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Post merger financial analysis on bank mega merger: An empirical study 2019-20

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Abstract: Recently Indian banking industry has witnessed bank mergers under the guidelines of RBI and Central Government Interventions. Many Banks (PSB) facing problems like Basel-III norms, CAR, NPA performance and assets valuations issues which may be improved from these recent mergers during 2019-20.Initially banks were merged to save non-performing banks or non efficient banks but as time evolved the system too evolved. In the recent times mergers and acquisitions have also been made on grounds of business growth, profitability and organizational restructure. Every merger creates its own noise but it is the substance that counts in the long run. The researchers want to reveal the post merger analysis of Indian Banks on the basis of financial performance and efficiency. They also want to highlight the issues and motives with Indian bank mergers during 2019-20

Keywords*:* Non Performing Assets (NPA), CASA (Current Account Saving Account) Ratio, PCR (Provision Coverage Ratio), NPL (Non Performing Loan)

I. INTRODUCTION

Mergers are a kind of corporate marriage in which different entities decided to form a new family with lots of expectation and happiness thereafter. So merger in country like India is not a new form, it's been more than a diamond jubilee when it's started.
Post independence its has been significantly observed mergers in banking sector and how a big fish swallow a weak one and many times due to RBI or Central Government Guidelines.
Conventionally, the general motives for bank mergers fall into four major groups: cost benefits (economies of scale, efficiency, cost of funding, risk diversification and returns); revenue benefits (economies and scope for large deals); economic conditions (business cycles); and other motives (valuation, managerial benefits, takeovers, etc).The story line can be on a same page but the intention by mandate body is quite questionable on many grounds.

So From 1st April 2020, the biggest overhaul in public sector banks has left India with only 12 banks now instead of 18 before the merger. Now the leftover big banks according to their market share are as follow:

Banking order (Largest to Smallest)	Business in Lakhs of crore Rupees	Market Share
State Bank of India	52.1	22.5
PNB+OBC+United Bank	17.9	7.7
HDFC Bank	17.5	7.6

Bank of Baroda	16.1	7
Canara + Syndicate Bank	15.2	6.6
Union+Andhra+Corporation Bank	14.6	6.3
ICICI Bank	12.7	5.5
Axis Bank	10.6	4.6
Bank of India	9.0	3.9
Indian + Allahabad Bank	8.1	3.5

History of Mergers in Indian Banking
Mergers of banks began in India in the 1960s in order to bail out the weaker banks and protect the customer interests. After that in post liberalization period the quest to create an Indian bank that would be in the league of global giants had been continuing since 1990. Moving on the path of creating one of the largest global banks, the government had approved the merger of five associate banks with SBI in February 2017. Later in March, the Cabinet approved merger of BMB also.

Merger & Nationalization during the period from 1961-1969: The period is called pre-nationalization period because in 1969 the government nationalized 14 private banks. As many as 46 mergers took place mostly of private sector banks in order to revive the poorly performing banks which proved to be quite a successful move for the underperforming banks.

The period from 1969-1991: The period was called post-nationalization period. It saw six private banks being nationalized in 1980. In this period 13 mergers took place mostly between public and private sector banks.

Bank Mergers (1993-2004): The merger of Oriental Bank of Commerce with Global Trust bank in 2004 saved the latter after its net worth had wiped off and also handed OBC a million depositors and a decent market in South India. Mergers of Punjab National Bank (PNB) with the then eroded New Bank of India (NBI) in 1993-94 and that of Banaras State bank Ltd with Bank of Baroda in 2002 also proved to be life saving for the weaker bank.

Bank Mergers & Consolidation 2008-2010: SBI first merged State Bank of Saurashtra with itself in 2008. In 2010, State Bank of Indore was merged with it. The board of SBI earlier approved the merger plan under which SBBJ shareholders got 28 shares of SBI (Re.1 each) for every 10 shares (Rs10 each) held. Similarly, SBM and SBT shareholders got 22 shares of SBI for every 10 shares.

