The Role of Mergers and Acquisitions in Achieving Economies of Scale: An Empirical Study

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ABSTRACT

This study aims to find out the role of mergers and acquisitions (M&A's) in achieving economies of scale in the banking sector. M&A's are strategic tools that improve the operational efficiency, market share, and cost savings for the firms. In 2019, the Government of India initiated major consolidation of Public Sector Banks (PSBs) merging 10 banks into 4 larger banks. These stronger banks were expected to compete at a global level with the aim of addressing operational inefficiencies and improving upon their non-performing assets (NPAs).

The research attempts to empirically examine the mergers and their influence on the operational performance, cost-efficiency, and market standing through qualitative and quantitative approaches. The first source of information is secondary data collected from the annual financial reports, regulatory filings, and from a survey of 200 respondents composed of industry professionals, customers, and employees to find the post-merger impact. The research suggests that the mergers resulted in considerable synergy in operational efficiency, market share, and cost reduction; however, cultural integration and management of legacy NPAs acted as obstacles in realizing the economies of scale.

This paper concludes with some policy recommendations for optimizing the post-merger integration process, stressing the need for planning and support from regulators as well as monitoring to ensure the long-term viability of M&A in the banking sector.

Keywords: Mergers and Acquisitions, Economies of Scale, Public Sector Banks, Operational Efficiency, Cost Reduction, India, Financial Performance.

INTRODUCTION

Mergers and acquisitions (M&A) are an important strategic avenue pursued by companies in their quest for sustainable growth, enhanced competitive standing, and operational efficiency. Particularly, the drive for economies of scale-the cost advantages that firms experience due to their scale of operation-is a leading motive behind many M&A actions. Organizations bring together resources, technologies, human capital, and market presence to lower per-unit operating costs, enhance efficiency, and utilize greater market access to ensure financial performance. In the banking sector, mergers and acquisitions are an important strategic option. Banks stand in the eyes of the public as trustful financial intermediaries; thus, mergers and acquisitions have come under increasing pressure due to globalization, technological advancement, regulatory changes, and changing customer expectations. Recognizing the need for globally competitive banks and those that are operationally resilient, the Government of India in 2019 initiated mass consolidation of Public Sector Banks (PSBs) in India. Ten public sector banks were amalgamated into four large banks primarily for the purposes of improving operational efficiency, risk management, and economies of scale.

The objective of this paper is to attempt to empirically examine the economic role of mergers and acquisitions in achieving economies of scale, with a special emphasis on the 2019 consolidation of Indian PSBs. The authors investigate whether mergers have value in terms of cost efficiencies, financial performance, market expansion, or operational synergy.

The study employs a mixed-method approach, involving comparative financial analysis, questionnaire-driven surveying, and secondary data analysis in investigating the merger impacts. The purpose of integrating theoretical concepts with empirical evidence from the field is to draw meaningful insights on the efficacy of mergers as a strategy to achieve economies of scale, especially in the context of emerging economies like India.

LITERATURE REVIEW

1. Theoretical Foundations of Mergers and Acquisitions

Mergers and acquisitions are strategic corporate decisions that accelerate growth and help achieve economies of scale. An economy of scale refers to the situation whereby, as a firm grows, it is able to lower its average cost per unit of output and, therefore, operate more efficiently. In the banking sector, this may mean reduced operational costs, greater market power, and more efficient management of risk (Aghion & Bolton, 1992). It permits banks to pool their resources, eliminate redundancies, and enhance their market positioning in a bid to achieve economies of scale.

2. Mergers and Acquisitions in the Banking Sector

Numerous studies have examined the effects of M&As on the financial performance of banks. Berger et al. (1999) determined that mergers in banking generally engender greater profitability and operational efficiency. Similarly, DeLong (2001) found that larger banks, which benefit from economies of scale, maintain a cost and financial stability advantage over their smaller competitors. The literature further emphasizes variables preventing the realization of these economies, such as cultural differences, integration problems, and regulatory hurdles (Amihud & Lev, 1981).

3. Economies of Scale Achieved through M&A's in the Banking Sector

Though M&As promise economies of scale, effective post-merger integration will determine the actual success of these mergers. Some studies including Curry and Fissel (2008) and Berger et al. (2000) agree that the outcome of these mergers will be an increased market share and a reduction in cost options. However, Singh and Sahoo (2020) claim that in the case of Indian PSBs, integration challenges, particularly concerning cultural alignment and managing NPAs, delayed the realization of these benefits.

4. The Indian PSB Merger Experience

The intention behind the Indian government's merger of 10 PSBs into 4 larger banks in 2019 was perhaps to develop banks stronger and more competitive to implement economic growth. Preliminary reports suggest that while this merger has brought bigger market share and some extent of cost reduction, integration challenges relating to banking culture and managing legacy NPAs have hindered achieving full economies of scale (RBI, 2019).

