of its parts and have “force multiplier effect”

REVIEW OF RELATED LITERATURE

Several studies have been conducted to examine the impact of mergers and Acquisition. Berger and Humphery (1997) in their study provide on extensive review on the efficiency of baking sector. They pointed out that majority of studies focused on the banking markets of well developed countries with particular emphasis on US market.

Anand Manoj & Singh Jagandeep (2008) studied the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. 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. The announcement of merger of Bank had positive and significant impact on share holder's wealth. The effect on both the acquiring and the target banks, the result showed that the agreement with the European and the US Banks Merger and Acquisitions except for the facts the value of share holder of bidder Banks have been destroyed in the US context, the market value of weighted Capital Adequacy Ratio of the combined Bank portfolio as a result of merger announcement is 4.29% in a three day period (-1, 1) window and 9.71 % in a Eleven days period (-5, 5) event window. The event study is used for proving the positive impact of merger on the bidder Banks.

Lehto Eero & Bockerman Petri(2008) evaluated the employment effects of Merger and Acquisitions on target by using match establishment level data from Finland over the period of 1989-2003. They focused cross border Merger and Acquisitions as well as domestic Merger and Acquisitions and analyzed the effect of employment of several different types of Merger and Acquisitions. They evaluated that the cross border Merger and Acquisitions lead to downsizing the manufacturing employment and the effects of cross border Merger and Acquisitions on employment in non- manufacturing are much weaker and change in ownership associated with domestic Merger and Acquisitions and internally restructuring also typically causes employment losses. To look the effects of cross border Merger and Acquisitions (M&As) Hijzen Alexander et al., (2008) studied the impact of cross border Merger and Acquisitions (M&As) and analyzed the role of trade cost, and explained the increased in the number of cross border Merger and Acquisitions (M&As) and used industry data of 23 countries over a period of 1990 -2001. The result suggested that aggregate trade cost affects cross border merger activity negatively, its impact differ importantly across horizontal and non-horizontal mergers. They also indicated that the less negative effects on horizontal merger, which is consistent with the tariff jumping agreement, put forward in literature on the determinant of horizontal FDI.

Mantravadi Pramod & Reddy A Vidyadhar (2007) evaluated that the impact of merger on the operating performance of acquiring firms in different industries by using pre and post financial ratio to examine the effect of merger on firms. They selected all mergers involved in public limited and traded companies in India between 1991 and 2003, result suggested that there were little variation in terms of impact as operating performance after mergers. In different industries in India particularly banking and finance industry had a slightly positive impact of profitability on pharmaceutical, textiles and electrical equipments sector and showed the marginal negative impact on operative performance. Some of the industries had a significant decline both in terms of profitability and return on investment and assets after merger.

Coming down on the various motives for Merger and Acquisitions, Mehta Jay & Kakani Ram Kumar (2006) stated that there were multiple reasons for Merger and Acquisitions in the Indian Banking Sector and still contains to capture the interest of a research and it simply because of after the strict control regulations had led to a wave of merger and Acquisitions in the Banking industry and states many reason for merger in the Indian Banking sector. While a fragmented Indian banking structure may be very well beneficial to the customer because of competition in banks, but at the same time not to the level of global Banking Industry, and concluded that merger and Acquisition is an imperative for the state to create few large Banks.

Müslümov Alövsat (2002) examined that synergy is one of the main factor behind the merger and took 56 mergers from US industry, and the cash flows improvement in the productive usage of assets and increasing the sales and showed the surviving firm improvement in operating cash flows. The post merger create additional value and shows the improvement of bidder firm with price to book ratio, used non-parametric test as most suitable method of testing post merger performance.

R. Srivassan et al., (2009) gave the views on financial implications and problem occurring in Merger and Acquisitions (M&As) highlighted the cases for consolidation and discussed the synergy based merger which emphasized that merger is for making large size of the firm but no guarantee to maximize profitability on a sustained business and there is always the risk of improving performance after merger.

