Impact of Mergers in Banking Sector: A Case Study

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***Abstract*- Merger, consolidation of companies or assets through various financial transaction provides the survivor organization growth along with competitive advantage in terms of technology, market share, infrastructure etc. It optimizes allocation of resources and improves efficiency of organizations. This work analyses the effect of mergers on Indian banking sector by considering the pre-merger and post-merger financial performances of Kotak Mahindra and ING Vysya banks that undergone merger. Secondary data as available from NSE website, annual report of the respective banks and other web based data sources were used to draw conclusions regarding the effect of the corporate event. The banks considered here are equally strong and well managed by competent professionals. The effect of this merger is primarily the growth of this survivor which gained the fourth position among the players in Indian banking sector. This analysis reveals that the corporate action is positive except in the case of non-performing assets which shows an increased trend compared to the post-merger results of Kotak Mahindra bank.**

***Keywords:* Mergers, impact, performance indicators, asset quality, non-performing assets.**

I. INTRODUCTION

Mergers are business strategy actions that are essential to provide an organization external progression and aid them reasonable benefits. Mergers can improve a company's competitiveness by gaining extra market shares.The huge numbers of corporate rearrangements taking place, particularly in the last couple of years is due to the downturn taking toll of many Indian businesses and the feeling of uncertainty surging over our businessmen. For this reason, a number of companies have been taken over and several have experienced internal restructuring, whereas some companies in the similar field of business have realized the advantage of coming together into a single entity. In this background, it would be worthwhile to study the effect of these corporate actions considering the deal of Kotak Mahindra and ING Vysya banks. This paper tries to unearth the effect of the corporate movement in Indian Banking sector.

1.1 Banking Industry in India:

Indian banking has earned several achievements to its credit during the past three decades. The most important is its wide range. The main aspect of growth is, Indian banking is no longer restricted to cities and metropolitan areas, it has its reach, to remote areas of the Nation. The banking industry in India came to existence with the starting of the Bank of Hindustan and the General Bank of India. The state bank of India, originally Bank of Calcutta started in 1806, is the largest and the oldest bank which is still in existence.

The development of banking sector in India is can be viewed through three stages. The 1st phase (1786-1969): - saw the establishment of numerous little banks. 2nd phase (1969-1991): - this period is a period of regularization and growth of Indian banks. 3rd phase (1991 onwards): - Liberalization and its after-effect marked this phase. The Government strategy of Liberalization resulted in authorization of private banks, which led to the advancement of the sector. Banking Sector has experienced a huge development due to an expansion in the demand for retail credit, multiplication of credit cards and ATMs, diminishing Non Performing Assets, enhanced large scale monetary conditions, broadening, loan fee spreads and administrative and strategy changes.

A. Literature Review

Zahoor Rahman, Arshad Ali and et.al (2018) analyzed the impact of mergers and acquisitions on stock price, in the banking sector of Pakistan. The market study concluded that most of the banks have negatively responded to mergers and acquisition. Aharon David. et al (2010) provided an outline on banking industry in India featuring the progress that occurred in the area post advancement and characterized the M&As according to AS-14. He thoroughly mentions the pre-requisite for the corporate action of mergers and acquisition in Indian context. The changes resulted from the corporate action is also dealt with. The author is of the opinion that the private sector banks in India is keen to accept the benefits of this move whereas the nationalized banks are hesitant to accept changes.

Tapas Kumar Sethy (2017) studied the operational effectiveness of banks post-merger. Pre and post-merger ratios of local banks were compared and analyzed and the results confirms that the financial performance has shown slight improvement after merger on parameters such as debt to equity ratio, growth rate of total assets ratio, equity capital to total asset ratio etc.

Data Envelopment Analysis through intermediate cost efficiency conducted by Rampratap Sinha, (2006), shows that the Private Sector Banks perform cost effectively in comparison to their public sector counter parts. The result is obtained assuming non-increasing return to scale and it won't hold if the assumption is relaxed.

