CHAPTER-10
FINDINGS AND CONCLUSIONS

10.1 CONCLUSION:

The financial sector reforms initiated in 1991 have brought about enormous changes in the functioning and structure of banks in India. These changes in the banking regulations have enabled Indian banks to move from a regulated setting to a deregulated business environment. This deregulated environment has facilitated banks to consolidate their operations through mergers and acquisitions and also embrace universalization of banking systems and practices. Presently Indian banks are on the verge of moving into the international banking phase where the banking sector is largely dominated by large banks who contribute meaningfully to emerging economies. Moving towards this international phase transition, consolidation in the banking industry is gaining momentum in order to combat the pressures of emerging global competition as well as to strengthen the financial and operating performance of banks. Towards this the Indian regulators have been encouraging Indian banks to consider mergers and acquisitions to create strong single entities. The Indian government is also considering infusing capital into banks that have been performing well.

Mergers and Acquisitions has always been of acute research interest to academicians and research scholars and the banking sector in particular is one of the few sectors that evoke a high research interest as a result of the deregulation and liberalization in this sector which encourages a wave of banking merger and acquisitions. The present study analyzes the pre-merger versus post-merger performance of Public Sector Banks vis-à-vis Private Sector Banks that have merged during the period 1993-1994 to 2004-2005.

The conclusions that have been drawn from conducting this study on the cases analyzed are:

b. Analysis of Post- Merger Performance of Public Sector Banks Vis-à-vis Private Sector Banks with respect to Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity.

c. Interview Discussions.

10.2 ANALYSIS OF PRE-MERGER VERSUS POST- MERGER PERFORMANCE OF ACQUIRING BANKS WITH RESPECT TO CAPITAL ADEQUACY, ASSET QUALITY, MANAGEMENT EFFICIENCY, EARNINGS QUALITY AND LIQUIDITY.

An analysis of the Total CAPITAL ADEQUACY of the acquiring banks during the pre-merger versus the post- merger period clearly indicates that, out of the four parameters that analyze CAPITAL ADEQUACY in banks, i.e Capital Adequacy Ratio, Debt Equity Ratio, Total Advances to Total Assets Ratio, Government Securities to Total Investment Ratio, there is no significant difference in the Capital Adequacy Ratio and Debt Equity Ratio of the acquiring Banks during the pre-merger period versus the post-merger period, however it is observed that the acquirer banks total quantum of safe investments from the total investment portfolio has increased with an increase in the Government Securities to Total Investment Ratio which has been significantly high in the post-merger period for the acquirer banks. It could indicate that since the investments made, are more in government securities the risk related to investments has declined significantly. Although the returns associated with government securities are low, yet they are risk free, therefore it implies that, with an increase in post-merger Government Securities to Total Investment Ratio, there seems to be a low risk associated with banks investments in the post-merger period. It is also observed that there is a significant difference in Total Advances to Total Assets Ratio which has been significantly higher in the post-merger period which could indicate that the acquirers may have become very aggressive in lending which could ultimately result in increased profitability, or it could also be interpreted that the target bank was an aggressive lender, which is now reflected in the Total Advances to Total Assets Ratio. Nonetheless it could lead to increase in profitability of the acquirer banks. Finally although there is no significant difference in the pre-merger versus post-merger Capital Adequacy Ratio of the acquirer banks, yet, it is noteworthy to observe that as per the mean value
of Capital Adequacy Ratio all the acquiring bank have maintained the minimum CAR prescribed as per RBI as well as per BASEL norms in both the pre-merger as well as the post-merger period.

The three parameters - Net Non-Performing Assets to Net Advances Ratio, Gross Non-Performing Assets to Net Advances Ratio and Total Investment to Total Asset Ratio that analyze the TOTAL ASSET QUALITY in banks, clearly indicate that there is no significant difference in pre-merger versus post-merger Total Investment to Total Asset Ratio of acquiring banks. However there is a significant difference in the Net Non-Performing Assets to Net Advances Ratio and Gross Non-Performing Assets to Net Advances Ratio in the pre-merger period versus post-merger period of the acquiring banks with a significant decline of these ratios in the post-merger period which imply that these ratios have significantly improved in the post-merger period. These ratios were significantly higher in the pre-merger period, which seem to reflect rising quantity of bad loans during the pre-merger period. It would also show the financial burden on the acquirer banks during the pre-merger period. This ratio has improved during the post-merger period as it shows a significant decline in the post-merger period. Therefore we can conclude that mergers and acquisitions may have aided the acquirer bank in reducing the Net Non-Performing Assets and may have been one of the tools in reducing the Non-Performing Assets. This could also imply that Mergers and acquisitions could be taken up as a strategy by Indian banks to reduce their Non-Performing Assets.