Sinha Pankaj & Gupta Sushant (2011) studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions(M&As) it came to the point that companies may have been able to leverage the synergies arising out of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency etc.

Aharon David Y et al., (2010), analyzed the stock market bubble effect on Merger and Acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investor take more risk. Merger of banks through consolidation is the significant force of change took place 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.

NEED FOR THE STUDY

It is seen that, most of the works have been done on trends, policies & their framework, human aspect which is needed to be investigated, whereas profitability and financial analysis of the mergers have not give 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. The study will also discuss the pre and the post merger performance of banks. An attempt is made to predict the future of the ongoing Merger and Acquisitions (M&As) on the basis of financial performance of Indian banking sector.

RESEARCH METHODOLOGY

A. DATA COLLECTION

For the purpose of evaluation of investigation data is collected from merger and Acquisition (M$As) of Indian Banking Industry. The financial and accounting data of banks is collected from banks annual reports to examine the impact of merger on financial performance of the banks.

B. METHODOLOGY

To test the prediction, methodology of comparing the pre and post performance of the banks after the merger has been adopted by using following financial parameters such as Gross Profit margin, Net Profit margin, Return on Capital Employed, Return on Equity and Debt Equity Ratio. Research has taken one case of merger as Sample i.e., merger of HDFC Bank ltd & Centurion Bank of Punjab. The pre merger (three years prior) and post merger (after three years) of the financial ratios being compared. The year of merger is considered as base year and denoted as 0 and it is excluded from the evaluation. Keeping in view the purpose and objective of the study independent T-test being employed under this study.

C. RATIOS

Gross Profit Margin Ratio	: Gross Profit / Sales X 100
Net Profit Margin Ratio	: Net Profit / Sales X 100
Operating Profit Margin Ratio	: Operating Profit / Sales X 100
Return on Capital Employed	: Net Profit / Total Assets X 100
Return on Equity	: Net Profit / Equity Capital X 100
Debt Equity Ratio	: Total Debt / Total Equity X 100

ANALYSIS AND INTERPRETATION

In this study deals with merger of HDFC Bank Ltd (bidder bank) and Centurion Bank of Punjab Ltd (Target Bank) . This deals took place in year 2008(i.e. may 23rd 2008). In order to analyses the financial performance of banks after the merger, the financial and accounting ratios like Gross Profit Margin, Operating Profit Margin, Return on Capital Employed, Return on Equity and Debt Equity Ratio have been calculated. Table 3 indicates that the financial performance of both the banks before the merger. Table 4 shows the financial performance of HDFC Bank ltd (bidder bank) after merger.

TABLE-3
FINANCIAL PERFORMANCE OF HDFC BANK LTD AND CENTURION BANK OF PUNJAB FOR THE LAST THREE FINANCIAL YEARS IS ENDING BEFORE THE MERGER
FINANCIAL RATIOS (IN PERCENTAGE)

Ratios	HDFC Bank Ltd (Bidder Bank)			Centurion Bank of Punjab(Target Bank)		
	As on 31-03-2005	As on 31-03-2006	As on 31-03-2007	As on 31-03-2005	As on 31-03-2006	As on 31-03-2007
Gross Profit Margin	74.1719	71.1233	69.9408	55.8583	53.4151	69.5703
Net Profit Margin	21.5119	19.4573	16.5691	8.7116	15.2490	9.5683
Operating Profit Margin	53.1167	46.0083	47.9309	37.2331	22.4315	37.6088
Return on Capital Employed	1.2941	1.18463	1.2511	0.6538	1.0810	0.6567
Return on Equity	214.7799	278.0801	357.3844	29.7572	86.9701	77.4651
Debt Equity Ratio	134.3883	192.7486	222.6536	35.2757	67.1107	100.8016

