International Journal for Multidisciplinary Research (IJFMR)
E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

Impact of Merger and Acquisition on Financial Performance of Public Sector Banks: A Case Study on Bank of Baroda

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ABSTRACT:

This study looks at merger process that has happened in the Indian banking sector, this can be achieved through cost reduction and increasing revenue. This study also analysis the recent trends in banks regarding the merger of banking sectors, especially in trying to understand various motivations for merger and how merger affect financial performance and operational efficiency, The Banking sector has played very important role in the Indian economy. In India, the mergers & acquisitions are the important process in the banking industry to reduce cost of operating NPA's and to increase the economies of scale till April 1, 2020 but now with the amalgamation of 10 public sector banks (PSB's) into 4 mega banks, the number decreased to 12 PSB's.

The main aim of the amalgamation of PSB's is to strengthen banking sectors of this nation, RBI regulators. The banking sector of the Indian economy keeps an eye on the functioning of the banks in our country.

Keywords: PSB's, mergers & acquisition, amalgamation, NPA's & RBI, Financial Ratio and Financial Performance

I. INTRODUCTION:

In the month of August 2019, the Finance minister of India M S Nirmal Sitharaman has announced to merge 10 public sector banks to increase the competitions of the Indian banks. Now the PSB's are reduced to 12 from 27 in 2020.The main aim of this amalgamation of PSB's is to reduce the NPA's (bad loans). Before the analysis of merger of the 10 banks, we should know the meaning of merger.

Merger meaning: A merger occurs when two separate entities combine force to create a new joint organization to reduce competition.
Here is all you need to know about the mega merger of PSB's that will come into force 1 April 2020.

Merger – 1
OBC+PNB+SUBI
Oriental bank of commerce & United bank of India are merged with the Panjab national bank after this merges PNB is second largest PSB in India after the SBI.

Merger -2

Syndicate bank + canara bank Syndicate bank is merged with the canara bank, after this merges canara bank is 4^{th} largest PSB in India.

Merger -3

Andhra bank + corporation bank + Union bank of India

Andhra bank & corporation bank is merged with union bank of India. After this Union bank of India is 5^{th} largest PSB.

Merger – 4

Indian bank merged with Allahabad bank.

MEANING:

Merger is a financial tool that is used for enhancing long-term profitability by expanding their operations. Mergers occur when the merging companies have their mutual consent as different from acquisitions,

DEFINITION:

Merger is defined as combination of two or more companies into a single company where one survives and the others lose their corporate existence. The survivor acquires all the assets as well as liabilities of the merged company or companies. Generally, the surviving company is the buyer, which retains its identity, and the extinguished company is the seller. Merger is also defined as amalgamation.

TYPES OF MERGERS:

Merger or acquisition depends upon the purpose of the offer or company it wants to achieve. Based on the offeror‟s objectives profile, combinations could be vertical, horizontal, circular and conglomeratic as precisely described below with reference to the purpose in view of the offer or company.

1. **Horizontal combination:** It is a merger of two competing firms which are at the same stage of industrial process. The acquiring firm belongs to the same industry as the target company. The main purpose of such mergers is to obtain economies of scale in production by eliminating duplication of facilities and the operations and broadening the product line, reduction in investment in working capital, elimination in competition concentration in product, reduction in advertising costs, increase in market segments and exercise better control on market
2. **Vertical combination:** A company would like to take over another company or seek its merger with that company to expand espousing backward integration to assimilate the resources of supply and forward integration towards market outlets. The acquiring company through merger of another unit attempts on reduction of inventories of raw material and finished goods, implements its production plans as per the objectives and economizes on working capital investments.
3. **Circular combination:** Companies producing distinct products seek amalgamation to share common distribution and research facilities to obtain economies by elimination of cost on duplication and promoting market enlargement. The acquiring company obtains benefits in the form of economies of resource sharing and diversification.

4. **Conglomerate combination**: It is amalgamation of two companies engaged in unrelated industries like DCM and Modi Industries. The basic purpose of such amalgamations remains utilization of financial resources and enlarges debt capacity through re-organizing their financial structure so as to service the shareholders by increased leveraging and EPS, lowering average cost of capital and thereby raising present worth of the outstanding shares.

ACQUISITION:

An Acquisition usually refers to a purchase of a smaller firm by a larger one. Acquisition, also known as a takeover or a buyout, is the buying of one company by another. Acquisitions or takeovers occur between the bidding and the target company. There may be either hostile or friendly takeovers. Acquisition in general sense is acquiring the ownership in the property. In the context of business combinations,

TYPES OF ACQUISITION

There are different types of Acquisitions/takeover are Friendly takeovers, Hostile takeovers and Reverse takeovers.