The six parameters that analyze the Total MANAGEMENT EFFICIENCY of banks signify that acquisitions may have led to a significant improvement in the total MANAGEMENT EFFICIENCY parameters of the acquiring banks. It is observed that whilst all the other parameter of Management Efficiency show a significant difference in the pre-merger and post-merger performance, only Total Expenditure to Total Income Ratio showed that there was no significant difference in the pre-merger versus post-merger performance. This could be seen as a positive sign which signifies that in the post-merger period although the expenditure of the acquiring bank has increased with the addition of the target banks expenditure without a corresponding addition in the income of the acquirer bank with the targets banks income, the
acquiring banks seems to have very tactfully managed its Total Expenditure to Total Income Ratio at least to the level of its pre-merger ratio.

Although there has been a significant difference in the pre-merger versus post-merger Asset Turnover Ratio of the acquiring bank, it is observed that this ratio has declined in the post-merger period. This decline could be due to an addition in the total assets of the acquiring bank in the post-merger period with the assets of the target bank without a corresponding addition in the income of the acquirer bank with that of the income of the target bank and in some cases the income has also been significantly low which may have led to a decline in the Asset Turnover Ratio in the post-merger period of the acquirer bank.

With the business of the target bank now becoming the business of the acquirer bank, the acquirer banks have used all their capabilities in converting this into sound business that will add to their bottom line and this seems to be reflected in the increasing Profits per Employee and Business per Employee ratios.

The Total Advance to Total Deposit Ratio, Diversification Ratio, Profits Per Employee and Business Per Employee Ratios have shown a significant difference in the pre-merger versus post-merger period, with the post-merger performance of these ratios being significantly higher than the pre-merger performance. The target banks have added to the number of branches, number of employees as well as number of customers which may have led to a significant positive increase in the above mentioned ratios. With the apt mix of the management capabilities of both the acquirer and target bank, the acquirer bank seem to have also managed to increase its diversification ratio by engaging more into fee based activities. An increase in the Total Advance to Total Deposit Ratio exhibits ability of the acquiring bank's management in converting the deposits available with the bank (excluding other funds like equity capital, etc.) into high earnings advances. Since the regulators do not give any standards for this ratio, an increasing ratio could signify more reliance by acquiring bank in the post-acquisition period on deposits for lending.

The Total EARNINGS QUALITY of banks as represented by i.e Net Profit Margin, Return on Equity, Net Interest Margin, Interest Spread and Interest Income to Total Income Ratio also seem
to show an improvement in the post-merger period for the acquirer bank. Amongst the five parameters that determine the Earnings Quality of banks; it is observed that the acquirer has very tactfully maintained the same level of Net Interest Margins in the post-merger period as that of the pre-merger period. On the basis of this it can be concluded that in the post-merger period, although there has been an increase in the total assets of the acquiring bank with the assets of the target bank without a corresponding addition in the income of the acquirer bank with that of the income of the target bank, the acquirer bank seems to be able to leverage on the assets and management skills of the target banks and generate higher core income for the bank as a higher NIM indicates better earnings as against the total assets of the acquirer bank. This is a healthy indication of the earnings quality of the bank since; it showcases the ability of the bank to keep the interest on deposits low and interest on advance high.

Net Profit Margin, Return on Equity, Interest Spread and Interest Income to Total Income Ratio of the acquiring banks have shown significant changes in the post-merger period and it is even more interesting to note that Net Profit Margin and Return on Equity shows higher performance in the post-merger period for the acquiring banks whereas the Interest Spread and Interest Income to Total Income Ratio shows higher performance in the pre-merger period.

