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ASSESSING THE PERFORMANCE OF MERGED BANKS: A CASE ANALYSIS

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Assessing the Performance of Merged Banks: A Case Analysis

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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. 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. Ratios analyses have been used to examine the pre and post-merger financial performance appraisal of acquiring banks. In order to test the statistical significance, researcher has applied independent sample t-test. The result of the study indicates that the banks have been positively affected by the event of Merger and acquisitions (M&As). These results suggest that merged banks can obtain efficiency and gains through Merger and Acquisitions (M & As) and passes the benefits to the equity share holders' in the form of dividend.

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

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INTRODUCTION

Merger and Acquisitions are strategic decisions taken for maximization of a company's growth by increasing its production and marketing operations. Therefore many companies find the best way to go ahead and like to expand ownership precincts through Merger and acquisitions (M&As).

Merger creates synergy and economies of scale. For expanding the operations and cutting costs, business entrepreneur and banking sector are using Merger and Acquisitions worldwide as a strategy for achieving larger size, increased market share, faster growth, and synergy for becoming more competitive through economies of scale. The companies must follow legal procedure of Merger and Acquisitions (M&As) as enshrined by RBI, SEBI, Companies' Act 1956 and Banking Regulation Act 1949.

The mergers which are taking place in the present era are mainly motivated by strategic and economic gains in the longer run, synergy opportunities may exist only in the mind of corporate leaders. A merger can also improve company's standing in the investment community; bigger firms often have an easier time raising capital than smaller ones.

Many of the mergers were successful but history trends show that roughly two-third of the merger would disappoint on their own terms, which means they lose value in the stock market. But still this strategy used by corporate in a wide assortment of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional businesses are purported at gaining strength, expanding the customer base, cutting competition or entering into a new market or product segment.

OBJECTIVES OF THE STUDY

The present study has aimed to analyze the post-merger operating performance appraisal of Acquiring Banks in terms of profitability in the Indian Banking Industry and compare the pre and post-Merger performance of Acquiring Banks.

REASONS FOR 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 in market competition- Innovation of new financial products and consolidation of regional financial system are the reasons for merger.

3) Markets developed and became more competitive and because of this market share

of all individual firm reduced so mergers and acquisition started.

4) Capability of generating economies of scale when firms are merged.

5) Transfer of skill takes place between two organization takes place which helps them to improve and become more competitive.

6) Globalization of economy impacted bank mergers.

7) New services and products- Introduction of e-banking and some financial instruments / derivatives.

8) Technology- 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.

9) 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. Cost Synergy is the savings in operating costs expected after two companies that complement each other's strengths join. Revenue Synergy is refers to the opportunity of a combined corporate entity to generate more revenue than its two predecessors stand-alone companies would be able to generate.

IMPACTS OF MERGER:

1) Diversification- When two firms merge their risk in investing assets diversify accordingly. When a firm is operating alone then they don't have many options to diversify their portfolio investment that they can get after merger.

2) Mergers and Acquisition allows firms to obtain efficiency gains through cost reductions (cost synergies) , revenue increases(revenue synergies).

3) 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.

4) Mergers and Acquisition helps firms to widen its consumer portfolio but it also leads to a more diversified range of services and offer scope economies by optimizing the synergies between the merged activities.

5) Domestic mergers cut costs for both the partners whereas for the majority of cases including domestic and cross border mergers and acquisition, the impact on profitability is insignificant but a clear trend to diversify the sources of revenue was apparent

6) In terms of cost efficiency and revenue efficiency it has been noticed that in domestic merger organisation get the benefit of cost efficiency(reduction in operating cost) and in cross border merger organisation get the benefit of revenue efficiency (increase in revenue) because of the benefit of geographical expansion and diversification.

7) Improvement in the activities of organisation, however, offer benefits from product complementarities which helps to enhance revenues.

8) Efficiency may be improved after merger and acquisition, if the acquiring company is more efficient already and brings the efficiency of the target up to its own level by providing its managerial expertise, policies and other operations.