1. **Friendly takeovers:** Before a bidder makes an offer for another company, it usually first informs that company's board of directors. If the board feels that accepting the offer serves shareholders better than rejecting it, it recommends the offer be accepted by the shareholders. In a private company, because the shareholders and the board are usually the same people or closely connected with one another, private acquisitions are usually friendly. If the shareholders agree to sell the company, then the board is usually of the same mind or sufficiently under the orders of the shareholders to cooperate with the bidder.
2. **Hostile takeovers:** A hostile takeover allows a suitor to bypass a target company's management unwilling to agree to a merger or takeover. A takeover is considered "hostile" if the target company's board rejects the offer, but the bidder continues to pursue it, or the bidder makes the offer without informing the target company's board beforehand. A hostile takeover can be conducted in several ways. A tender offer can be made where the acquiring company makes a public offer at a fixed price above the current market price. Tender offers in the USA are regulated with the Williams Act. An acquiring company can also engage in a proxy fight, whereby it tries to persuade enough shareholders, usually a simple majority, to replace the management with a new one which will approve the takeover.

1. **Reverse takeovers:** A reverse takeover is a type of takeover where a private company acquires a public company. This is usually done at the instigation of the larger, private company, the purpose being for the Private Company to effectively float itself while avoiding some of the expense and time involved in a conventional IPO. However, under AIM rules, a reverse take-over is an acquisition or acquisitions in a twelve month period which for an AIM company would.

- Exceed 100% in any of the class tests; or
- Result in a fundamental change in its business, board or voting control;

STAGES INVOLED IN ANY MERGER AND ACQUISITION

Phase 1: Pre- acquisition review: this would include self –assessment of the acquiring company with regards to the need for M&A ascertains the valuation (undervalued is the key) and chalk out the growth plan through the target.

Phase 2: Search and screen target: this would include searching for the possible apt takeover candidates; this process is mainly to scan for a good strategic fit for the acquiring company.

Phase 3: Investigate and valuation of the target: once the appropriate company is shortlisted through primary screening, detailed analysis of the target company has to be done. This is also referred to as due diligence.

Phase 4: Acquire the target through negotiation: once the target company is selected, the next step is to start negotiations to come to consensus for a negotiated merger or a bear hug. The brings both the companies to agree mutually to the deal for the long term working of the M&A.

Phase 5: Post-merger integration: if all the above steps fall in place, there is a formal announcement of the agreement of merger by both the participating companies.

Recent trends in merger of Indian banking sectors

Name of the acquiring bank	Name of the target bank	Year of merger
Panjab National Bank	New Bank Of India	1993
Bank Of India	Bank Of Karad Ltd	1994
State Bank Of India	Kashinath State Bank	1995
Oriental Bank Of Commerce	Panjab Co- Op Ltd	1996
Oriental Bank Of Commerce	Bari Doab Bank Ltd	1997
Union Bank Of India	Sikkim Bank Ltd	1999
Bank Of Borada	Bareilly Co Op Ltd	1999
HDFC Bank Ltd	Times Bank Ltd	2000
ICICI Bank	Bank Of Madur	2001
Bank Of Baroda	Banaras State Bank Ltd	2002
ICICI Bank	ICICI Ltd	2002
Panjab National Bank Ltd	Nedungadi Bank Ltd	2003
Oriental Bank Of Commerce	Global Trust Bank	2004
Bank Of Baroda	South Gujarat Local Area Bank	2004
IDBI Bank	IDBI	2004
IDBI Bank	United Western Bank	2006
Federal Bank	Ganesh Bank of Kurandwad	2006
Icici Bank	Singli Bank	2006
Indian Overseas Bank	Bharath Overseas Bank	2007
HDFC Bank	Centurion Bank Of Panjab	2008
Icici Bank	Bank Of Rajastan Ltd	2010
Kotak Mahindra Bank	ING Vyasa Bank	2014
Panjab National Bank	Orinatl Bank Of Commerce & Union Bank Of India	2021

Canara Bank	Syndicate Bank	2020
Union Bank Of India	Andra Bank & Corporation Bank	2020
Indian Bank	Allahabad Bank	2020
Bank Of Baroda	Vijay Bank And Dena Bank	2019
HDFC	HDFC BANK	2023

II. OBJECTIVES OF STUDY

- To know the reasons or motives for M & A of banks
- To measure the impact of M & A of banks on shareholders wealth
- To know the impact of M & A of on the financial performance on banks
- To know about the impact of announcement of Merger on market price of share and earning price of share of target and acquired banks.
- To study the positive and negative impacts on financial performance of banks
- To know about history of merger and acquisition of Indian banking sector.

III. REVIEW OF LITERATURE

In this study, the relevant research papers were reviewed to explore the reasons for merger and acquisition, through the extensive study, explored that the main motives of all sectors to improve the structure and efficiency especially in trying to understand various motivations for merger and how merger affect financial performance and operational efficiency, The Banking sector has played very important role in the Indian economy. **(Dr Azeem Ahmadkhan 2016)** measured the impact of merger on shareholders' value/ wealth of Indian banking sector, the study period is covered from 2002 to 2010 and he measured the impact of merger on shareholders wealth. Author used paired t- test to measure the 15 days prior to and 15 days after merger announcement of acquired and target banks and he showed the relationship of average excess return and cumulative average excess return.**(sony kuria kose & M S Senam raju 2013**) measured the exchange ratio between acquired and targets and he stated that different valuation methods to calculate the stock exchange ratio and explained that the nature of merger & medium of exchange like cash or stock mode. **(liargovas & Repousis 2011)** investigated the impact of M&A on the performance of Greek banking sectors, he stated that the merger have no impact to create wealth to the shareholders, the study also examined the operating performance of Greek sectors banks with help of 20 ratios,**(muttalib, mahammad faizan malik and shehzad khan 2019)** examined the impact of M & A on pakistani banks, he measured pre and post M & A situation with the operating performance (ROA) & marketing performance (Tobbin's Q ratio)

