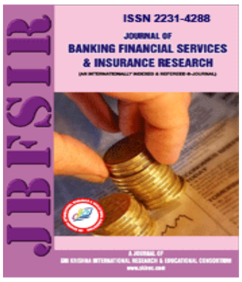
The Journal of Sri Krishna Research & Educational Consortium

JOURNAL ON BANKING FINANCIAL SERVICES & INSURANCE RESEARCH

Internationally Indexed & Listed Referred e-Journal



IMPLICATION OF MERGERS AND ACQUISITIONS ON FINANAICAL POSITION OF SELECTED BANKS

P. NATARAJAN*; K.KALAICHELVAN**

*Professor, Department of Commerce,
Pondicherry University, RV Nagar Kalapet,
Puducherry- 605014.
**Ph.D Scholar, Department Of Commerce,
Pondicherry University, RV Nagar Kalapet,
Puducherry- 605014.

ABSTRACT

In today's globalized economy, competitiveness and competitive advantages have become the buzzwords, for corporates around the world. Companies are increase singly using Mergers and Acquisitions (M &A) mainly for entering new markets aiming asset growth, garnering greater market share/additional manufacturing capacities, and gaining complementary strengths and competencies, and to become more competitive in the market place. M&A are not to the Indian banking sector. Between 1961-2004, 71 merges took place among various banks in India.

Mergers and acquisitions are used for improving competitiveness of companies and gaining competitive advantage over other firms though gaining greater market share, broadening the portfolio to reduce business risk and entering new markets. There is variation in terms of impact on performance following mergers, depending on the firm acquired – domestic or cross-border. In particular mergers have had a positive effect on key financial and operational performance of firms acquiring domestic firms while a slightly negative impact of the firms acquiring cross-border firms. Therefore an attempt is made in this article to evaluate the performance of acquiring banks based on comparing key financial position indicates before and after acquisition period of 5 years. The researchers has used accounting ratios metric viz., liquidity ratios, activity ratios and profitability ratios to elicit financial position of the banks during pre and post acquisition periods. This will help to asses the implications of M&A on the financial position of acquisition bank in the deal.

KEYWORDS: *Mergers and Acquisition, Liquidity, Activity, Profitability.*

INTRODUCTION

In today's globalized economy, competitiveness and competitive advantages have become the buzzwords, for corporates around the world. Companies are increasingly using Mergers and Acquisitions(M&A) mainly for entering new markets, aiming asset growth, garnering greater market share/additional manufacturing capacities, and gaining complementary strengths and competencies, and to become more competitive in the market place.

M&A IN INDIAN INDUSTRY

The Indian economy has undergone a major transformation and structural change following the economic reforms introduced by the government of India in 1991(Surit kaur2002). Since then, the M&A movement in India has gained momentum. In the liberalized economic and business environment, 'magnitude and competence' have become the focal points of every business enterprise in Indian as companies have realized the need to grow and expand in businesses that they understand well to face the growing competition. Indian corporates have undertaken restructuring exercise to sell off non-core business and to create stronger presence in their core areas of business interest. M&A emerged as one of the most effective methods of such corporate restructuring and have, therefore, become an integral part of the long-term business strategy of corporates in India(Pramond Mantravadi .Aidyadhar reddy(2007).

M & A IN BANKING

The banking industry is an important area in which mergers and acquisitions do make enormous financial gains. As a result of changes in the expectation of the corporate customer, banks are now constrained to rethink their business and devise new strategies. On the other hand, competitors both from India and abroad are encroaching upon every area of business in the prevailing policy of LPG. Therefore, Indian bankers are to struggle to survive in a competitive environment, and hence they adopt different strategies. They have no other option except to reduce their costs (both operational costs and the cost of credit) the only way to manage competitiveness, which enables the bankers to spread its overhead cost over a large customer base. To gain competitive cost advantage, consolidation of operation in the form of M&A is one of the effective strategies widely adopted by the bankers.