HYPOTHESIS

To substantiate the objectives mentioned above, the hypothesis has been formulated and tested.

H0 (Null Hypothesis) = There is no significance difference between the Pre-merger and Post-merger Profitability

H1 (Alternative Hypothesis) = There is significance difference between the Pre-merger and Post-merger Profitability

DATA AND METHODOLOGY

For the purpose of analyzing the profitability of acquiring banks after Merger and Acquisitions various financial and accounting ratios are undertaken. Data of operating performance ratios for up to four years prior and seven years after the Merger and Acquisitions were collected from the financial statement of company's extracted from the website of money control. With the help of Independent sample t-test the pre-merger spanning for four years and post-merger seven years financial ratios have been compared.

The Student's t- distribution is as follows:

$$t = \frac{\bar{x}_1 - \bar{x}_2}{s} \sqrt{\frac{n_1 n_2}{n_1 + n_2}}$$

$$\bar{x}_1 = \frac{\sum x_1}{n_1}, \quad \bar{x}_2 = \frac{\sum x_2}{n_2}$$

Where $\bar{x}_1$ is the mean of pre-merger ratios of acquiring bank, $\bar{x}_2$ is the mean of post-merger ratios acquiring bank, n_1 and n_2 are the number of observations of 1st and 2nd series respectively. S is the combined standard deviation,

$$S = \sqrt{\frac{\sum(x_1 - \bar{x})^2 + \sum(x_2 - \bar{x})^2}{n_1 + n_2 - 2}}$$

$(n_1 + n_2 - 2)$ is Degree of freedom

FINANCIAL PROFITABILITY RATIOS

Operating Profit Margin = EBIT /Net Sales*100

Net Profit Margin = Net Profit /Net sales*100

Return on Net Worth= Pat /Net Worth*100

Return on Capital Employed = Net Profit /Total Assets*100

ANALYSIS AND INTERPRETATION

Researcher has selected two cases for the study that are shown in table-1. First the Merger of the Global Trust Bank Ltd with the Oriental Bank of Commerce on

14th August 2004, and the second the Merger of the South Gujarat Local Area Bank Ltd with Bank of Baroda on 25th June 2004 has been undertaken. In order to analyze the financial profitability of Acquiring Banks after the merger the Financial and Accounting ratios like Operating Profit Margin, Net Profit Margin, Return on Net Worth & Return on Capital Employed have been calculated.