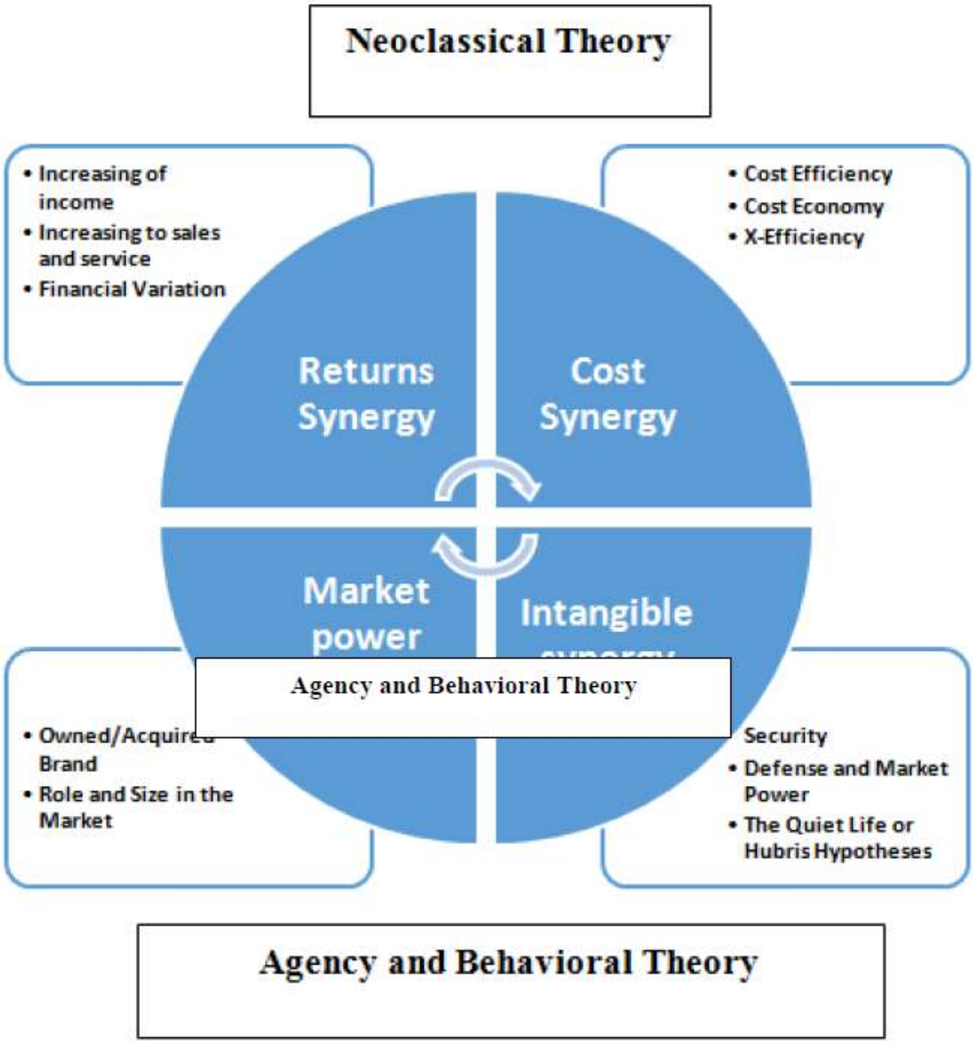
Consolidation of Banks (2015-2017) – This phase saw five associates of SBI and Bhartiya Mahila Bank getting merged in SBI. The vision was to have strong banks rather than having large number of banks. This resulted in SBI being one amongst the 50 largest banks in the world.

Merger of Banks 2018- The government had merged Dena Bank and Vijaya Bank with Bank of Baroda, creating the third-largest bank by loans in the country in 2018.

