CHAPTER 5

FINDINGS AND CONCLUSION

Bank mergers are generally conceived with an intention to improve the performance of concerned banks and such merger decisions have an impact on most of their stakeholders. Among the numerous implications of bank mergers their impact on stock value and financial performance are thought to be important. Though bank merger decisions are usually taken on the basis of due diligence reports failures are not uncommon. Hence, it is essential to verify the gains made by concerned banks and their stockholders, and analyse the reasons for losses, if any. In this context, post-reform bank-to-bank mergers in India were analysed with the following null hypotheses:

- $H_{01}$: There is no significant difference in the stock returns of acquiring banks before and after merger announcement
- $H_{02}$: There is no significant difference in the stock returns of acquired banks before and after merger announcement
- $H_{03}$: There is no significant difference in the performance of merged banks before and after merger

5.1 Findings

Among the sixteen bank mergers that were analysed nine mergers were carried out on voluntary basis and seven were done on regulatory compulsions. Voluntary mergers were done for strategic reasons such as market expansion, new product offering and branch network expansion. Typical forced mergers involved acquisition of weaker banks by stronger public sector banks. The only exception was acquisition of Ganesh Bank of
Kurundwad by Federal Bank, a private sector bank. However, irrespective of the nature of merger, stock returns of acquiring banks and acquired banks appears to have declined after merger announcement. Hence, the first null hypothesis and second null hypothesis are rejected.

Similarly, the profit efficiency of acquiring banks appears to have declined after merger. However, cost efficiency of acquiring banks appears to be relatively unaffected by merger. Hence, the third hypothesis is partly accepted. Overall, various reasons cited in favour of bank consolidation by the government, RBI and bank managers are questionable. Although, it is important to create bigger banks that could compete globally the action need not be merger always. Likewise, consolidation is not the only option to protect the interest of stakeholders and to achieve rapid growth; other alternatives could be considered to achieve the required results.

However, some of the mergers have resulted in gains to either the acquiring or the acquired banks. Likewise, in exceptional cases some banks had experienced profit efficiency gains or cost efficiency gains. In the merger involving HDFC Bank and Times Bank, the first post-reform market-driven merger in India, the market reaction was positive for both the banks. Stockholders appear to have been motivated by expectation of higher economies of scale and lower operating expenses. Yet, these sentiments were not reflected in the actual performance of HDFC Bank in the post-merger period. Both cost efficiency and profit efficiency of the bank appeared to decline after merger.

ICICI Bank acquired Bank of Madura to expand its presence in Southern India. Both were financially sound private sector banks and the market reaction for both banks was positive. Conversely, performance of ICICI Bank declined after merger which is evident from the lower cost efficiency and profit efficiency values. It appears that the stockholders overestimated the potential benefits of merger.
Bank of Baroda, a public sector bank, acquired Benares State Bank, an unlisted old generation private sector bank. Unlike the previous two mergers this merger was carried out based on regulatory compulsion since the latter bank was incurring losses. Consequently, stock price of Bank of Baroda declined immediately after the merger announcement was made and after a few days the stock prices recovered. However, the cost efficiency and profit efficiency of the merged entity showed a declining trend. It appears that the initial assessment of the stockholders was correct and the price recovery was unfounded.

Punjab National Bank, a public sector bank, acquired Nedungadi Bank on being directed by Reserve Bank of India. Nedungadi Bank was an old generation private sector bank which was incurring loss. The market reaction was negative for Punjab National Bank and positive for Nedungadi Bank. The stockholders of Nedungadi Bank were probably relived that the bank was being acquired by a stronger bank. Nevertheless, cost efficiency and profit efficiency of Punjab National Bank declined after merger. It could be stated that the assessment made by stockholders of Punjab National Bank was correct. They had rightly anticipated a decline in performance of their bank.

Bank of Baroda, a public sector bank, was advised by Reserve Bank of India to acquire South Gujarat Local Area Bank, an unlisted new generation private sector bank. The latter bank was incurring losses and hence the merger was promulgated to protect the interest of depositors and other stakeholders. The market reaction for Bank of Baroda was negative as expected and the profit efficiency declined after merger. Cost efficiency was not adversely affected by the merger. The stockholders appear to have rightly assessed the potential negative outcome of this merger.