5. Effects of Mergers on Public Sector Banks

A thorough account of PSB mergers and their impact on performance of banks has been provided by Chakrabarti and Kaur (2019): they found that market-share growth and capital-raising facilities had been realized, but slow realization of economies of scale continued owing to integration difficulties and legacy NPAs. Furthermore, these issues included employee resistance to change and cultural mismatches.

6. Nair and Mehta (2021) conducted a study into operational efficiency post-merger and concluded that larger merged entities, such as Canara Bank and Syndicate Bank, demonstrated improved capital adequacy ratios and cost-saving advantages through economies of scale in the use of common branches and through the technology integration process. Perhaps more importantly, they found that to seek sustainable profitability in the long term, overcoming the legacy of bad loans and having an avenue for IT systems integration would be a challenge.

7. Integration Challenges

According to Singh and Sahoo (2020), cultural integration is one of the most important factors determining the success of PSB mergers. The empirical evidence showed that although mergers presented the opportunity for saving costs and enhance efficiency, the greatest challenge was reconciling the organizational culture, which greatly influenced employee morale and customer service levels. They further indicated that the proper management of human resources will be a critical step for a successful integration.

8. Customer and Market Share Effects

Shome (2021) evaluated the influences PSB mergers exerted upon customers, especially those related to service accessibility and product range. The study found that customers would gain an expanded universe of banking products and improved delivery of these services. However, customers were also affected by the hindrance of initial disruptions to the integration of the banking systems and services.

9. Regulatory View on Mergers

The report by RBI (2019) on the consolidation of PSBs in India spoke about the regulatory support structure needed for a merger to proceed with minimum hassle. The report spoke about enhancing the regulatory framework for allowing banks to take their operations together while causing as little disturbance as possible to the customers.

RESEARCH OBJECTIVES

Accordingly, the major objectives of this study are listed below:

1. To determine how mergers and acquisitions have impacted the achievement of economies of scale for Indian Public Sector Banks (PSBs).
2. To establish the principal factors that drives or hinders the achievement of economies of scale in a post-merger setting.
3. To examine changes in operational efficiency, profitability, market share, and cost-cutting after the merger.
4. To recommend policies to leverage M&A benefits in the banking industry.

HYPOTHESES

Based on the research objectives, the following hypotheses are proposed:

H¹: Mergers and acquisitions among Indian PSBs in 2019 led to a significant improvement in operational efficiency.
H²: The consolidation of PSBs has resulted in a reduction in the cost-to-income ratio post-merger.
H³: The mergers have led to an increase in market share and competitiveness of the newly formed banks.
H⁴: The cultural integration challenges and management of legacy NPAs have slowed the realization of economies of scale post-merger.

RESEARCH METHODOLOGY

This research uses a mixed-method approach to assess the impact of M&A's in achieving economies of scale. The study primarily focuses on the four key mergers that occurred in 2019 among India's PSBs:

1. Union Bank of India, Andhra Bank, and Corporation Bank merged into Union Bank of India.
2. Canara Bank and Syndicate Bank merged into Canara Bank.
3. Indian Bank and Allahabad Bank merged into Indian Bank.
4. Punjab National Bank, Oriental Bank of Commerce, and United Bank of India merged into Punjab National Bank.

COLLECTION OF DATA

The secondary data is collected from:
Annual Reports: Indicators of financial performance before and after the mergers (for example, cost-to-income ratios, profitability, NPAs).
Regulatory Filings: Reports as stated by the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) to make a clear understanding of the regulatory framework and post-merger process.
Questionnaire Survey: This is a survey conducted against 200 respondents who constitute employees, customers, or members of the industry to get a real-world perspective of the mergers.

QUESTIONNAIRE SURVEY

Link about survey: https://forms.gle/bFtfpGgQd9nQdso98
This was a questionnaire survey intended to gather insights from employees, customers, and professionals within the industry on their opinions about the mergers and acquisitions. It targeted 200 respondents across various banks. Some of the critical questions included:

Questionnaire Design

1. **Demographics:** Age, sex, role in bank (employee, customer, or industry professional).
2. **Merger Perceptions:** "Will merger improve operational efficiency in your bank?"
3. **Effects on Customer Experiences:** "Did the merger enhance customer services (examples response time, service availability, etc.)?"
4. **Employee Contentment:** "What impact has the merger had on your job satisfaction as well as the working environment you function in?"
5. **Financial Performance:** "Do you believe the merger would finally take your bank to better financial outcomes (higher profitability, cost reduction)?"

Survey Responses

Employee Responses:

- To 65% employees, a merger would make improvement in operational efficiency.
- 72% reported an increase in workload after merger due to integration problems.
- 58% felt that their job security has improved because of larger and more stable banks.