Mega Merger of Banks 2019- With the mega merger announces on August 30, 2019, ten public sectors banks are now reduced into four large banks. The four sets of banks that have been created out of Canara Bank and Syndicate Bank merger; Indian Bank and Allahabad Bank merger; Union Bank of India, Andhra Bank and Corporation Bank merger; and the bank to be created after merger of Punjab National Bank, Oriental Bank of Commerce and United Bank of India. So our study is based on the mega merger of 2019 in which four banks are left after subsuming 6 banks as per the guidelines of finance minister and RBI regulations[1].

[1] *Source : TOI dated Aug 31. 2019*

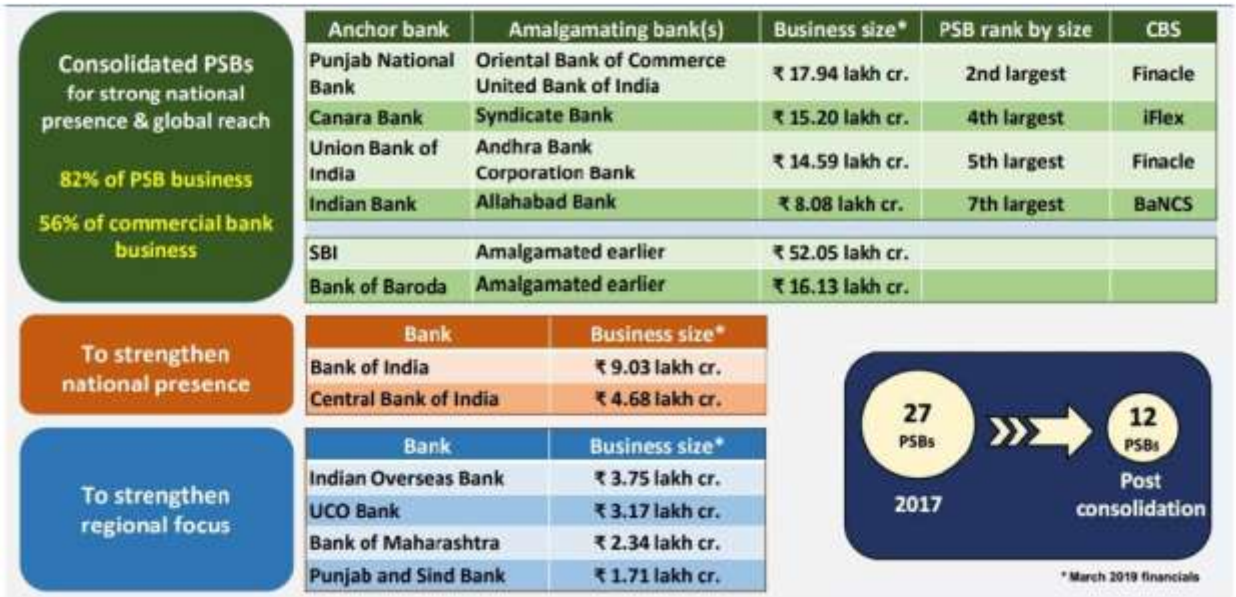
Generally mergers happen in manifolds, but however some common context can be observed in mega mergers as per theories suggested



So many mergers are inclined towards agency and behavioral theory which clearly indicates four aspects namely Return Energy(Cost Benefit Analysis),Cost Energy, Market Power(Capturing National and International) and Intangible Synergy(1+1 > 2).