The increasing ratios of Net Profit Margin and Return on Equity in the post-merger period indicate that the acquiring banks earnings have rather seem to have become stable following the acquisition of the target bank. The Return on Equity may have also been positively influenced by Net Interest Margin, since in the post-acquisition period, acquiring banks are very efficiently being able to mobilize deposits at a lower rate and advance these to customers to generate higher returns than the cost of deposits; hence the acquiring banks seem to create additional revenues in the post-merger period that may accrue to shareholders.

Finally when it comes to Earnings Efficiency, although there is a significant difference in the pre-merger versus post-merger Interest Spread and Total Interest Income to Total Income Ratio, these ratios show higher performance in the pre-merger period. This could be immediately linked to the ability of the acquiring banks to diversify their income into fee based services also and not restrict it to the fund based ones in the post-merger period. It could thus imply that in the post-
merger period, banks have started looking for increasing fee based income rather than the traditional interest income that is fund based. This may be further confirmed by the Total Interest Income to Total Income Ratio which has shown better performance in the pre-merger period. Nonetheless the decline in performance of this ratio in the post-merger period could signify increased reliance on other sources of revenue by the bank rather than the traditional lending operation revenue. In conclusion the Earnings Efficiency seem to have also shown an improved performance in the post-merger period.

There are four parameter that analyze the Total LIQUIDITY in banks. These parameters are Cash to Deposit Ratio, Government Securities to Total Asset Ratio, Investment to Deposit Ratio and Interest Expended to Interest Earned Ratio.

The Total LIQUIDITY in banks, assessed through the parameters of Cash to Deposit Ratio, Government Securities to Total Asset Ratio and Investment to Deposit Ratio during the pre-merger versus post-merger period of acquiring banks, seem to show that even after acquisition, the acquiring banks have been able to maintain their liquidity position at least like the pre-merger performance of liquidity and is successful in meeting its obligation towards the depositors of the bank.

The Interest Expended to Interest Earned Ratio of the acquiring bank showed higher performance in the pre-merger period, which could imply that the acquiring banks seem to be generating enough interest from advances to meet its interest obligations of deposits which signifies sound liquidity of the acquiring bank in the pre-merger period and the acquiring banks have been able to retain this liquidity fitness in the post-acquisition period too.

In conclusion the Pre-Merger versus Post- Merger Performance of Acquiring Banks with respect to Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity seem to show improved performance in the post-merger period.
10.3 ANALYSIS OF POST- MERGER PERFORMANCE OF PUBLIC SECTOR BANKS VIS-À-VIS PRIVATE SECTOR BANKS WITH RESPECT TO CAPITAL ADEQUACY, ASSET QUALITY, MANAGEMENT EFFICIENCY, EARNINGS QUALITY AND LIQUIDITY.

The four parameters that assess the Capital Adequacy Ratio for banks i.e, Capital Adequacy Ratio, Debt Equity Ratio, Total Advance to Total Asset Ratio and Government Securities to Total Investment Ratio show that both Public Sector Banks as well as Private Sector Banks seem to have maintained almost same level of performance with respect to Capital Adequacy Ratio as well as Total Advances to Total Assets Ratio and that the Capital Adequacy Ratio was much higher than the regulatory requirements , however in the post-merger period the Private Sector banks have had increased borrowings as against Public Sector Banks as a result of which the Debt Equity Ratio of Private Sector bank is significantly higher than that of Public Sector Banks. The Government Securities to Total Investment Ratio reveals that Public Sector banks have a significantly large proportion of total investments in government securities as against Private Sector Banks which is also reflected in the Public Sector banks performance of Government Securities to Total Investment Ratio which is significantly higher than the Private Sector Banks. Overall in conclusion Capital Adequacy performance during the post-merger period has been almost the same for Private Sector Banks as well as Public Sector Banks, yet on the Debt Equity Ratio and Government Securities to Total Investment Ratio the post-merger performance of Public Sector Banks was significantly improved than Private Sector Banks.

It is also clear that of the three parameters of Total Asset Quality i.e. Net Non-Performing Assets to Net Advance Ratio, Gross Non- Performing Assets to Net Advance Ratio and Total Investment to Total Asset Ratio, The Total Investment to Total Asset Ratio does not show any significant difference in the performance of Public Sector Banks vis-à-vis Private Sector Banks.

