# THE WAVES OF M&A IN INDIAN BANKING SECTOR AND ITS IMPACT ON BANKS SAILING

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## ABSTRACT

*Mergers and Acquisitions immensely assist banks in expanding their operations, in attaining synergy and in acquiring the stressed assets of weaker banks. As it is a well accepted fact that banking sector is most extensively regulated in Indian financial market. Despite the truth that regulation increases performance at various levels, business growth is the perpetual quest for all companies, and banking companies are not alien to that. Fast growth of consolidations revealed that banking operations, though stringently regulated aspire for a high rate of profitability and business presence. There are many instances in Indian context that show different reasons of mergers and acquisitions in banking sector in India.*

*This paper attempts to ascertain the financial impacts on Indian banks on account of merger and acquisitions. The merger and acquisitions that will be taken up for study are: Global Trust Bank merger with Oriental Bank of Commerce (2004); IDBI Bank merger with IDBI (2005); Merger of Centurion Bank of Punjab with HDFC Bank (2008); Merger of Bank of Rajasthan with ICICI Bank (2010) and ING Vyasa Bank and Kotak Mahindra Bank merger (2014).*

***Keywords:*** *M&A Scenario in Indian Banking Sector; Impact on Business Valuations; Impact on Reported Net Profit After Tax. JEL Classification: Financial Economics*

## INTRODUCTION

The international banking scenario has witnessed substantial changes in the past some years in terms of the Mergers and Acquisitions. Due to financial system deregulation, entry of new players and products with advanced technology, globalization of financial markets, changing customer behaviour, wide gamut of services at economical rates, shareholder wealth demands etc. have been soaring.

In this scenario, Mergers and Acquisitions is one of the mostly used strategies by banks to strengthen and maintain their position in the market. Companies are confronted with the facts that only mammoth players can afford to breathe as there exits cut-throat competition in the market and the success of merger depends on how well the two companies integrate themselves in execution of day to day operations. It has been observed that banks have derived the merits of economies of scale by embracing the trajectory of mergers and acquisition. Further, for expanding the operations and reducing costs, banking sector globally is using mergers and acquisitions as a stratagem for attaining larger size, enhanced market share, faster growth, and synergy for becoming more competitive through economies of scale.

## REVIEW OF LITERATURE

Goyal K.A. & Joshi Vijay (2011) in their paper provided an overview on Indian banking sector and highlighted the changes that took place in the banking sector after post liberalization and defined the Merger and Acquisitions as per Accounting Standard-14. The need of Merger and Acquisition in India has been examined under this study. It also provided the idea of changes that happened after M&As in the banking sector in terms of financial, human capital and legal aspects. Kuriakose Sony & Gireesh Kumar G. S (2010) in their paper, assessed the strategic and financial similarities of merged banks, and pertinent financial variables of respective banks were considered to assess their relatedness. The outcome of the study revealed that only private sector banks are in favour of the voluntary merger wave in the Indian Banking Sector and public sector bank are unwilling toward their type of restructuring. Target banks are more leverage (dissimilarity) than bidder banks, so the merger lead to accomplish optimum capital structure for the bidders and asset quality of target firms is very poor except the cases of HDFC Vs the CBOP merger in 2007. The factor responsible for voluntary amalgamation are synergies, efficiency, cost saving, economies of scale. The merging partners strategically similarities and relatedness are very critical in the synergy creation because the relatedness of the strategic variable have an important impact on the bank performance and the effect of merger on the stock market.

Aharon David Y et al., (2010), analyzed the stock market bubble effect on Merger and Acquisitions followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have resulted into 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 important force of change that took place in the Indian banking sector.

## OBJECTIVE OF THE STUDY

1) To comprehend the impact of merger and acquisition in Indian Banking industry on business valuations and other key financials i.e. the banks espousing the merger and acquisition trajectory.
2) To understand the merger and acquisition scenario in Indian Banking industry.