Tables: 2 & 3 show the Pre-merger and the Post-merger financial performance of acquiring bank (Oriental Bank of Commerce) in terms of above ratios. The **Premerger** financial performance appraisal of the acquiring bank (**Oriental Bank of Commerce**) on the basis of ratio analysis is done. The operating profit margin for the year 2000 was 73.3314 percent. The net profit margin was 7.35447 percent with RONW & ROCE at 19.50574 and 1.13531 percent. The operating profit margin decreased at 71.8403 percent in 2001 but the net profit margin increased at 11.33495 percent. The RONW & ROCE reduced at 13.101 and 0.74943 percent. The operating profit margin remains unchanged with 71.17057 percent and the net profit margin had slightly decline at 10.54277 percent. However, the RONW & ROCE shows improvement in the year 2002 at 19.79033 and 0.99355 percent. But in the financial year before the merger, the operating profit margin dropped at 69.33823 percent as well as the net profit margin, RONW & ROCE escalate in the year 2003 at 13.86928, 21.66317 and 1.34445 percent. The **Post-merger** performance appraisal of acquiring bank (Oriental Bank of Commerce) for the very next year declined in terms of operating profit margin at 66.51977 percent but the net profit margin mount at 20.32727 percent. The RONW & ROCE remain unchanged at 21.82349 and 1.34284 percent in the year 2005. The operating profit margin has improved in the year 2006 with 71.03755 percent however the net profit margin, RONW & ROCE reduced at 13.52684, 10.77516 percent and 0.94534 percent. The operating profit margin has increased in the year 2007 at 75.96332 percent but the other ratios like net profit margin & RONW remain unchanged except the return on capital employed show declined with 11.24532, 10.37103 and 0.78555 percent. The net profit margin, RONW & ROCE reduced in the year 2008 at 5.16454, 6.11541 & 0.38941 percent but the operating profit show improved performance and moved up to 84.8385 percent. The net profit margin, RONW &ROCE again shows positive movement in the year 2009 after declined in the previous year at 10.22326, 12.2297 & 0.80422 percent and the only operating profit margin slightly decline in the year 2009 at 78.45936 percent. The operating profit margins again fell at 75.60757 percent and the net profit margin, RONW & ROCE rose in the year 2010 at 11.06236, 13.77381 & 0.82563 percent. The ratio analyses for the year 2011 had declined in terms of operating profit margin, net profit margin, RONW & ROCE moved at 74.36245, 8.71017, 9.48775 & 0.65256 percent. In tables 4 & 5 further shed the light on the Pre-Merger and Post-Merger ratios of Bank of Baroda (Acquiring Bank) which is used for the analysis. The ratio analyses of the **Pre-merger** period of acquiring bank (**Bank of Baroda**) for the years 2000 to 2003.The operating profit margin for the year 2000 at 64.51834 percent with the net profit margin was 9.63125 percent along with the ratios like RONW & ROCE at 15.54349 and 0.85789 percent. The operating profit margin and net profit margin declined in the year 2001 at 58.8454 & 4.7706 percent. The RONW and ROCE also dropped off at 8.18346 and 0.43375 percent. Later in 2002 all the ratios such as operating profit margin, net profit margin, RONW & ROCE improved with 65.12541, 9.16659, 14.26212 & 0.76987 percent. In the year 2003 operating profit margin decreased at 64.00915 percent and the ratios like net profit margin, RONW & ROCE improved before the merger of banks at 12.67361, 17.61534 & 1.01125 percent. The **Post-merger** ratios of acquiring bank for the very next year 2005 were declined, the operating profit margin and net profit margin at 46.80839 and 10.52397 percent. The RONW and ROCE were 12.0268 and 0.71499 percent. The ratio analyses for the year 2006 shows improved performance as comparing with the previous year, the OPM, NPM and ROCE mount at 53.49295, 11.64732 & 0.72928 percent except the return on net worth 10.54198 percent. For the year 2007, the operating profit margin increased at 64.12472 percent and net profit margin has remained same at 11.4197 percent. The return on net worth and return on capital employed were at 11.86678 and 0.71707 percent. The operating profit margin increased in the year 2008 was at 68.2084 percent and ratios like NPM, RONW & ROCE shows improvement and moved at12.15155, 12.99827 and 0.79928 percent. The operating profit margin and net profit margin showed a positive improvement and moved up to at 69.92945 and 14.75789 percent, while the return on net worth and return on capital employed increased up to at 17.35182 and 0.97939 percent in the year 2009. All the ratios shows positive improvement in the year 2010 the performance of acquiring bank in terms of OPM, NPM,RONW & ROCE and stimulated at 73.00462, 18.31517, 20.24527 & 1.09886 percent. The performance of acquiring bank for the year 2011 continuously increased except the operating profit margin which had slightly reduced. But the net profit margin & return on capital employed moved the highest level at 19.38086 and 1.8351 percent along with return on net worth for the same year was 20.2051 percent.