Some Information Glimpse of Mega Mergers Announcement:

A trend already set for the mergers it's just announcement called earlier but finance minister office already started covering various aspect in which they came up with big plan mergers. As we can observe the post merger business size was an attraction factor and which strengthen the regional and national presence (Pictorial 1)

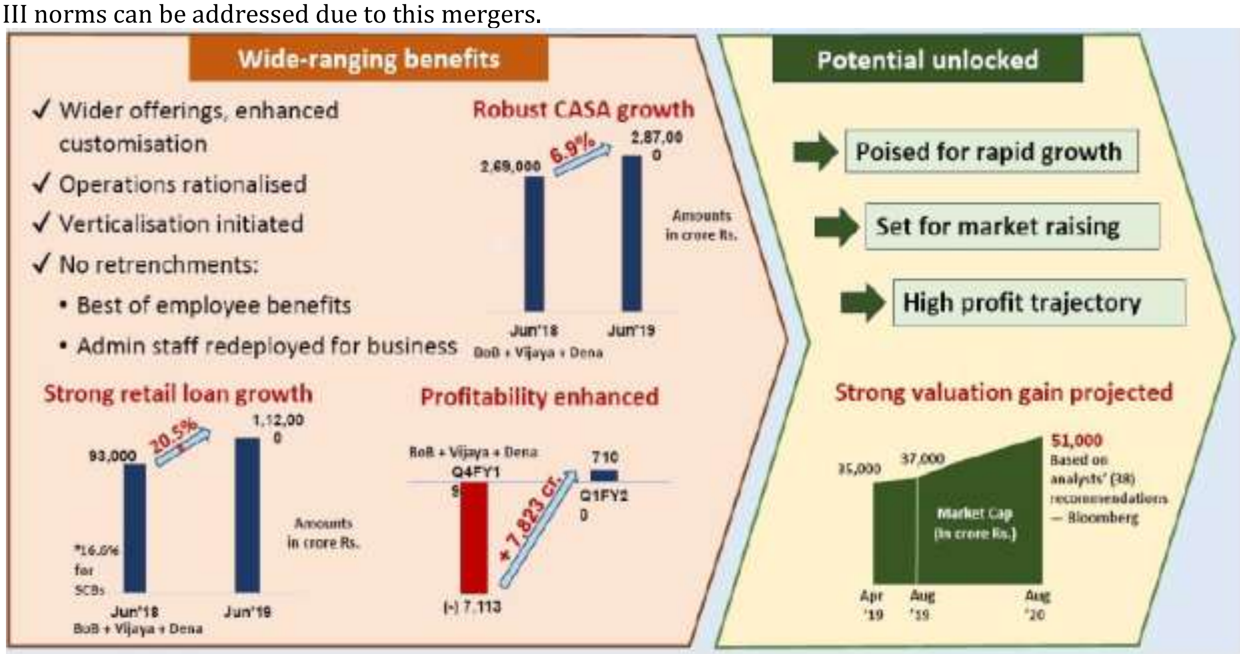


Pictorial 1: Upcoming trends in PSB

Source: Department of Financial Services, Ministry of Finance, GoI

It also more clearly dictate the conceptual framework of government for reducing 27 PSB into 12 PSB while considering pros and cons in major areas.

