Financial Performance Of State Bank Of India –An Overview On Pre & Post Merger

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ABSTRACT
This research paper looks at Mergers and Acquisitions (M&A’s) that have happened in Indian banking sector to understand the resulting synergies and the long term implications of the merger. The paper also analyses emerging future trends and recommends steps that banks should consider for future. The paper compares pre and post merger financial performance of merged bank with the help of financial parameters like, Operating Profit Margin, Net Profit Margin, Return on Assets, and Return on Equity, Earning per Share, Debt Equity Ratio and Dividend Payout Ratio has been made in case of SBI. SBI, there is no significant improvement in the performance after the merger as the merger was mainly in the interest of the public. In the initial stage, after merging, there may not be a significant improvement due to teething problems but later they may improve upon.

Key words:
Mergers, Acquisitions, Financial Performance, Ratio, Profitability

Today, the banking industry is counted among the rapidly growing industries in India. In the last two decades, there has been paradigm shift in banking industries. A relatively new dimension in the Indian banking industry is accelerated through M&A. In order to attain the economies of scale and also to combat the unhealthy competition Consolidation of Indian banking sector through M&A’s on commercial considerations and business strategies are the essential pre-requisite. Consolidation has been a significant strategic tool and has become a worldwide phenomenon, driven by advantages of scale-economies, geographical diversification, and lower costs through branch and staff rationalization, cross-border expansion and market share concentration. The new Basel II norms have also led banks to consider M&As.

In this scenario, Mergers and Acquisitions is one of the widely used strategies by the banks to strengthen and maintain their position in the market. Companies are confronted with the facts that the only big players can survive as there is a cut throat competition in the market and the success of the merger depends on how well the two companies integrate themselves in carrying out day to day operations. Banks will get the benefits of economies of scale through mergers and acquisition. For expanding the operations and cutting costs, Business Entrepreneur and Banking Sector is using mergers 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. A Merger is a combination of two or more companies into one company or it may be in the form of one or more companies being merged into the existing companies. On the other hand, when one company takes over another company and clearly well-known itself as the new owner, this is called as Acquisition. The banks must follow the legal procedure of mergers and acquisitions which is given by the Reserve Bank of India, SEBI, Indian Companies Act and Banking Regulation Act 1949. Mergers and acquisitions is not a short term process, it takes time to take decisions after examining all the aspects. Indian Corporate Sector had stringent control before liberalization but, the Government has initiated the Reform after 1991 which resulted in the adaptation of the different growth and expansion strategies by the Companies.
Reasons for Bank 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 market competition: Innovation of new financial products and consolidation of regional financial system are the reasons for merger. Markets developed and became more competitive and because of this market share of all individual firm reduced so mergers and acquisition started.
3) Economies of scale: Capability of generating economies of scale when firms are merged.
4) Skill & Talent: Transfer of skill takes place between two organisation takes place which helps them to improve and become more competitive.
5) Technology, New services and Products: Introduction of e-banking and some financial instruments / Derivatives. 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.
6) Positive Synergies: When two firms merge their sole motive is 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.

Few other reasons
- Sick banks survived after merger & Enhanced branch network geographically.
- Larger customer base (rural reach)& Increased market share.
- Attainment of infrastructure & restrict competition and prevent overcrowding of banks & utilize under and unutilized resources so that the banks can compete the foreign banks in global era.

Literature Review and Gap
A firm can achieve growth both internally and externally. Internal growth may be achieved by expanding its operation or by establishing new units, and external growth may be in the form of Merger and Acquisitions (M&As), Takeover, Joint venture, Amalgamation etc. Many studies have investigated the various reasons for Merger and Acquisitions (M&As) to take place, just to look into the effects of Merger and Acquisitions on Indian financial services sector.

Goyal K.A. & Joshi Vijay (2011) in their paper, gave an overview on Indian banking industry and highlighted the changes occurred in the banking sector after post liberalization and defined the Merger and Acquisitions as per AS-14. The need of Merger and Acquisition in India has been examined under this study. It also gave the idea of changes that occurred after M&As in the banking sector in terms of financial, human resource & legal aspects. It also described the benefits come out through M&As and examined that M&As is a strategic tools for expanding their horizon and companies like the ICICI Bank has used merger as their expansion strategy in rural market to improve customers base and market share. The sample of 17 Merger of post liberalization and discussed about communication in M&As, the study lightened the role of media in M&As.