Table 6 shows t-test analysis of **case I** (the Global Trust Bank Ltd with the Oriental Bank of Commerce). The analysis indicates that the mean of operating profit margin (71.4201 vs 75.2555) and t-value of -1.279 which leads to the conclusion that there is improvement in the Operating Profit Margin after the Merger but not significant statistically, the results also indicate that the mean of Net Profit Margin (10.7754 vs 11.4658) and t-value of -.267 which shows the performance in terms of net profit margin of oriental bank of commerce improved but not significant statistically, it is found that there is increase in the mean of Return on Net Worth (18.5151 vs 12.0823) and t-value 2.254. It seems to have declined so it is considered that it is not affected by merger therefore it is not significant statistically. The mean value of Return on Capital Employed(1.0557 vs 0.8208) and t-value 1.352 which leads to the conclusion that the performance of bank in terms of return on capital employed has declined so it is not significant statistically.

Table 7 shows the **case II (**the South Gujarat Local Area Bank Ltd with the Bank of Baroda). The comparison of the Pre-Merger and Post-Merger operating performance ratios for the sample of banks merger shows that there is no change in the mean of Operating Profit Margin (63.1446 vs 64.0480) and t-value -.174 which is statistically insignificant but there is positive improvement in the Net Profit Margin after the merger with mean value (9.0605 vs 14.0281) and t-value - 2.292 which is however significant statistically. While Return on Net Worth the mean is (13.9011 vs 15.0337) and t-value -.440 which records slightly improvement in post-merger period but leads to the conclusion that it is not significant statistically. The mean value of Return on Capital Employed (0.7682 vs 0.8889) and t- value -0.901 which leads to the conclusion that there is no change in the return on capital employed after the merger therefore it is statistically insignificant. It is therefore concluded that all the financial ratios do not improve after the merger so the performances of banks in terms of financial profitability remain unchanged.

TABLE 1: LIST OF SELECTED BANKS MERGER FOR STUDY

S. No	Name of the Transferor Bank	Name of the Transferee	Bank Date of Merger
1	Global Trust Bank Ltd.	Oriental Bank of Commerce	August 14, 2004
2	South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 25, 2004

Source: Researcher's compilation from Report on Trend and Progress, RBI, Various Issues, VIII competition and consolidation, 04 Sep 2008.

TABLE 2: PRE MERGER RATIO ANALYSIS OF ORIENTAL BANK OF COMMERCE FOR THE YEARS 2000 TO 2003 Financial Ratios (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net worth	Return on Capital Employed
2000	73.3314	7.35447	19.50574	1.13531
2001	71.8403	11.33495	13.101	0.74943
2002	71.17057	10.54277	19.79033	0.99355
2003	69.33823	13.86928	21.66317	1.34445

Source: Researcher's compilation from financial statement of Banks retrieved from http://www.moneycontrol.com/stocksmarketsindia/

TABLE 3: POST MERGER RATIO ANALYSIS OF ORIENTAL BANK OF COMMERCE FOR THE YEARS 2005 TO 2011 Financial Ratios (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2005	66.51977	20.32727	21.82349	1.34284
2006	71.03755	13.52684	10.77516	0.94534
2007	75.96332	11.24532	10.37103	0.78555
2008	84.8385	5.1654	6.11541	0.38941
2009	78.45936	10.22326	12.2297	0.80422
2010	75.60757	11.06236	13.77381	0.82563
2011	74.36245	8.71017	9.48775	0.65256

Source: Researcher's compilation from financial statement of Banks retrieved from http://www.moneycontrol.com/stocksmarketsindia/

TABLE 4: PRE MERGER RATIO ANALYSIS OF BANK OF BARODA FOR THE YEARS 2000 TO 2003 Financial Ratios (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2000	64.51834	9.63125	15.54349	0.85789
2001	58.8454	4.7706	8.18346	0.43375
2002	65.12541	9.16659	14.26212	0.76987
2003	64.00915	12.67361	17.61534	1.01125

Source: Researcher's compilation from financial statement of Banks retrieved from http://www.moneycontrol.com/stocksmarketsindia/

TABLE 5: POST MERGER RATIO ANALYSIS OF BANK OF BARODA FOR THE YEARS 2005 TO 2011 Financial Ratios (in Percentage)