The Indian banking sector is going through a process of restricting, mainly driven by pervasive trends such as deregulation, disintermediation, technological progress, innovation and severe competition(D.S Prasad and Sandhya Goyal(2008) M&A are not new to the Indian banking sector. Between 1961- 2004, 71 mergers took place among various banks in India.(Lakshminarayanan..P. (2005) M&A undertaken in banking sector during pre and post Financial Sector Reform periods are given in the table1.

TABLE 1
LIST OF MERGERS IN INDIAN BANKING INDUSTRY SINCE 1969

Year	Merging Bank	Merged With
1969	Bank of Bihar	State Bank Of India
1970	National Bank of Lahore	State Bank Of India

1984	Laxmi Commercial Bank	Canara Bank
1984	Miraj State Bank	Union Bank of India
1985	Bank of Cochin	State Bank Of India
1986	Hindustan Commercial	Punjab National Bank
1988	Traders Bank	Bank of Baroda
1989	United Industrial Bank	Allahabad bank
1989	Bank of Tamil Nadu	Indian Overseas Bank
1989	Bank of Thanjavur	Indian Bank
1989	Karur Central bank	Bank of India
1990	Purvanchal Bank	Central Bank of India

BANKS GONE FOR M&A DURING POST FINANCIAL SECTORS REFORM PERIOD

Year	Merging Bank	Merged With
1993	New Bank of India	Punjab National Bank
1993	BCCI	State Bank of India
1994	Bank of Karad	Bank of India
1995	**Kashinath Seth Bank**	**State Bank Of India**
1996	Bari Daab Bank	Oriental Bank Of Commerce
1996	**Punjab Co-operative Bank**	**Oriental Bank Of Commerce**
1999	**Bareilly Corporation Bank**	**Bank of Baroda**
1999	**Times Bank**	**HDFC Bank**
2000	**Bank of Madura**	**ICICI Bank**
2002	**Benaras State Bank Ltd.**	**Bank of Baroda**
2002	**Nedungadi Bank Ltd.**	**Punjab National Bank**
2004	**Global Trust Bank**	**Oriental Bank of Commerce**

” Source from: Manoj kumuar “Efficiency Gains from Mergers and Acquisitions of Indian Banks: A Data Envelopment Analysis Approach

Mergers and acquisitions are used for improving competitiveness of companies and gaining competitive advantage over other firms through gaining greater market share, broadening the portfolio to reduce business risk and entering new markets. There are variations in terms of impact on performance following mergers, depending on the firm acquired – domestic or cross-border. In particular, mergers have had a positive effect on key financial and operational performance of firms acquiring domestic firms while a slightly negative impact on the firms acquiring cross-border firms. Therefore an attempt is made in this article to evaluate the performance of acquiring banks based on comparing key financial position indicates before and after acquisition period of 5 years. The researcher has used accounting ratios metrics viz., liquidity ratios, activity ratio and profitability ratios to elicit financial position of the banks during pre and post acquisition periods. This will help to asses the implications of M&A on the financial position of acquisition bank in the deal.

OBJECTIVES OF THE STUDY

The main objective of this study is to analyze the pre and post-merger operating performance of banks who underwent M&A deal in the Post-Reforms Period, from which is up to 2009

METHODOLOGY OF THE STUDY

It is an empirical study with the intention to analyse the performance of the bank after assuming structural changes with another bank. A comprehensive survey has been undertaken from among the banks those have gone for M&A during the post-reform period. Their performance in the pre and post acquisition period has been analysed so as to elicit the effectiveness of M & A.

DATA COLLECTION

Data of operating performance ratio of pre period of 5years and post period of 5years of the acquisition for each acquiring banks has been extracted from the prowess database of Centre for Monitoring Indian Economy (CMIE).

DATA ANALYSIS

Pre and Post-merger operating performance ratios were computed and compared for the entire sample banks that have gone through mergers during the period 1995-2004. Based on availability data, analysis of financial position have been done only for 8 banks which have undergone M&A deal. Data of operating performance ratio of pre period of 5years start in 1990 and post period of 5 years M&A deal ends with 2009.