Kuriakose Sony & Gireesh Kumar G. S (2010) in their paper, they assessed the strategic and financial similarities of merged Banks, and relevant financial variables of respective Banks were considered to assess their relatedness. The result of the study found that only private sector banks are in favor of the voluntary merger wave in the Indian Banking Sector and public sector Bank are reluctant toward their type of restructuring. Target Banks are more leverage (dissimilarity) than bidder Banks, so the merger lead to attain optimum capital Structure for the bidders and asset quality of target firms is very poor except the cases of the HDFC Vs the CBOP merger in 2007. The factor behind voluntary amalgamation are synergies, efficiency, cost saving, economies of scale. The merging partners strategically similarities and relatedness are very important in the synergy creation because the relatedness of the strategic
variable have a significant impact on the Bank performance and the effect of merger on the stock market.

Aharon David Y et al., (2010)\(^2\), analyzed the stock market bubble effect on Merger and Acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investor take more risk. Merger of banks through consolidation is the significant force of change took place in the Indian Banking sector.

Kuriakose Sony et al., (2009)\(^3\), focused on the valuation practices and adequacy of swap ratio fixed in voluntary amalgamation in the Indian Banking Sector and used swap ratio for valuation of banks, but in most of the cases the final swap ratio is not justified to their financials. Schiereck

Dirk et al., (2009)\(^4\), explained the relationship between bank reputation after Merger and Acquisitions and its effects on shareholder’s wealth. This study considered 285 European merger and Acquisition transaction announced between 1997 and 2002 and finds that on average wealth not significantly effect by Merger and Acquisitions. It is found in the study of Bhaskar A Uday et al., (2009) that Banking sector witness of Merger activities in India when banks facing the problem of loosing old customer and failed to attract the new customers. It described that the acquiring firms mainly focuses on the economies of scale, efficiency gain and address the need of communication and employee concern, and described the integration process was handled by professional and joint integration committee. Road map is prepared and HR integration is done as per schedule and they took a case of the Bank of Punjab acquired the Lord Krishna Bank and later on the Centurion Bank of Punjab acquired by the HDFC Bank and gave the frame of integration. This study regulate the link between communication, HR integration, management action and consequent contribution of post merger success by conducted interview in a recent bank merger, in depth interviews work conducted in a recent mergers of a Indian Bank. It was inferred that proactive communication, changes in organizational structure, and appropriate human resource integration would smoothen the journey towards successful integration.

Mantravadi Pramod & Reddy A Vidhyadhar (2007)\(^5\) evaluated that the impact of merger on the operating performance of acquiring firms in different industries by using pre and post financial ratio to examine the effect of merger on firms. They selected all mergers involved in public limited and traded companies in India between 1991 and 2003, result suggested that there were little variation in terms of impact as operating performance after mergers. In different industries in India particularly banking and finance industry had a slightly positive impact of profitability on pharmaceutical, textiles and electrical equipments sector and showed the marginal negative impact on operative performance. Some of the industries had a significant decline both in terms of profitability and return on investment and assets after merger.

**Research Gap**

As observed from the above studies, most of the works have been done on trends, policies and their framework but researchers was not focussed on mergers and acquisitions in the banking sector. The present paper would go to investigate the details of Mergers and Acquisitions (M&As) with greater focus on the Indian Banking sector in post liberalisation period. The study will also discuss the pre and the post-merger performance of banks.

**Objectives of the Study**

The objectives of the paper are:

- To evaluate the banks performance in terms of Operating and Net Profitability
- To analyse the performance of the Banks after merger in terms of return on Assets
To find out the impact of merger on company’s debt equity ratio
To examine the effects of merger on equity shareholders through EPS

Methodology

Sources of Data:
The study is based on secondary data. The financial and accounting data of bank is collected from the Annual report of the select Bank to examine the impact of Mergers and Acquisitions on the performance of the sample bank. Data are also collected from the Bombay Stock Exchange, National Stock Exchange, Securities and Exchange Board of India and Money Control for the study.

Sample:
Public Sector bank to evaluate the impact of mergers and acquisitions on the performance of the Banks

Period of the Study:
To compare the performance of Bank, three years pre merger and three years 2013-2016, post merger financial ratios are being computed and compared. The year of merger was considered as a base year.

Financial Parameters:
The performance of the Bank is made in respect of the financial parameters such as Net Profit Margin, Operating Profit Margin, Return on Assets, Return on Equity, Debt Equity Ratio, and Earning per Share.

