SHAREHOLDERS' WEALTH CREATION THROUGH MERGERS AND ACQUISITIONS

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Abstract

Mergers and Acquisitions are very much popular concept in the recent changing scenario. More, so it is significantly popular strategy after 19th century where India entered in to the phase Liberalization, Privatization and Globalization (LPG). India has witnessed a storm of mergers and acquisitions in recent years. The winds of LPG are blowing over all the sectors of the Indian economy but its major impact is seen in the industrial sector. It caused the market to become hyper-competitive, to avoid unhealthy competition and to face international and multinational companies. The primary objective of an organization towards mergers and acquisitions is to create a niche of core competencies and transform the organizational culture to a better and improved form. It helps in design and develops system in accordance to the changing face of business across all industrial sectors. With a view to face global challenges, most of the forward – looking business organizations prefer a path of rapid growth through mergers and acquisitions. It drives the organization to create synergy and value creation by way of diversification and improved management. This study examines the impact of merger on shareholders wealth of the individual and combined firm in the Indian banking sector.

Key Words: Mergers, Acquisitions, Shareholders' Wealth, Financial Performance

Introduction

The growing tendency towards mergers and acquisitions world-wide has been driven by intensifying competition. There is a need to reduce costs, better financial planning, and desire to expand business. An organization that aims in mergers and acquisitions are perpetrated to extend the relationship with clients beyond the professional horizons to provide them high level of satisfaction and assurance. Consolidation through M&As is considered one of the best ways of restructuring for effective response to competitive pressures. With a view to face global challenges, most of the forward – looking business concerns prefer a path of rapid growth through mergers and acquisitions. As in all other sectors of the economy, the banking industry saw a flurry of activities. Several new private sector banks opened shop as did several foreign banks; drastically changing the environment from a government protected and regulated one to a market driven and competitive one. The new private sector banks provided intensive competition to public sector banks with their efficiency and technology driven services. In the process they managed to carve out an ideal position for themselves in the banking sector. However, their lean structure and tech-savvy initiatives could not quite match the perfect size and reach of the well-established public sector banks. The normal way of their growth was both time consuming and capital intensive. Therefore, the private sector banks resorted to the Mergers & Acquisitions (M & As) route for faster spread and widespread growth. The merger of Kotak Mahindra bank and ING Vysya bank in the year 2014 is the eighth voluntary merger and the latest in India after the merger of ICICI Bank Merger with Bank of Rajasthan in the year 2010, compared with other voluntary mergers.

Mergers and Acquisitions

MERGER

Merger refers to a fusion between two or more firms that involves the integration of their operations with a view to bring in certain operational efficiencies. In other words, it is where two firms agree to integrate their operations on a reasonably co-equal basis because they have resources and capabilities that together may create a stronger competitive advantage. The assets and liabilities of the merging companies get transferred to the merged (combined) company. Normally, the shareholders of the merging companies become shareholders in the combined firm or say the merged company.

Company A + Company B = Company C

Thus, merger refers as legal and physical consolidation of two companies into one entity, with the aim to bring certain operating and financial synergies for the combining firms. Such synergies are mainly on account of benefits of economies of scale in operations and financing. In India the word 'Amalgamation' is use for 'Merger' in legal parlance.

ACQUISITION

Acquisition in general sense is acquiring the ownership in the property. Acquisition is referred the purchase by one company by another in which no new company is formed. In other words, it is where one firm buys another firm with the intention of more effectively using a core competence. It is also known as 'takeover' or 'buyout'.

Company A + Company B = Company A

Motives of Mergers and Acquisitions

- **Economies to scale –** Large scale business organizations enjoy both internal and external economies.
- **Increase managerial skills –** M&A increase the managerial personnel or technical expertise. Any merger, regardless of the specific motive for it, contributes to the maximization of shareholders wealth.
- **Synergy –** It implies a situation where the combined firm is more valuable than the summation of the individual combining firms. It is stated as *'two plus two equal to five'* (2+2=5) phenomenon.

  $$V(AB) = V(A) + V(B)$$

- **Elimination of competition –** It eliminates severe, intense and wasteful expenditure by different competing organization.
- **Increase in market share –** An increase the market share is one of the plausible benefits of M&A.