Mahesh, and Rajeev (2004), finds that financial sector reforms resulted in improved productive efficiency and performance of banks both in public and private sector. They used the stochastic frontier technique and estimated banks' deposits, advance and investment efficiencies for the period 1985-2004. The study collected panel data of 94 banks for 20 years. Publication of Indian Banks Association and Reserve Bank of India provided the relevant data.

Mahima Rai & Sharma M.C (2014): conducted study on the Stock Price Behavior on announcement of the corporate event of mergers and acquisition. The study analyzed stock price behavior of ICICI bank – pre and post announcement of the corporate deal and concludes that mergers do not show any benefit over a short horizon. The positive result of the merger will be evident only in the long run.

B. Data and Methodology

The work is intended to examine the performance of Kotak Mahindra Bank in terms of its growth of total assets, profits, revenues, investment and deposits. The pre-merger and post-merger averages for a set of key financial ratios were computed for two years prior to, and two years after, the year of merger completion. To study the impact of mergers on physical and financial performance of the selected bank a number of financial and accounting variables were used. The data for the same was obtained from Bank's annual and quarterly reports. Daily stock price data was collected from NSE website.

II. RESULTS AND DISCUSSION

The merger of Kotak Mahindra Bank and ING Vysya Bank is a case of integration of two equally strong corporate entities to achieve competitive advantage and market share. The event propelled the bank to fourth rank.

Figure. 1 Pre and post-performance of different parameters (Earnings, Expenditure, Employees Cost, Basic EPS)

Figure. 2 Pre and post-performance of different parameters (Diluted EPS, Gross NPA)

The above analysis shows that, even though there is a sudden jump in the selected parameters close to the merger period and can be contributed to consolidation. It then regains the pre-merger trend. This is the case with earnings, expenditure and EPS etc. The only negative impact is on Net Non-Performing Assets which shows a rather increasing and irregular trend post the merger (fig. 2 panel 3)

Figure. 3 Pre and post-performance of different parameters (Net Profit Margin, Operating Profit Margin, ROE, Current Ratio, Quick ratio)

The post-merger scenario shows an increased trend for Return on Equity (fig. 3 panel 1) and is a clear indication that the merger is a positive corporate event that happened to Kotak Mahindra Bank.

Net Interest Margin dropped soon after merger and started increasing, which means the bank has invested its funds efficiently. Data shows the interest income to total assets ratio has decreased after the corporate event for Kotak Mahindra Bank. The implication is that the interest earning assets increased in relation to other assets which are a positive sign. Operating profit after a slight dip immediately after the merger shows an increasing trend (fig. 3 panel 1).Operating expenses i.e. the expenditure for performing normal business operations raised soon after the merger then started decreasing (fig. 3 panel 1). There was decrease in the current ratio after the merger deal and it started to recover from the down trend in less than a year and the ratio started showing an increasing trend (fig. 3 panel 2). Quick ratio has shown a down trend before and after merger for some time and it started to increase (fig. 3 panel 3). The Kotak Mahindra Bank had a strong trend of increasing Capital Adequacy Ratio during the pre-merger period (fig. 3 panel 4). The ratios showed a decreasing trend after the merger till 2016 and it has started to recover slightly.

The event study conducted compared the abnormal returns during pre and post-merger period. The comparison of means shows that there is no remarkable difference between the pre and post-merger return performance.

III. CONCLUSIONS

The above analysis shows the positive impact of merger of Kotak Mahindra Bank Ltd with ING-Vysya Bank. Kotak Mahindra Bank had a momentous increment in various budgetary angles like operating profit, net profit, earnings per share, interest earned, return on assets, equity share capital, income on investments etc. After the consolidation, the efficiency and performance of the bank increased in terms of different financial parameters. The action provided competitive advantage and propelled the bank to fourth rank.

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