LIQUIDITY POSITION

Liquidity Position of a bank could be measured in terms of various accounting ratios, such as current ratio, quick ratio and cash asset ratio to indicate liquidity position of acquiring banks. An acquiring bank is considered to be sound if it is in a position to carry on its business smoothly and meet all its obligations during 5 years period without any damage to the goodwill of the bank.

OPERATIONAL PERFRMANCE

Activity ratios are financial ratios that measure how efficiently a firm is using its current and fixed assets. Firms will typically try to turn their resources into cash as far as possible because this will generally lead to higher revenues. The ratios such as working capital turnover, asset turnover, etc are generally used to evaluate the activity of a firm. Here in this article, the activities of the public and private sector banks before and after their acquisition activities are evaluated using working capital turnover ratio, asset turnover ratio and fixed asset turnover ratios.

PROFITABILITY POSITION

The primary objective of any firms is to earn profits. Profit earning capacity is considered to be essential for the survival of the firms. A banking sector needs profits not only for its existence but also for expansion and diversification in other financial areas. The profitability ratios are used to test the efficiency of the management, as the measure of worth of their investment to the creditors, the margin of safety to employees as a source of benefits, to Government a measure of tax paying capacity, etc. The status of various profitability ratios in 5 year pre and post event period are compared for this purpose.

FINANCIAL POSITION OF PUBLIC SECTOR BANKS

In the following section of this article , the financial performance before and after acquisition activities of all public sector banks for a period of 5 years is compared based on liquidity, activity and profitability ratios. The results of comparative analysis for public sector banks are reported in Table.2 the status of liquidity for the period of 5 years is taken up before and after acquisition deals of public sector banks. However, activities with regard to utilization of fixed assets for income generation (difference between pre and post period is significant) and profitability in term of GPM (difference between pre and post period is insignificant) vary during the 5 years period. That is, the difference in fixed assets turnover ratio is insignificant for 5 years period in pre and post acquisition and the above scenario is vice versa in the case of GPM.

TABLE 2
COMPARISON OF VARIOUS RATIOS BETWEEN PRE AND POST ACQUISITION PERIOD OF 5 YEARS FOR PUBLIC SECTOR BANKS

Financial Ratios	Pre Period Mean (SD)	Post Period Mean (SD)	t-value
Current Ratio (CR)	4.3960 (2.3312)	3.9043 (2.2603)	0.83
Quick Ratio (QR)	4.1393 (2.2302)	3.6813 (2.1259)	0.81
Cash Ratio (CSHRAT)	3.1854 (1.7845)	2.9218 (1.5798)	0.61
Working Capital Turnover Ratio (WCTO)	1.3660 (0.5300)	1.2113 (0.4257)	1.25
Asset Turnover Ratio (ATR)	0.1094 (0.0056)	0.0939 (0.0124)	6.26***
Fixed Asset Turnover Ratio (FATO)	14.9717 (7.2563)	12.4798 (4.3603)	1.61
Gross Profit Margin (GPM)	0.6775	0.7043	-1.67*

	(0.0597)	(0.0644)	
Operating Profit Margin (OPM)	0.6685 (0.0576)	0.6844 (0.0632)	-1.02
Net Profit Margin (NPM)	0.0683 (0.0347)	0.0977 (0.0297)	-3.52***
Return on Net Worth (RONW)	14.7500 (4.9800)	15.6593 (5.0942)	-0.70
Return on Capital Employed (ROCE)	9.5300 (4.8600)	10.9040 (4.4311)	-1.15

Figures in brackets are standard deviation
***Significant at 1% level; *Significant at 10% level

Only the behaviour of Asset turnover ratio (t-value = 6.26, $p < 0.01$) and NPM (t-value = -3.52, $p < 0.01$) remains same for both shorter and longer time intervals. That is, for longer period also, there has been significant impact of acquisition deal of public sector banks on their FATO and NPM. On the whole, it is concluded that the performance of public sector banks in terms of generating income relative to their investment in fixed assets is significantly and negatively affected whereas their performance in respect of their net earnings is positively influenced by acquisition deals.