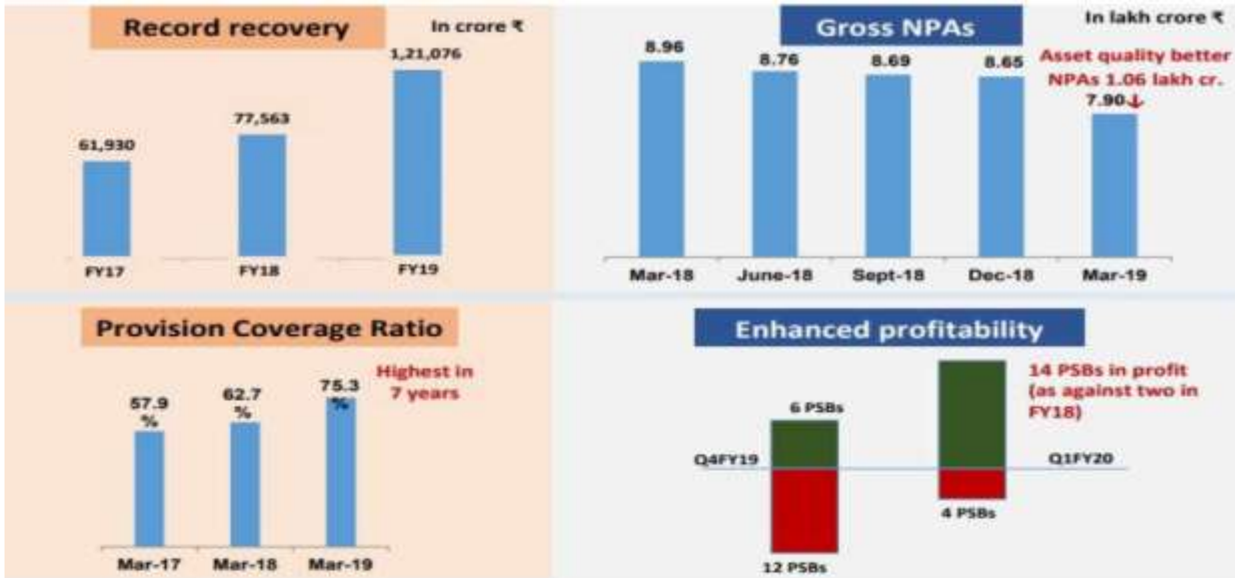
Talk about benefits, apart from this customer base and NPA valuation will be improved , followed by BASEL-III norms can be addressed due to this mergers.



Pictorial 2 : Win-Win Situation for PSB

Source: Department of Financial Services, Ministry of Finance , GoI

While in pictorial 3 the Bank PCR, Assets Quality(Loans & Advance) and loss making PSB will have better future growth potentials as of big pool generates synchronization of bad loans in good growth



Pictorial 3: Bank Heart Pumping Growth

Source: Department of Financial Services, Ministry of Finance, GoI

II. LITERATURE REVIEW:

As per recent trend many mergers can be observed during last one decade in banking sectors, as far as **Venkatesh(2020)** in his working paper **"Is the merger of banks on the path of expected yields?"** in which they highlighted the model of InvDEA which evaluate merger entity efficiency on various ground, in which they show case that the public sector banks are performing well to achieve the merger gains. Even the differences observed may improve in first financial year results with the positive note.
While **Adhana and Raguvanshi(2020)** in their paper **"Big Bank Theory: A Study of amalgamation plan of 10 public sector bank into 4 entities"** they needed more lending capacity so they could provide better services using modern technology, consolidation required and capturing international market. Along with that merger the focus should be on adequate reforms in governance and management of these banks on positive note.

In same context **Adhana and Saxena(2016)** in his paper **"Big is Beautiful : A Study of amalgamation plan of 27 public sector bank into 6 large instituitions"** discussed the government seems committed to fusing banks will lead to improve the efficiency and service delivery of the public sector banks, but however capital' scare as many of the banks were low on capital, and then came the 'NPA' scare has also led its more difficult.

According to **The ECB Report (2006),** small bank M&As are mostly being carried out for cost efficiency reasons, such as economies of scale. Larger bank M&As often have structural changes which led to firm cost optimization

Renaud (2016) witnessed the main reason for merger and acquisition is the synergy that can be generated by the combination of business activities which will lead to sustainable growth

KomalGupta (March 2015) said Banking sector plays a crucial role into the economic growth and development of a nation. In order to address the changing environment, the banking sector is resorting to the process of mergers, corporate restructuring and strengthening to remain efficient and viable which is the need of the hour.