IV. Research Gap

As observed from the above studies, most of the works have been done on trends, policies and framework but researchers were not focused on impact of M & A on EPS, MPS and benefit(**synergy** of both target and acquired banks. This proposal would go to investigate the impact of M & A on Indian banking sectors by analyzing of financial performance of both target and acquired banks, the study will also discuss the pre and post merger performance of Indian banks

V. Research methodology

- The data study for the study collected from different sources like websites of banks, National stock exchange, Bombay stock exchange, moneycontrolled.com and screener.com ext….
- This sample includes financial statements of BOB bank.
- Period of the study to compare the performance of banks, four years for pre merger period and four years for post merger period

VI. Impact of mega merges of PSB's on Indian economy

Positive impact:

- **Cost reductions**: the process of merger will reduce the cost of operation of bank.
- **Cost benefit synergy:** the bank merger will lead to cost benefits of synergy. This would have a positive effect on the Indian banking system.
- **Competitive advantage:** It has gained a competitive advantage by investing & adopting technologies are across the bank being amalgamated and the main aim of the merger of PSB's in to enhance the globe competition.
- **Reduce risk on bad loans (NPA's) & operational risk:** The main aim of merger is to reduce risks in the business. So that merger of PSB's is to reduce the NPA's.
- **The process of merging of PSB's helps in better management of banking capital:** The main aim of the merger of PSB's in India is to increase the competition & reduce the cost of operation but it effects badly on customers & economy.

Negative impact:

- **Tech integration:** This is the main problem of merger of PSB's because banks use different software and technology when in the process of merger. It is difficult to merges in technology and it also effects on the man resource to adopt of different technology for merger banks.
- The process of mergers of PSB's is effect on **human resource of banking sector in case of promotion, transfer etc.**
- Mergers of PSB's are affected on customers to adopt new types of process for merged Banks' customers because when a bank merges with another bank. The IFSC, MIPC code, account number, place of bank is changed.
- The process of merging of PSB's is affected on **decision making process when two banks are merged.**

VII. DATA ANALYSIS AND INTERPRETATIONS OF BOB BANK

Merger of Bank of Baroda (Acquirer Bank) with Vijay Bank (Acquired) and Dena bank (Acquired)

Merger of public sector banks emphasizes on consolidating the smaller banks with bigger banks, with approval of cabinet one of the first tripartite merger on January 2, 2019, bank of Baroda will become the 2nd largest bank in India, Vijay Bank and Dena bank were merge into Bank of Baroda on April 1, 2019 this was focused on consolidation and strengthening of public sector banks and also reducing non-performing assets(NPA), the amalgamation will be made by way of issuing shares of Bank of Baroda to existing shareholders of Vijay bank and Dena bank.

The primary objective of this amalgamation is aimed at improving the customer base and enables the merged banks to compete with global banking level, further this consolidation is also expected to reduce lending cost, NPA and increase the stability in the operation.

Table shows Financial ratios of Bank of Baroda before and after

Financial ratios	Before merger				After merger			
	2016	2017	2018	2019	2020	2021	2022	2023
Net profit margin	-10.98	4.17	-3.98	0.87`	0.71	1.17	10.40	15.74
Operating profit margin	-13.61	6.81	-4.57	-11.77	-12.85	-16.36	-6.02	4.55
Return on employed	-0.14	0.98	1.28	1.78	1.77	1.85	1.81	1.91
Return on Assets	-0.007	.002	-0.002	0.05	0.04	0.07	0.56	0.96
Return on equity	-13	3	-6	0.94	0.76	1.07	8.46	14.36
Debt-equity ratio	15.26	15.70	15.05	13.35	14.04	12.95	12.90	12.77
Basic EPS	-21.99	7.88	-7.13	4.16	1.36	1.78	14.06	27.28

In before merger period, the net profit ratio and debts equity ratio show a declining trend. The return on equity, return on assets and Basic EPS show an upwording trend. But operating profit margin shows mixed trend.

In after merger period, all ratios except Debt- Equity ratio show an increasing trend. But Debt – Equity ratio shows downwarding trend. The above table shows that impact of M & A among banks is positively impacted on financial performance of banks.

Conclusion

Merger and Acquisition is useful tool for growth and expansion of banking sectors We conclude that the process of merging has aim to achieve global competitiveness & reduce the cost of operation and bad loans but it has badly affected on human resource of banking sectors, any change in bank sector will affect on the activities of Indian economy because banking sector is playing vital role in Indian economy, so merge of PSB’s affected on economy. M & A is positively impacted on Indian banking sectors by analysis of financial performance, so concluded that merger among banks is benefited to Indian banking sectors.

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