FINANCIAL POSITION OF PRIVATE BANKS

The financial performance of private sector banks before and after their acquisition activities are evaluated by comparing various ratios pertaining to liquidity, activity and profitability between pre and post period of 5 years and the results of the analysis are presented in Table 3. The performance of private banks for longer time period after acquiring other banks is not attractive. The liquidity position become weak even for 5 years from their acquisition deals and significantly less compared to their liquidity position during 5 years before the acquisition. Moreover, ATR on an average for 5 years has become significantly less after acquisition activities of private sector banks (t-value = 1.90, $p < 0.10$ for the difference in means). Regarding profitability, there is no remarkable change in GPM, OPM and NPM when considered for 5-year time intervals (t-values are insignificant). However, the profitability, on an average for 5 years, relative to Capital employed has declined at marginal level from 11.5540 times in pre-period to 7.5210 times in post period (t-value = 1.84, $p < 0.10$).

Hence, from the results comparing the liquidity, activity and profitability ratios, on an average for 5-years period, it is found that the deals pertaining to acquiring of other banks by private sector banks have significant negative effect on their liquidity position as well as on their overall financial performance.

FINANCIAL POSITION OF BOTH PUBLIC AND PRIVATE SECTOR BANKS

The financial performance for 5 years before and after acquisition activities is compared by means of various ratios pertaining to liquidity, activity and profitability for all public and private sectors banks involved in acquiring other banks. The results of the analysis are depicted in Table 4.

TABLE 3
COMPARISON OF VARIOUS RATIOS BETWEEN PRE AND POST ACQUISITION PERIOD OF 5 YEARS FOR PRIVATE SECTOR BANKS

Financial Ratios	Pre Period Mean (SD)	Post Period Mean (SD)	t-value
Current Ratio (CR)	4.3160 (2.1354)	1.3530 (0.4494)	4.29***
Quick Ratio (QR)	4.2780 (2.1507)	1.2150 (0.3993)	4.43***
Cash Ratio (CSHRAT)	3.2917 (1.7675)	0.9396 (0.3595)	4.12***
Working Capital Turnover Ratio (WCTO)	1.6942 (0.8434)	0.4635 (1.0430)	2.90**
Asset Turnover Ratio (ATR)	0.1013 (0.0276)	0.0798 (0.0230)	1.90*
Fixed Asset Turnover Ratio (FATO)	2.9674 (1.1950)	3.9829 (1.5416)	-1.65
Gross Profit Margin (GPM)	0.7175 (0.2284)	0.7407 (0.0355)	-0.32
Operating Profit Margin (OPM)	0.6830 (0.2247)	0.6883 (0.0474)	-0.07

Net Profit Margin (NPM)	0.1405 (0.0621)	0.1400 (0.0271)	0.02
Return on Net Worth (RONW)	16.5210 (9.2095)	16.1030 (7.5022)	0.11
Return on Capital Employed (ROCE)	11.5540 (4.1210)	7.5210 (5.5603)	1.84*

Figures in brackets are standard deviation

***Significant at 1% level; **Significant at 5% level; *Significant at 10% level

TABLE 4
COMPARISON OF VARIOUS RATIOS BETWEEN PRE AND POST ACQUISITION PERIOD OF 5 YEARS FOR ALL SECTOR BANKS

Financial Ratios	Pre Period Mean (SD)	Post Period Mean (SD)	t-value
Current Ratio (CR)	4.3760 (2.2571)	3.2665 (2.2577)	2.20**
Quick Ratio (QR)	4.1740 (2.1839)	3.0648 (2.1371)	2.30**
Cash Ratio (CSHRAT)	3.2120 (1.7582)	2.4263 (1.6252)	2.08**
Working Capital Turnover Ratio (WCTO)	1.4480 (0.6275)	1.0244 (0.7024)	2.84**
Asset Turnover Ratio (ATR)	0.1074 (0.0146)	0.0904 (0.0166)	4.88***
Fixed Asset Turnover Ratio (FATO)	11.9706	10.3556	1.04