Objectives of the study

- To analyze relationship between bank valuation from the change in CASA ratio, NPA and CAR of post bank merger during 2019-20
- To study the pre-post merger analysis on the basis of key factors
- To highlight the issues highlighted during mega bank mergers

Research Hypothesis

Ha1 : There is a significant relationship on bank valuation from the change in CASA ratio,NPA and CAR of post bank merger period

Ha2 : There is a significant change in pre-post merger financial analysis of bank mergers

III. RESEARCH METHODOLOGY

Sample Size: For analyzing bank post merger performance researcher have taken all the 4 resultant bank of mega-merger which was made by Union Finance Minister **Nirmala Sitharaman** in 2019 for analyzing the hypothesis for which the data is available on RBI websites and other portals

S. No.	Acquirer Bank(merged to)	Merging Banks(Dissolving Bank)
1	Punjab National Bank	Oriental Bank of Commerce and Union Bank of India
2	Indian Bank	Syndicate Bank
3	Canara Bank	Allahabad Bank
4	Union Bank of India	Andhra bank and Corporation Bank

Statistics: For analyzing the relationship, following test will be used namely

- Correlation & R^2
- T test for Significance(p value)

For Comparing Pre-Post Merger analysis

- T Paired Test(P values)
- Correlation & R Squared

Software Tools: Using SPSS and Excel

IV. DATA ANALYSIS AND INTERPRETATIONS

	PNB		CANARA BANK		INDIAN BANK		UNION BANK	
	NOW	POST MERGER	NOW	POST MERGER	NOW	POST MERGER	NOW	POST MERGER
Loan book size (₹ cr)	4,58,200	6,84,500	4,27,700	6,32,800	1,81,300	3,23,500	2,96,900	5,77,000
CASA ratio (%)	42.2	40.5	29.2	30.2	34.7	41.6	36.1	33.8
Net NPL (%)	6.6	6.4	5.4	5.6	3.7	4.4	6.8	6.3
PCR (%)	61.7	59.7	41.5	44.3	49.1	66.2	58.3	63.1
Tier-1 equity (%)	7.5	8.3	9.2	9.8	11.5	9.8	9.6	10

BCCL

[2]

Four Mega Merger Banks have been taken as sample and paired T test Applied;

Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	CASA_RATIO_Before	35.5500	4	5.34072	2.67036
	CASA_RATIO_After	36.5250	4	5.44633	2.72316
Pair 2	provision_coverage_ratio_Before	52.6500	4	9.14239	4.57120
	provision_coverage_ratio_After	58.3250	4	9.71953	4.85976
Pair 3	Non_performing_Loan_Before	5.6250	4	1.42449	.71224
	Non_performing_Loan_After	5.6750	4	.92150	.46075

While the Standard error for mean is low in case of NPL and CASA ratio, its shows the improvement as the variation is low while comparing Pre-Post merger analysis.

Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	CASA_RATIO_Before & CASA_RATIO_After	4	.697	.303
Pair 2	provision_coverage_ratio_Before & provision_coverage_ratio_After	4	.630	.370
Pair 3	Non_performing_Loan_Before & Non_performing_Loan_After	4	.994	.006

As far as correlation is concern, there is high degree of correlation in NPL , which shows high degree of dependency and P value<0.05, which make it significant as compare to others.

Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference Lower	Upper			
Pair 1	CASA_RATIO_Before - CASA_RATIO_After	-.97500	4.20268	2.10134	-7.66240	5.71240	-.464	3	.674
Pair 2	provision_coverage_ratio_Before - provision_coverage_ratio_After	-5.67500	8.13362	4.06681	-18.61741	7.26741	-1.395	3	.257
Pair 3	Non_performing_Loan_Before - Non_performing_Loan_After	-.05000	.51962	.25981	-.87682	.77682	-.192	3	.860

As we can see, T test showing there is no improvement/significant in terms of CASA Ratio, while in PCR and NPL showing significant change in post merger analysis.