Source: financial statements of Banks

http://www.moneycontrol.com/stocmarketsindia/

TABLE-4

FINANCIAL PERFORMANCE OF HDFC BANK LTD FOR THE NEXT THREE FINANCIAL YEAR WAS ENDING AFTER THE MERGER ANNOUNCEMENT

FINANCIAL RATIOS (IN PERCENTAGE)

Ratios	HDFC Bank Ltd (Bidder Bank)		
	As on 31-03-2009	As on 31-03-2010	As on 31-03-2011
Gross Profit Margin	74.76217	74.66454	76.2925
Net Profit Margin	13.74548	18.23227	19.70267
Operating Profit Margin	54.61426	51.12141	54.53866
Return on Capital Employed	1.22493	1.3255	1.41566
Return on Equity	527.75165	644.18447	843.96749
Debt Equity Ratio	342.04104	393.9357	479.29082

Source: financial statements of Banks

http://www.moneycontrol.com/stocmarketsindia/

TABLE-5

MEAN AND STANDARD DEVIATION OF PRE-MERGER AND POST-MERGER RATIOS OF COMBINED (CBOP & HDFC BANKS) AND ACQUIRING BANK (HDFC BANK)

		Mean	**Std. Deviation**	**t-value**	**Sig.**
Gross Profit Margin	Pre	70.2136	1.9711	-4.008	0.016
	Post	75.2397	0.9130		
Net Profit Margin	Pre	18.8413	3.3731	0.610	0.575
	Post	17.2268	3.1033		
Operating Profit Margin	Pre	46.7550	4.5640	-2.319	0.081
	Post	53.4248	1.9951		
Return on Capital	Pre	1.1877	0.0475	-2.182	0.095

Employed	Post	1.3220	0.0954		
Return on Equity	Pre	2.1775	48.0414	-4.711	0.009
	Post	6.7197	159.9283		
Debt Equity Ratio	Pre	1.4876	36.5495	-5.667	0.005
	Post	4.0509	69.3013		

Source: based on tables 3&4, 5% level of significance**.**

In the present case, the merger of the Centurion Bank of Punjab and the HDFC Bank, the comparison between pre and post performance we seen that the Mean value of Gross Profit margin(70.2136% Vs 75.2397%) has increased with t-value -4.008 which shows significant improvement in the Gross Profit margin after the merger but in Net Profit margin and Operating Profit margin you can see the decline the in the Mean of both parameters that indicates that there is no change in the performance of banks Net Profit margin and Operating Profit margin after merger and results shows that there is no significance with Mean (18.8413% Vs 17.2268%) and t-value 0.610 and (46.7550% Vs 53.4248%) and t-value -2.319 and the mean Return on Capital Employed(1.1877% Vs 1.3220%) and t-value -2.182 which also not Significant statically and shows that no charge has been in term of investment after the merger. the mean of return on equity and debt equity ratio shows improvement and statically conformed significant to mean value (2.1775%vs6.7197%)and t value -4.711and (1.4876%vs4.0509%) and t value -5.667.the mean value of equity in post merger has been n increased so it increased the share holders return held it also shows the improved performance of bank after merger. Similarly debt equity ratio also improved after the merger, the mean value shows the change in debt equity ratio after the merger. From the above analyses we can conclude that some ratios indicates no effect but most of the ratios shows the positive effect and increased the performance of banks after merger announcement.

CONCLUSION

Merger is the useful tool for growth and expansion in Indian Banking Sector. It is helpful for survival of weak banks by merging into larger bank. This study shows that impact of merger on financial performance of Indian Banking sector. For this a comparison between pre and post merger performance examined in terms of Gross Profit margin, Net Profit margin, Operating Profit margin, Return on Capital employed, Return on Equity and Debt equity ratio. In the present case study , the return on equity , debt –equity ratio and Gross Profit margin has shows the improvement after the merger and for the purpose and objective of the study, investigator apply t-test for analyzing the pre and post merger performance of banks and result suggested that after the merger the financial performance of the banks have increased. The most important is that to generate net higher profit after the merger in order to justify the decision of merger undertaken by the management to the shareholders.

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