Years	Operating Profit Margin	Net Profit Margin	Return on Net Worth	Return on Capital Employed
2005	46.80839	10.52397	12.0268	0.71499
2006	53.49295	11.64732	10.54198	0.72928
2007	64.12472	11.4197	11.86678	0.71707
2008	68.2084	12.15155	12.99827	0.79928
2009	69.92945	14.75789	17.35182	0.97939
2010	73.00462	18.31517	20.24527	1.09886
2011	72.767276	19.38086	20.2051	1.18351

Source: Researcher's compilation from financial statement of Banks retrieved from http://www.moneycontrol.com/stocksmarketsindia/

TABLE 6: MEAN AND MEDIAN OF THE PRE MERGER AND POST MERGER RATIOS OF ACQUIRING BANK (ORIENTAL BANK OF COMMERCE)

	Mean		Standard deviation		t-value
	Pre	Post	Pre	Post	
Operating Profit Margin	71.4201	75.2555	1.65591	5.73912	-1.279
Net Profit Margin	10.7754	11.4658	2.68589	4.68717	-0.267
Return on net worth	18.5151	12.0823	3.73410	4.91166	2.254
Return on capital employed	1.0557	0.8208	0.24992	0.28982	1.352

Source: Researcher's compilation based on tables 2&3, 5% level of significance

TABLE 7: MEAN AND MEDIAN OF THE PRE MERGER AND POST MERGER RATIOS OF ACQUIRING BANK (BANK OF BARODA)

	Mean		Standard deviation		t-value
	Pre	Post	Pre	Post	
Operating Profit Margin	63.1246	64.0480	2.88904	10.13876	-0.174
Net Profit Margin	9.0605	14.0281	3.25550	3.55518	-2.292
Return on net worth	13.9011	15.0337	4.05441	4.13656	-0.440
Return on capital employed	0.7682	0.8889	0.24425	0.19679	-0.901

Source: Researcher's compilation based on tables 4&5, 5% level of significance

RESULTS AND DISCUSSIONS

The analysis suggests that the performance of Oriental Bank of Commerce after acquired global trust bank Ltd has not been improved in terms of Operating Profit Margin, Net Profit Margin, Return on Net Worth & Return on Capital Employed with t- values (-1.279, -.267, 2.254, 1.352) which led to the conclusion that there is no significance difference in all the ratios after the merger and the performance of Oriental Bank of Commerce was not improved in terms of profitability, similarly the performance of Bank of Baroda after acquired South Gujarat Local Area Bank ltd has not been improved in terms of Operating Profit Margin, Return on Net Worth & Return on Capital Employed. Only Net Profit Margin shows improvement after the merger with t-values (-.174,-2.292,-.440,-901) which concludes that there is no difference in the mean value of the Pre-Merger and Post-Merger operating performance of acquiring (Bank of Baroda) and concluded that it is not significant statistically. The profitability of both acquiring banks has not improved after the merger, therefore Null Hypothesis is accepted and Alternative Hypothesis is rejected. The results say that though Merger is helpful for expansion and growth but no guarantee for improving the profitability of acquiring banks.

CONCLUSION

It is clear from the analysis that the only hypothesis set for the validation has been accepted. Both the acquiring banks (Oriental Bank of Commerce & Bank of Baroda) have not created positive difference after the merger in terms of profitability. For comparing the accounting ratios like, Operating Profit Margin, Net Profit Margin, Return on Net worth etc. of the Pre and Post-merger the t-test is applied. After the merger we see that the various financial parameters of the bank performance have not improved in both cases, the profits are not visible but it may be possible that improved performance of merged Bank will show in later years. There are various motives, which attract the bank for merger but it is not necessary to achieve all objectives after merger. The size of the bank may increase but no guarantee to increase net profitability after merger. Result concluded that the merger and acquisitions is the useful tool for growth and expansion in the Indian banking sector. Future research in this area could be the study of impact of merger on shareholder's wealth and take more banks to a larger sample concerning a longer time period for the study which would have given better result.

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