	(8.1972)	(5.3450)	
Gross Profit Margin (GPM)	0.6875 (0.1225)	0.7134 (0.0602)	-1.20
Operating Profit Margin (OPM)	0.6721 (0.1190)	0.6854 (0.0591)	-0.63
Net Profit Margin (NPM)	0.0864 (0.0528)	0.1083 (0.0342)	-2.20**
Return on Net Worth (RONW)	15.1900 (6.2100)	15.7703 (5.6853)	-0.43
Return on Capital Employed (ROCE)	10.0300 (4.7200)	10.0583 (4.8924)	-0.02

Figures in brackets are standard deviation

***Significant at 1% level; **Significant at 5% level

It can be seen from Table.4 that the average CR, QR and CSHRAT in three years during pre-period, which stood at 4.3760 times, 4.1740 times and 3.2120 times has declined to 3.2665 times, 3.0648 times and 2.4263 times in five years during pre and post-period respectively. The difference in average CR in 5 years between pre and post period is significant for CR (t-value = 2.20, $p < 0.05$), QR (t-value = 2.30, $p < 0.05$) and Cash Ratio (t-value = 2.08, $p < 0.05$). This shows that there has been significant decline in liquidity position of both public and private sector banks together due to their activities pertaining to acquiring private limited banks. Similarly, the efficiency of both public and private sector banks together (all sector banks) have declined at remarkable level after their acquisition deals.

That is, the WCTO and ATR, which stood at 1.4480 times and 0.1074 times on an average for 5 years during pre-period has declined to 1.0244 times and 0.0904 times during post-periods and the change in these two ratios between pre and post periods is seen to be significant at 5 per cent (t-value = 2.84, $p < 0.05$ for WCTO) and 1 per cent (t-value = 4.88, $p < 0.05$ for ATR) levels respectively. The above scenario has indicated that the efficiency of the banks involved in acquisition activities has declined after takeover deals.

Regarding profitability, it can be further seen from table that there is no remarkable change (either increase / decrease) in GPM, OPM, RONW and ROCE against takeover deals of both public and private sector banks over 5 years in pre and post event periods. However, the net earnings after all expenses in 5 years, i.e., net profit on an average for 5 years have increased from 8.64 per cent in pre-period to 10.83 per cent in post-period against acquisition deals of all sector banks. That is, net earnings tend to increase against taking over of private limited banks by public and private sector banks in India.

CONCLUSION

So far, from the entire above inferences pertaining to financial performance against acquisition activities of public and private sector banks, The performance of private sector banks is found to be better in pre-period compared to their performance in post-acquisition period. It is concluded that there is notable change in liquidity position of the public sector banks due to their acquisition activities whereas there has been significant decline their activities in turning their assets for generating income. It is identified that the deals pertaining to acquiring by private sector banks have significant negative effect on their liquidity position as well as on their overall financial performance. It is also concluded that the performance of public sector banks in terms of generating income relative to their investment in fixed assets is significantly and negatively affected whereas their performance in respect of their net earnings is positively influenced by acquisition deals However, overall from combining the financial performance of both public and private sectors banks, it is identified that that the banks' activities in respect of acquiring other private sector banks does not tend to make any notable changes in their liquidity position and profitability levels, It is finally concluded the net earnings in longer time period of five years tend to increase against taking over of private sector banks by public and private sector banks in India.

REFERENCE

1. Lakshminarayanan, P., (2005}, Consolidation in the Banking Industry through Mergers and Acquisitions, Special Issues, IBA Bulletin, IBA, (January}, pp 92-99.

2. Manoj kumuar "Efficiency Gains from Mergers and Acquisitions of Indian Banks: A Data Envelopment Analysis Approach

3. Pramond Mantravadi & A Vidyadhar reddy (2007) " Mergers and Operating performance: Indian experience" 2007 The ICFAI university Press.

4. D.S. Prasad and Sandhya Goyal (2008) ' Issues in banking mergers – An Indian Perspective" ICFAI (Special Issue) Mergers and acquisitions the icfai University press.

5. Surjit, Kaur (2002): A Study if Corporate Takeover in India, Ph.D. Dissertation (unpublished) University of Delhi, New Delhi.