MERGERS AND ACQUISITION IN INDIAN BANKING SECTOR

The Indian banking sector has not remained insulated from the various global forces driving Mergers and Acquisitions across the countries. Intense competition among the banks has redefined the entire banking system. The banks are looking for new techniques not only to attract but also to retain the customers and acquire competitive advantage over their competitors. Mergers and Acquisitions activity in the Indian banking sector is not something new, as it has taken place even before the independence. However, economic reforms introduced in the early 1990's brought out a comprehensive change in the business strategy of banks, whereby they resorted to Mergers and Acquisitions to enhance the size and efficiency to gain competitive strength. Mergers and Acquisitions as a means for inorganic growth is increasingly being used the world over to undertake restructuring leading business organizations. It is followed as a part of the strategy to achieve a large size and fast growth in market share and to become more competitive through economies of scale and scope. India too is witnessing one of the highest cape cycle, with most of the companies aggressively building the capacity for Mergers and Acquisitions to cater to the growing and global competition in the markets. M& A provide an ample opportunity to banking sector to share the resources, reduce intermediate costs and expand delivery platforms and to improve chances for economies of scale in their operations. These developments are likely to have important implications for financial performance and profitability in the banking system.

Literature Under Review

Mergers and Acquisitions (M&A) in the banking sector have seen a sharp increase. The growing M&A activity has basically been a response to the deregulation of the industry as exemplified by the abolition of geographic limitations on banks and the demolition of demarcation lines between different types of financial services.

- **Dutta and Dawn (2013),** in a paper "*Merger and acquisitions in Indian banks after liberalization: An analysis"* investigates the financial performance of merged banks in terms of the growth of its total assets, profits, revenue, deposits, and number of employees. The financial performance of merged banks is compared taking four years of prior-merger and four years of post-merger. The findings of the study indicate that the post-merger periods were successful and saw a significant increase in total assets, profits, net worth, revenue, deposits, and in the number of employees of the acquiring firms of the banking industry in India.
- **Azhagaiah & Kumar (2013),** in their study tested hypothesis concerning whether there is significant improvement in the corporate performance of the Indian manufacturing corporate firms following the merger event using paired t-test. The findings of study indicate that Indian corporate firms involved in M&A have achieved an increase in the liquidity position, operational performance, profitability, and reduce financial and operating risk. In another such study they examined a sample consisting of 20 acquiring firms during the period 2007. They concluded that corporate in India appear to have performed better financially after the merger, as compared to their performance in the pre-merger period.
- **Goyal and Joshi (2012),** probed the motive of banks for mergers and acquisition with special reference to *Indian Banking Industry* and the study was conducted on the basis of number of branches, geographical penetration in the market and benefits from the merger.
- **Azhagaiah & Kumar (2011),** in their study tested hypothesis concerning whether there is significant improvement in the corporate performance of Indian manufacturing corporate firms following the merger event using paired t-test.
- **Antony Akhil (2011),** in an analysis *"Post-merger profitability of selected banks in India"* emphasized the impact of the banks merged in India from 1999 to 2011. Between 1999 and 2011, around 18 Mergers and Acquisitions took place in the Indian banking sector. The studies for the samples were six acquirer banks selected, three of them were public sector banks and three were private sector banks. The study used paired t-test. The study findings indicate that there is a significant difference in the profitability and investment ratios, like (growth of total assets ratio, growth of net profit ratio, return on assets ratio, return on equity ratio, and net interest margin ratio) of banks in the post-merger scenario.
- **Murthy (2007),** examined the case of five bank mergers in India viz. Punjab National Bank and New Bank of India, ICICI Bank and Bank of Madura, ICICI Bank, Global Trust Bank and Oriental Bank of Commerce and Centurion Bank with Bank of Punjab. It was concluded by the researcher that consolidation is necessary due to stronger financial and operational structure, higher resources, wide branch network, huge customer base, technological advantage, focus on priority sector, and penetration in the rural market. Further some issues in aforesaid mergers were identified as managing human resources, managing client base, acculturation and stress on bank employees.