Oriental Bank of Commerce, a public sector bank, acquired Global Trust Bank, a loss making new generation private sector bank, on regulatory compulsion. There was no swap arrangement and the latter bank stockholders
were not issued any stocks of Oriental Bank of Commerce. Since Global Trust Bank had a significant presence in Southern India the market reaction was positive for Oriental Bank of Commerce and negative, as expected, for Global Trust Bank. However, post-merger profit efficiency and cost efficiency of Oriental Bank of Commerce declined indicating that the stockholders’ assessment was incorrect.

Centurion Bank, a new generation private sector, acquired Bank of Punjab, a new generation private sector bank based on commercial considerations. The market reaction was negative for Centurion Bank and positive for Bank of Punjab. This could be attributed to the high NPA level of Bank of Punjab. The cost efficiency and profit efficiency of Centurion Bank declined after merger and this was correctly assessed by stockholders of the bank. Federal Bank, an old generation private sector bank, was advised by Reserve Bank of India to takeover Ganesh Bank of Kurundwad. The latter was an unlisted old generation private sector bank and was under financial distress. The market reaction was initially negative for Federal Bank and after a few days it turned positive. It was expected that Federal Bank could increase its agricultural loan exposure in Maharashtra. However, the cost efficiency and profit efficiency declined after merger indicating that the stockholders’ expectation was not met.

IDBI Bank, a public sector bank, was forced by RBI to acquire United Western Bank, an old generation private sector bank, which was incurring losses. The initial market reaction for both the banks was negative and after a few days the stock price of both banks recovered. The profit efficiency of IDBI Bank improved after merger and the cost efficiency was not adversely affected. Hence, it could be stated that the stockholders overcame the initial shock to realise the potential benefits of gaining access to
extended branch network in semi-urban and rural India. This was further confirmed by the increase in profit efficiency.

Indian Overseas Bank, a public sector bank, acquired Bharat Overseas Bank, a private sector bank, based on regulatory compulsion. Consequently, the market reaction was negative for both the banks. Though Bharat Overseas Bank was not facing any financial problems the acquisition was viewed negatively by both the stockholders. Post-merger cost efficiency and profit efficiency declined after merger indicating that the assessment of stockholders was correct.

Centurion Bank of Punjab, a private sector bank, acquired Lord Krishna Bank, an unlisted old generation private sector bank, on voluntary basis. The market reaction was positive for the former bank. The cost efficiency was not adversely affected though the profit efficiency declined after merger. It could be implied that the market assessment of potential benefits was incorrect and performance outcome was negative.

ICICI Bank, a private sector bank, acquired Sangli Bank, an unlisted private sector bank under financial distress on voluntary basis. Consequently, the market reaction was negative and there was a marginal decline in cost efficiency after merger. However, profit efficiency declined significantly after merger. It could be stated that the assessment of stockholders about the negative outcome of this merger was correct.

HDFC Bank, a private sector bank, acquired Centurion Bank of Punjab which was also a private sector bank. Both the banks were financially sound at the time of merger. However, the market reaction was negative for both the banks. This was also reflected in the post-merger performance in the form of declined cost efficiency and profit efficiency. It appears that the stockholders’ anticipation about the negative outcome of this merger was correct.
State Bank of India, a public sector bank, acquired State Bank of Saurashtra, its unlisted subsidiary bank, for operational reasons. However, the market reaction was negative for State Bank of India and this was also reflected in the post-merger performance of the bank. Both cost efficiency and profit efficiency of the bank declined after merger. It could be implied that the assessment of stockholders about the negative impact of this merger on performance was correct.

Later, State Bank of India acquired State Bank of Indore which was also its unlisted subsidiary. In this case too, the market reaction was negative and there was a marginal decline in cost efficiency. However, the decline in profit efficiency was significant. The time gap between these two mergers was less than three years and hence it is difficult to isolate the effects of the former merger from this merger. Yet, the overall impact of these mergers on stockholders and performance of the bank appears to be negative.

ICICI Bank acquired Bank of Rajasthan, an old generation private sector bank under financial distress on voluntary basis. The market reaction was negative for both the banks. Interestingly, the cost efficiency and profit efficiency of ICICI Bank improved after merger. It appears that stockholders failed to identify the positive impact of this merger on the bank’s performance.

In general, stock value of most of the acquiring banks and acquired banks appear to have declined after merger announcement. Likewise, mergers also appear to have adversely affected the performance of merged banks. In many cases stockholders seem to have correctly assessed the negative outcome of merger. The cumulative returns also reflect the same trend where acquiring banks and acquired banks appear to lose stock value after merger announcement. The mean cost efficiency of acquiring banks appears to be
relatively unaffected by merger. The mean profit efficiency of acquiring banks appears to have declined after merger.