### Research Methodology

1) DuPont Analysis: This tool assists in valuing the performance of the firm with reference to Return on Equity.
2) Standard Deviation & Coefficient of Variation: This statistical tool is applied on the Reported Net Profit after Tax of four banks out of the five banks considered for study to observe the impact on their Reported Net Profit after Tax post merger and acquisition. The fifth merger, i.e. ING Vyasa Bank and Kotak Mahindra Bank have not been considered for the application of the mentioned statistical tool since it is quite recent, i.e. 2014 and so a good number of years have not yet elapsed to measure the impact on Reported Net Profit after Tax of Kotak Mahindra Bank due to the merger.

### Limitations of the Study

1) The study is based on the secondary data
2) Due to technical constraints only five banks have been covered for the study.

**Regulatory Structure for M&A in Banking**

The comprehensive regulatory structure of amalgamation or merger between two banks, irrespective of their business and capital adequacy is by and large the product of sequential work groups appointed by RBI. The regulatory framework for M&As in the banking sector is provided in the Banking Regulation Act, 1949. In the post independence epoch, the legal edifice for amalgamations of banks in India was provided in the Act. For voluntary amalgamation, Section 44A of the Banking Regulation Act provides that the scheme of amalgamation of a banking company with another banking company is needed to be approved individually by the two-thirds shareholders (in value) of both the banking companies. Further, Section 44A of the Banking Regulation Act requires that after the scheme of amalgamation is approved by the required majority in number representing two-third in value of shareholders of each banking company, the case can be submitted to the Reserve Bank for sanction. However, the Reserve Bank of India possess the discretionary powers to approve the voluntary amalgamation of two banking companies under section 44A of the Banking Regulation Act.

So far the experience of the Reserve Bank has been, by and large satisfactory in giving approval to the schemes of amalgamation of private sector banks in recent past and there has been no occasion to decline any scheme of amalgamation submitted to it for approval. Most of these voluntary mergers were between robust banks, somewhat on the lines suggested by the first Narsimham Committee. The committee was of the view that the move towards the restructured organization of the banking system should be market-driven and based on profitability considerations and brought about through a process of M&As.

Regarding 'Compulsory Amalgamations' are concerned, these are induced or compelled by the Reserve Bank of India under Section 45 of the Banking Regulation Act, in public interest, or in the interest of the depositors of a distressed bank, or to secure proper management of a banking company, or in the interest of the banking system. In the case of a banking company in financial distress, the Reserve Bank of India under Section 45(2) of the Banking Regulation Act may apply to the Central Government for an order of moratorium regarding a banking company and during the period of such moratorium, may prepare a scheme of amalgamation of the banking company with any other banking institution (banking company, nationalized bank, SBI or its subsidiary). Such a scheme formulated by the Reserve Bank in needed to be sent to the banking companies concerned for their suggestions or objections, including those from the depositors, shareholders and others. After considering the same, the Reserve Bank sends the final scheme of amalgamation to the Central Government for sanction and notification in the official gazette. The notification issued for compulsory amalgamation under Section 45 of the Banking Regulation Act is also required to be placed before the two Houses of Parliament. The amalgamation becomes effective on the date indicated in the notification issued by the Government in this regard.

**Impact on Business Valuation**

In order to ascertain how the merger and acquisition have impacted the banks that have espoused the mentioned route, the ensuing paragraphs focuses upon various financial dimensions to conclude whether the M&A (Merger & Acquisition) have proved to be fruitful or not. In view of this, the following financial and statistical tools have been used- DuPoint Analysis, Standard Deviation and Coefficient of Variation to gauge post Merger and Acquisition impacts on two critical components, i.e. Return on Equity and Reported Net Profit After Tax. No doubt, there are other tools or methods or parameters to measure the impact of merger and acquisition on the valuation of the firm or its key financials, in this

article, two financial measures have been considered, that is, Return on Equity and Report Net Profit After Tax. In order to judge the impact on Return on Equity or ROE, DuPont Analysis is used. The DuPont Analysis is a method of performance measurement. This method states that ROE is affected by three things, i.e. Operating efficiency is measured by profit margin; Asset use efficiency is measured by total asset turnover and Financial leverage is measured by the equity multiplier.