[2] Source: Kotak Securities

Descriptive Statistics

	Mean	Std. Deviation	N
Bank_Valuation_Merger_In_Crores	1487250.0000	410297.75773	4
CASA_RATIO_After	36.5250	5.44633	4
provision_coverage_ratio_After	58.3250	9.71953	4
Non_performing_Loan_After	5.6750	.92150	4

Correlations

		Bank_Valuation_Merger_In_Crores	CASA_RATIO_After	provision_coverage_ratio_After	Non_performing_Loan_After
Pearson Correlation	Bank_Valuation_Merger_In_Crores	1.000	-.458	-.795	.615
	CASA_RATIO_After	-.458	1.000	.763	-.320
	provision_coverage_ratio_After	-.795	.763	1.000	-.186
	Non_performing_Loan_After	.615	-.320	-.186	1.000
Sig. (1-tailed)	Bank_Valuation_Merger_In_Crores	.	.271	.103	.192
	CASA_RATIO_After	.271	.	.119	.340
	provision_coverage_ratio_After	.103	.119	.	.407
	Non_performing_Loan_After	.192	.340	.407	.
N	Bank_Valuation_Merger_In_Crores	4	4	4	4
	CASA_RATIO_After	4	4	4	4
	provision_coverage_ratio_After	4	4	4	4
	Non_performing_Loan_After	4	4	4	4

While seeing the relations of Business Valuation of Banks Giants, NPL have a positive correlation, while PCR and CASA have negative correlation which reflects that higher business value leads to low Provision Coverage and low Current Account and Saving Account.

Some Points related to general issue/implications in Mega Mergers 2019:

1. Larger mergers are not always stronger as many small banks are quite well on their individual existence like Allahabad bank having improved NPA, but most merger entity has huge impact on NPA due the poor maintenance of resultant company.
2. If the merger is a market-driven process, some factors could have been discounted. But since it is one from a mandate, uncertainties arise about efficacy of this exercise falling short of expectations in the long run.
3. The brokerage believes that under its swap ratio assumptions, the negative impact would be the highest for Union Bank and Indian Bank due to poor assumptions. The mergers will keep state run banks busy in the integration process for a long time and thus Arbitrage situations can be seen with private banks further consolidate their business market share.
4. Banks are merged only on papers. Their people and culture are difficult to change. It is a recipe for disaster as it leads to poor culture fit not ideal for the organization or the economy which can be seen with regional banks.

5. Bank Customers got affected in many ways from their account number to IFSC code and other notification, credit limits, balance maintenance, Borrowing or Lending or Deposit rates may have an impact which cannot be measured while announcing mergers.
6. The diversity in cultures may prove challenging during integration and may also lend no major cost benefits from the merger. Further, Indian Bank will see deterioration in its asset quality owing to Allahabad Bank's unhealthy loan book and Dena Bank.
7. However, its asset quality position of mega merger banks will take a hit, with the merged bank likely to report the highest gross NPA ratio among the four entities which make them bitter to digest.
8. A recent McKinsey report (2019) sees banks in Asia Pacific 'grappling with thinning margins, declining asset quality, and rising capital costs', which can be seen quite often in Indian Bank Mergers.
9. It must be an organic merger , which create ambush opportunities for both merged and resultant company but however the execution part is the major concern
10. In operational efficiency front, high rate of labor turnover also accompanied by new hiring because of the management style of new banking led, but it's not that motivation for regional banks as they have diverted many customer on regional facilitating grounds which not as followed by merged banking motto.
11. Many smaller banks will lose local characteristics, which customers preferred because of cultural affinity and local support which led to bigger customer base.
12. In Economic slowdown, it's a challenge to put each step towards new formation is important, as it might lead to any crisis, so a balance approach is quite appropriate

And there are many views from the expert in which stated that, "In general everything looks good from rear views, but the implication to do justice with mergers is quite questionable, it's not about how big or small mergers, but rather its more to understand how we can take it for long run in a sustainable base".

V. CONCLUSION

Without any single thought, mergers and amalgamation is an huge tools in maintain liquidity & solvency , creating more transparency in business and effective banking administrative efficiency ,but the fact is that not any of the amalgamating bank is showing negative return or unstable scenario. We would like to conclude that the even after huge arrangement quarterly performance is not that satisfactory as expected or projected by government, yes indeed it's a long run show, but however the initial sign of positivity in the eye of investor still subject to many unanswered questions.

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