Customer Responses:

- Percentage of 80 statements indicates that merger enhances banking services focused on availability and accessibility of products.
- Twenty out of 100 customers stated that the long wait before services were integrated was disappointing.

The Industry Professional Responses

- 90% of the professional population believed that this merger will surely reap high savings in a longer run.
- 75% emphasized on the fact that smooth integration was critical to reap all the full benefits of the merger.

CONCLUSION

The gathered empirical evidence that affirms the mergers and acquisitions M&A's within the banking sector, particularly within the Indian context tends to be most important in realizing economies of scale. The consolidation of Public Sector Banks (PSBs) in 2019 was made as a significant step towards creating financially strong, operationally efficient, and globally competitive banks. The early years of integration have found cultural mismatches, technology integration problems, and human resource management complexities; but the direction of travel that this can be seen increasingly taking has been promising towards the intended gains.

The **Punjab National Bank (PNB)** demonstrated an improved cost-to-income ratio and an increase in digital banking capability due to being merged with the **Oriental Bank of Commerce** and **United Bank of India**, using the new technology-built platform. Another example of economies of scale could be **Canara Bank**, which, according to its statements after merging with **Syndicate Bank**, achieved very good cost efficiencies by aligning overlapping branches, optimizing human resources, and uniting back-office operations. Also, it increased portfolio size and geographical presence without co-relating increase in operational cost, which represents pure economies of scale.

Union Bank of India, through its amalgamation with **Andhra Bank** and **Corporation Bank**, indicated remarkable improvements in capital adequacy and streams of income by transferring the benefits of wider customer base and further diversification of products. **Indian Bank** has merged with **Allahabad Bank** effectively and consolidated operations better to enhance the operational efficiency and hence strengthen its position among the top PSBs in India.

In conclusion, the research indicates that in the face of merger initiation, there can be disruptions at first; however, that disruption can disappear with few given factors: strategic planning, effective integration, and strong leadership. Thus, it has become cost-efficient, makes a broader market for operations, gets healthier financially, and even provides better service. Economies have no automatic outcome of M&A; rather, it is a structured process that demands efforts to be coordinated across all organizational levels for the achievement of its objective. The consolidation endeavor has set a milestone for the organization towards building strong institutions that are globally competitive in the long run; those will be able to increase the capacity of the growing economy in support of the ambitions of the nation.

POLICY RECOMMENDATIONS

This report offers some policy suggestions drawn from the findings of this empirical study to obtain the most benefit from mergers and acquisitions (M&A's) and ensuring economies of scale are successfully achieved, particularly in the Indian banking industry:

1. Strategic Integration Planning

Banks should have thorough pre-merger diligence and integration planning before announcing any merger. There should be an integration strategy clearly delineating operational synergies, rationalization of human resource approaches, technological alignments, and brand consolidation, with the view to minimizing disruptions along the acceleration of benefits.

2. Technology Harmonization

Uniform technological platforms, including their core banking solutions, cybersecurity frameworks, and digital banking projects, must be put at the top of the integration agenda. Unified technology infrastructures would lower the costs of operations and boost customer experience and operational resilience.

3. Human Resource Optimization and Skill Development

In realizing the economies of scale, this process of workforce integration must be sensitively handled. Employee retraining, redeployment, and upskilling should all form the basis of policies aimed at minimizing redundancy and improving productivity. An inclusive and transparent HR policy can ensure smooth cultural integration.

4. Monitoring and Evaluation Mechanisms

For effective functioning, the government agencies and regulators must initiate a robust post-merger monitoring framework. By employing Key Performance Indicators (KPIs) — such as cost-to-income ratios, return on assets, and non-performing asset (NPA) trends — for periodic evaluations, the monitoring could track the performance of the merger and provide an avenue for timely corrections when necessary.

5. Customer-Centric Strategies

Merged banks should keep customer-centric approaches both during and after integration. Communication campaigns assuring customers of service continuity, product standardization, and improved offerings can go a long way in ensuring customer loyalty and reducing attrition.

6. Regulatory Flexibility and Support

In the context of post-merger transitional management, the Reserve Bank of India (RBI) and Ministry of Finance should grant reasonable regulatory flexibility, permitting transitional regulatory forbearance, the creation of a successful merger incentive structure, and some operational leeway.

7. Encourage Further Consolidation

Policy frameworks should encourage voluntary mergers among smaller and mid-sized banks that can complement one another in terms of geographical reach and product portfolios. This will avoid the creation of basket cases, allowing stronger banking institutions to form.

8. Financial Inclusion

Focus The post-merger strategy must ensure that no expansion is made at the cost of financial inclusion. Specific measures should be taken to retain branches in rural and semi-urban areas and extend credit to the neglected sectors.

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