Since, shareholders being the key stakeholders of the company, it is imperative to comprehend the impact of any major financial event on their wealth and one of barometer to judge the impact is Return on Equity, as it is an indicator of the performance of equity investments.

The next financial parameter that is judged is Reported Net Profit after Tax. As it is the bottom line that matters a lot for any business organization, since it determines the survival and growth of an organization. Hence, in this article an effort have been made to observe the impact on Reported Net Profit After Tax of the banks that espoused the trajectory of merger and acquisition. In order to ascertain which bank's Reported Net Profit after Tax got affected the most, Standard Deviation of the Reported Net Profit after Tax and its Co-efficient of Variation is computed.

**1) DuPont Analysis**

**ROE = Profit Margin x Total Assets Turnover x Equity Multiplier**

**= Net Profit / Sales x Sales / Total Assets x Total Assets / Equity**

In this article for applying the mentioned approach, Total Income have been presumed to be sales.

**a) Merger of Global Trust Bank with Oriental Bank of Commerce**

The merger took place in the year 2004 and to its impact on Return on Equity (ROE):

| Years | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| ROE | 1.40 | 3.57 | 4.53 | 5.34 | 3.86 | 4.59 | 3.76 | 1.60 |

Figures have been computed from the financial statements of Oriental Bank of Commerce

**b) Merger of IDBI Bank with IDBI**

The merger took place in 2005 and its impact on ROE:

| Years | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|
| ROE | 0.74 | 0.82 | 1.02 | 1.06 | 1.40 | 1.57 | 1.59 | 1.44 | 0.72 | 0.58 |

Figures have been computed from the financial statements of IDBI

**c) Merger of Centurion Bank of Punjab with HDFC Bank**

The merger took place in 2008 and its impact on ROE:

| Years | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|
| ROE | 5.19 | 6.62 | 8.51 | 10.90 | 14.39 | 17.84 | 21.58 |

Figures have been computed from the financial statements of HDFC Bank.

**d) Merger of Bank of Rajasthan with ICICI Bank**

The merger took place in 2010 and its impact on ROE:

| Years | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| ROE | 5.67 | 7.12 | 9.0 | 10.68 | 10.97 |

Figures have been computed from the financial statements of ICICI Bank.

**e) ING Vyasa Bank and Kotak Mahindra Bank merger**

The merger took place in 2014 and its impact on ROE:

| Year | ROE |
|---|---|
| 2015 | 7.54 |

Figures have been computed from the financial statements of Kotak Mahindra Bank

**Standard Deviation and Coefficient of Variation**

**a) Impact on the Reported Net Profit after Tax of Oriental Bank of Commerce after merger of Global Trust Bank with Oriental Bank of Commerce**

| Years | Reported Net Profit After Tax (INR crore) (x) | d | d² |
|---|---|---|---|
| 2008 | 353.22 | -647.05 | 418673.70 |
| 2009 | 905.42 | -94.85 | 8996.52 |
| 2010 | 1134.68 | 134.41 | 18066.05 |
| 2011 | 1502.87 | 502.6 | 252606.76 |
| 2012 | 1141.56 | 141.29 | 19962.86 |
| 2013 | 1327.95 | 327.68 | 107374.18 |
| 2014 | 1139.41 | 139.14 | 19359.94 |
| 2015 | 497.08 | -503.19 | 253200.18 |
| | | | |
| | ∑x = 8002.19 | | ∑d² =1098240.19 |

$X^{-}$ = 8002.19 / 8 = 1000.27

Standard Deviation (θ) = √∑d² / n = √1098240.19 / 8 = 370.51

Coefficient of Variation = Standard Deviation / Mean x 100 = 370.51 / 1000.27 x 100 = 37.04%