5.2 Conclusion

Overall, seven mergers were carried out on the basis of regulatory compulsions and nine mergers were carried out on commercial considerations. Out of the seven forced mergers six mergers involved public sector banks and among these six mergers, the merger between Oriental Bank of Commerce and Global Trust Bank alone resulted in higher stock returns to the acquiring bank. In all the other cases returns were either negative or negative during the first few days after merger announcement for the acquiring banks. Similarly, positive returns were observed for one acquired bank in forced merger of public sector banks. Stockholders of Nedungadi Bank, which was merged with Punjab National Bank, appeared to gain. In all the other cases returns for acquired banks were either negative or negative during the first few days after merger announcement. The only forced merger involving a private sector bank i.e. Federal Bank and Ganesh Bank of Kurundwad, also resulted in negative returns to Federal Bank during the first few days after merger announcement.

This is a point to be considered by the Reserve Bank of India which compels stronger banks to acquire structurally weak banks in order to protect the interest of depositors and other stakeholders and also for public good. Forced merger of public sector banks has caused depletion of stock value in most cases and this is against the interest of minority stockholders. Hence, RBI could initiate corrective actions to set right the financials of weaker banks instead of forcing them to merge with stronger banks.

The stockholders appeared to sense the negative outcome of forced mergers correctly in most cases and the only exception was IDBI Bank where
profit efficiency improved post-merger. In all other cases profit efficiency of merged banks showed a declining trend. Likewise, cost efficiency of just two banks, namely Bank of Baroda and IDBI Bank, appeared not be adversely affected by merger. In all other cases cost efficiency of merged banks had reduced. Interestingly, in voluntary mergers too, only three mergers had resulted in overall gains to stockholders of acquiring banks. Stockholders of HDFC Bank (acquired Times Bank), ICICI Bank (acquired Bank of Madura) and Centurion Bank of Punjab (acquired Lord Krishna Bank) experienced gains. Among acquired banks, Times Bank, Bank of Madura and Bank of Punjab (acquired by Centurion Bank) experienced gains in stock value and in other cases the returns were negative.

However, stockholders appeared to overestimate potential benefits in most of the voluntary mergers. The profit efficiency and cost efficiency of ICICI Bank alone had improved after its merger with Bank of Rajasthan. Profit efficiency of all other banks involved in voluntary mergers had declined after merger. Cost efficiency of Centurion Bank of Punjab was not adversely affected due to its acquisition of Lord Krishna Bank. However, cost efficiency had declined after merger in all the other cases.

It seems that bank managers appear to overestimate the potential benefits in case of voluntary mergers driven by their desire to build bigger banks either for strategic reasons or operational reasons. In most cases costs overweigh the benefits leading to decrease in financial performance and efficiency. In some voluntary mergers stockholders also appear to have been driven by hubris and that had led to unfounded gains in stock returns. Among the sixteen mergers that were analysed most of the merger announcements had resulted in depletion of stock value for either the acquiring bank or the acquired bank.
In many cases the assessment of stockholders about the merger outcome was negative and it was confirmed by lower cost efficiency and profit efficiency measures. In almost all the mergers the profit efficiency had declined after merger. Likewise, the cost efficiency had declined for most of the banks and in certain cases the cost efficiency was not adversely affected. In a way it also leads to the conclusion that the Indian stock market is semi-strong in form as most merger announcements led to immediate changes in stock prices.

The government also supports consolidation since it is unable to allocate more capital to the public sector banks. The government also intends to create larger banks which could compete with international banks. However, bigger size alone cannot guarantee better performance or higher stock returns. Size in one of the factors that could contribute to higher efficiency and even here there is no consensus or strong evidence in support of bigger banks.

Here, the merged banks appear to have incurred higher interest expenses and operating expenses nullifying the positive effects of larger capital base and higher loan disbursements. The presumed benefits were not realised by most of the acquiring banks. Consequently, the income and profit after tax declined after merger and that resulted in lower profit efficiency and cost efficiency.

Overall, bank mergers in India during the post liberalisation period from 1999 to 2010 had not resulted in higher stock returns or higher efficiencies. It would be prudent if the bank managers, RBI and government approach bank consolidation with caution. Big banks have failed in the past and it is wise to learn from their experience than experimenting with consolidation. Merger route must be chosen with caution if and only if it could result in improved performance by elimination of inherent inefficiencies.