Hypothesis:

1. $H_0$ (Null Hypothesis) – There is no significant difference between the pre and post-merger Operating Profit Margin
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Operating Profit Margin

2. $H_0$ (Null Hypothesis) – There is no significant difference between the pre and post merger Net Profit Margin
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Net Profit Margin

3. $H_0$ (Null Hypothesis) – There is no significant difference between the pre and post merger Return on Equity
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Return on Equity

4. $H_0$ (Null Hypothesis) – There is no significant difference between the pre and post merger Earning Per Share
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Earning Per Share

5. $H_0$ (Null Hypothesis) – There is no significance difference between the pre and post merger Debt Equity Ratio
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Debt Equity Ratio

6. $H_0$ (Null Hypothesis) – There is no significant difference between the pre and post merger Dividend Payout Ratio
$H_1$ (Alternative Hypothesis) - There is a significant difference between the pre and post merger Dividend Payout Ratio
Tools for Analysis:
Ratios and percentages are used for the analysis of data and for better understanding. Bar Diagrams are used for the presentation of the data. To test the hypothesis, ‘t’ test is employed. The performance of the banks before and after the mergers and acquisitions has been compared. For the pre merger, the combined ratios of both the banks are considered and for the post merger the ratios of acquiring bank were used.

Table 1: Sample Banks

<table>
<thead>
<tr>
<th>No.</th>
<th>Acquirer Bank</th>
<th>Merged Bank</th>
<th>Date of Merger</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>State Bank of India (SBI)</td>
<td>State Bank of Indore</td>
<td>Aug 26, 2010</td>
</tr>
</tbody>
</table>

The study is presented merger of the State Bank of Indore with the State Bank of India on August 26, 2010 is selected and analysed. To analyse the financial performance of the Bank before and after merger, a few ratios like Operating Profit Ratios, Net Profit Margin, Return on Assets, Return on Equity, Debt Equity Ratio, Dividend Payout Ratio, Earning per Share have been calculated.

**Ratios**
- Operating Profit Margin = Operating Profit/Sales × 100
- Net Profit Margin = Net Profit/Sales × 100
- Return on Assets =Net Profit/Total Assets × 100
- Return on Equity (ROE) =Net Profit/Equity Share Holder’s Funds × 100
- Debt Equity Ratio (Pure Ratio) = Total Debt/ Share Holder Equity
- Dividend Payout Ratio = Dividend / Net Income X 100

Table 2
FINANCIAL PERFORMANCE OF STATE BANK OF INDIA

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Pre Merger</th>
<th>Post merger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Profit Ratio</td>
<td>22.74</td>
<td>23.43</td>
</tr>
<tr>
<td>Net Profit Ratio</td>
<td>11.67</td>
<td>11.93</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>1.01</td>
<td>1.04</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>17.82</td>
<td>15.07</td>
</tr>
</tbody>
</table>
Table 2 shows the analysis of the financial performance of SBI before and after the merger of State Bank of Indore with SBI. It is found that there is not much difference in the mean of the Operating Profit Margin (22.49% to 10.88%). There is a decline in the Net Profit Margin (11.42% to 7.55%), Return of Assets (0.98% to 0.56%), and Return on Equity (15.64% to 8.76%). Earnings per Share are (138.25% to 58.75%), percent in the post merger period. There is no significant change in the Debt Equity Ratio increase (11.99% to 12.02%) and Dividend Payout Ratio (20.38% to 20.12%).

The result states that the performance of the State Bank of India (SBI) has not improved after it acquired the State Bank of Indore. H0 (Null Hypothesis) is accepted in terms of all the financial parameters viz., Operating Profit Ratio, Net Profit Ratio, Return on Assets, Return on Equity, Debt Equity Ratio, and Dividend Payout Ratio. There is no significant difference in the performance of SBI before and after the merger with State Bank of Indore and the merger was mainly in the interest of the public and not to gain materially.

Conclusion

Mergers and Acquisition is a useful tool for the growth and expansion in any Industry and the Indian Banking Sector is no exception. It is helpful for the survival of the weak banks by merging into the larger bank.

This study shows the impact of Mergers and Acquisitions in the Indian Banking sector and two cases have been taken for the study as sample to examine the as to whether the merger has led to a profitable situation or not. For this purpose, a comparison between pre and post merger performance in terms of Operating Profit Margin, Net Profit Margin, Return on Assets, Return on Equity, Earning per Share, Debt Equity Ratio and Dividend Payout Ratio has been made in case of SBI, there is no significant improvement in the performance after the merger as the merger was mainly in the interest of
the public. In the initial stage, after merging, there may not be a significant improvement due to teething problems but later they may improve upon.

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