**IDBI Bank merger with IDBI Bank**

| Years | Reported Net Profit After Tax (INR crore) (x) | d | d² |
|---|---|---|---|
| 2006 | 543.92 | -577.32 | 333298.38 |
| 2007 | 588.31 | -532.93 | 284014.38 |
| 2008 | 746.70 | -374.54 | 140280.21 |
| 2009 | 766.54 | -354.7 | 125812.09 |
| 2010 | 1020.53 | -100.71 | 10142.50 |
| 2011 | 1563.51 | 442.27 | 195602.75 |
| 2012 | 2013.12 | 891.88 | 795449.93 |
| 2013 | 1906.29 | 785.05 | 616303.50 |
| 2014 | 1166.20 | 44.96 | 2021.40 |
| 2015 | 957.26 | -163.98 | 26889.44 |
| | | | |
| | ∑x = 11272.38 | | ∑d²= 2529814.58 |

$X^{-}$ = 11272.38 / 10 = 1121.24
Standard Deviation = √2529814.58 / 10 = 502.97
Coefficient of Variation = 502.97 / 1121.24 x 100 = 44.86%

**Merger of Centurion Bank of Punjab with HDFC Bank**

| Years | Reported Net Profit After Tax (INR crore) (x) | d | $d^2$ |
|---|---|---|---|
| 2009 | 2252.13 | -3596.58 | 12935387.7 |
| 2010 | 3032.91 | -2815.8 | 7928729.64 |
| 2011 | 4017.69 | -1831.02 | 3352634.24 |
| 2012 | 5273.40 | -575.31 | 330981.59 |
| 2013 | 6900.28 | 1051.57 | 1105799.46 |
| 2014 | 8764.51 | 2915.80 | 8501889.64 |
| 2015 | 10700.05 | 4851.34 | 23535499.80 |
| | | | |
| | ∑x = 40940.97 | | $\sum d^2$ = 57690922.07 |

$X^{-}$ = 40940.97 / 7 = 5848.71
Standard Deviation = √57690922.07 / 7 = 2870.81
Coefficient of Variation = 2870.81 / 5858.71 x 100 = 49%

**Merger of Bank of Rajasthan with ICICI Bank**

| Years | Reported Net Profit after Tax (INR crore) (x) | d | $d^2$ |
|---|---|---|---|
| 2011 | 6318.19 | -3482.83 | 12130104.81 |
| 2012 | 7937.63 | - 1863.39 | 3472222.29 |
| 2013 | 10129.88 | 328.86 | 108148.90 |
| 2014 | 11677.12 | 1876.10 | 3519751.21 |
| 2015 | 12942.30 | 3141.28 | 9867640.038 |
| | | | |
| | √x =49005.12 | | $\sum d^2$=29097867.25 |

$X^{-}$ = 49005.12 / 5 = 9801.02
Standard Deviation = √29097867.25 / 5 = 2412.38
Coefficient of Variation = 2412.38 / 9801.02 x 100 = 24.61%

**Data Analysis or Findings**

By applying DuPont Analysis it can be observed that Return on Equity of Oriental Bank of Commerce have registered a rising trend after Global Trust Bank merged with it. As in 2008, the ROE was 1.40 which enhanced to 1.60. Somewhat the scenario was similar with IDBI , HDFC Bank and ICICI Bank. However, the rise in ROE was substantial in case of HDFC and ICICI Banks. As in case of HDFC Bank the ROE was 5.19 in 2009, which increased to 6.62 in 2010, then to 8.51 in 2011, to 10.90 in 2012 and then whopping 21.58 in 2015. For ICICI Bank, the ROE after merger of Bank of Rajasthan with it in the year 2010 have registered a notable hike. In 2011, the ROE was 5.67, which went up to 7.12 IN 2012, then 9.0 in 2013, and finally ending up at a mammoth 10.97 in 2015.

Similarly, the standard deviation and coefficient of variation are observed to be highest in case of IDBI and HDFC Bank, i.e. 502.97 & 44.86% and 2870.81 & 49% respectively, thereby exerting a strong impact on Reported Net Profit after Tax post merger. Since the coefficient of variation for the Reported Net Profit after Tax for IDBI and HDFC Banks are greater, it can be concluded that the mentioned financial measure has become more variable or less consistent due to the execution of the mergers. But the variability can be reduced if the management of both the banks embrace efficiency in operations, resulting in decline in costs and enhancement in revenue.

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