- **Manoj Anand and Jagandeep Singh (2008),** have analyzed five mergers in the Indian banking sector to know the shareholder wealth effects of bank mergers.
- **Rao, Narsimha,V, and Rao, P,V, Krishna(1987),** attempts to evaluate the impact of such mergers on the performance of a corporation. Though the theoretical assumption refers that mergers improve the overall corporate performance due to increased market share, the author supports his paper to evaluate the same in the scenario of economy of India.

Research Methodology

The study is concerned with the Indian banking system and is based on secondary data. The required data have been collected from the various issues of the Banking Statistics, published by Reserve Bank of India, research journals, magazines and newspaper reports for the comparison the performance of selected sector banks. The various ratios are analyzed to examine the performance of the selected sectors.

Objectives of Study

- To review the impact of merger under the study on the financial performance with regard to Return on Investment, Profitability and Liquidity position of the selected banks.
- To examine the impact of merger on shareholders wealth of the individual and combined firm.
- To disentangle the specific conditions under which merged banks thrive or fail.
- To analyze the pre and post merger performance of the individual and combined firm and to examine whether synergies of firms would be able to create values or not.

Accounting Standard Related to Study

Accounting Standard 14 on Accounting for amalgamation, issued by the Institute of Chartered Accountants of India which came into effect in respect of accounting period commencing on or after April 1, 1995 is mandatory. The statement deals with the accounting for amalgamation and treatment of any resultant goodwill or reserves. The standard specifies two methods of accounting for amalgamation namely:

1. Pooling of Interest Method
2. Purchase Method

List of Merger and Acquisitions (M&As) in Indian Banking Sector since Nationalization of Banks

Transferee Bank	Transferor Bank	Year of transfer
HDFC Bank	Times Bank	2000
ICICI Bank	Bank of Madura	2001
Bank of Baroda	Benaras State Bank	2002
Punjab National Bank	Nedungadi Bank	2003
Oriental Bank of commerce	Global trust Bank	2004
Centurion Bank of Punjab	Bank of Punjab	2005
Centurion Bank of Punjab	Lord Krishna Bank	2007
HDFC Bank	Centurion Bank of Punjab	2008
ICICI Bank	Bank of Rajasthan	2010
Kotak Mahindra	ING Vysya Bank	2014

Pre and Post Merger Analysis of ICICI Bank in contrast with Bank of Rajasthan

	2010	2012
Liquidity Parameters(Quick Ratio)	14.70	15.86
Solvency Parameters(Debt Equity Ratio)	3.87	4.12
Profitability Parameters(Net Profit Ratio)	12.18	15.82
Investments Parameters(Return on Net Worth)	7.25	9.35
Market Parameters(Earning per Share)	36.09	45.73

Above analysis showed the satisfactory post merger results. The liquidity position has increased in the post merger times. Debt equity ratio has also improved. Net Profit margin is increasing year by year. Return on net worth has been increased after merger and the EPS has taken a good move after merger. Mergers and acquisitions have positive impact on financial performance as well as shareholders' wealth.

Pre and Post Merger Analysis of Kotak Mahindra in contrast with ING Vysya Bank

Ratio	**2010**	**2012**
Solvency Parameters(Capital Adequacy Ratio)	16.5	17.6
Profitability Parameters(Net Profit Ratio)	29.9	37
Investments Parameters(Return on Net Worth)	14.26	12.83
Market Parameters(Earning per Share)	32.0	34.3

Kotak Bank has acquired the ING Vysya Bank for a share swap ratio of 0.725 to 1. The merger is a great significance for Kotak Bank as not only is the valuation attractive, but after the merger, Kotak will become the fourth largest private bank in terms of branch network and size of its assets. The two banks have significant opportunities to drive synergy benefits by leveraging on:

(1) Presence in international markets through ING;

(2) The strong small- and medium-sized enterprise (SME) franchise of ING in southern states; and

(3) The retail and capital market strength of Kotak Bank. Further, we believe that Kotak can drive significant productivity improvements in ING Vysya branches, resulting in synergy benefits accruing over the long term.

Conclusion

Mergers and Acquisition is a useful tool for the development 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 considered 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 financial performance in terms of Operating Profit Margin, Net Profit Margin, Return on Assets, Return on Equity, Earning per Share, Debt Equity Ratio, Dividend Payout Ratio and Market Share Price has been made.

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