However in the post-merger period the Non-Performing Assets has significantly been higher for Public Sector Banks as the Net Non-Performing Assets to Net Advance Ratio and Gross Non-Performing Assets to Net Advance Ratio of Public Sector Banks vis-à-vis Private Sector Banks is significantly higher for Public Sector banks than the Private Sector banks. An increasing ratio
seems to reflect rising bad quality of loans in Public Sector Banks. It is due to this rising proportion of Net-Non-Performing Assets in Public Sector banks, few Public Sector banks are forced to take up acquisitions by RBI, due to which the Net Non-Performing Assets of the target banks are now accounted for as Net Non-performing assets of the acquiring Public Sector Banks due to which the ratio may have shown a steep increase in Public Sector Banks as against Private Sector Banks.

The Total Management Efficiency of Public Sector Banks vis-à-vis Private Sector banks reveal that the Total Management Efficiency of Private Sector Bank is significantly higher than that of Public Sector Banks, which indicate that Private Sector Bank have improved Management Efficiency than Public Sector Banks.

The six parameters that analyze Management Efficiency in banks reveal that there is a difference in the performance of Total Expenditure to Total Income Ratio, Total Advance to Total Deposit Ratio, Diversification Ratio, Profits Per Employee and Business Per Employee of Public Sector Banks vis-à-vis Private Sector Banks.

The performance of Total Advance to Total Deposit Ratio, Diversification Ratio, profits Per Employee and Business per Employee of Public Sector Banks vis-à-vis Private Sector Banks show that Private Sector Banks have a higher performance than Public Sector banks. This clearly shows that Private Sector banks seem to be very proficient with respect to their Management Efficiency as all the parameters clearly signify the sound and healthy state of the banks. A higher Total Advance to Total Deposit Ratio indicates more reliance on deposits for lending by Private Sector banks. Since the regulator does not provide any standard norm or level for the ratio it shows that a very low ratio indicates banks that Public Sector banks seem to not be making full use of their resources for lending through their deposits. A look at the diversification Ratio also indicates increasing proportion of fee-based income by Private Sector Banks. It shows the ability of Private Sector Banks to generate income other than interest income from regular banking activities. In the pre-merger period a large proportion of Private Sector Banks income seem to be generated through its lending activities, however presently these banks have also started enhancing its income by resorting to activities other than regular banking activities. The Public
Sector Banks have also gradually started adopting this business strategy; however yet Private Sector banks Diversification Ratio is significantly higher than that of Public Sector bank.

The Private Sector banks also have a significant high Profits Per Employee and Business Per Employee vis-à-vis Public Sector Banks, which indicates that the Private Sector banks seems to have an expert management that inspire and stimulate employee to earn more profits and generate more business for the bank per employee.

The Private Sector banks have also outperformed the Public sector banks on the parameter of Total Expenditure to Total Income Ratio, where the Total Expenditure to Total Income Ratio performance is significantly higher for Public Sector banks as against Private Sector banks as a substantial part of operating expense of banks seem to consists of salaries to employees, technological up gradations and branch rationalization, however rising costs could also signify that Public Sector banks may need to control its expenditure as it is an essential aspect to enhance the profits for the bank. Another reason could also be attributed to the forced acquisitions by RBI, due to which the expenditure of the target banks is now accounted for in the acquiring Public Sector Banks without corresponding income generation from target bank.

However when it comes to Asset Turnover Ratio, there is no significant difference in the performance of Public Sector Banks vis-à-vis Private Sector Banks.

The Earnings Quality in banks shows that there is a significant difference in the Net Profit Ratio and Interest Income to Total Income Ratio of Public Sector Banks vis-à-vis Private Sector Banks. The Interest Income to Total Income Ratio performance shows that it is significantly higher for Public Sector banks as against Private Sector banks. This could be due to the fact that Public sector banks seem to engage more in regular banking activities like lending, to generate the regular banking income which is Interest Income. Public Sector banks also do not seem to largely engage in fee based services and depends largely on fund based income like interest income, unlike Private Sector Banks where this mean ratio is low as the Diversification Ratio is significantly higher than Public Sector Banks, which indicates that apart from interest income, the total income of Private Sector banks could also include certain proportion of fund based income.
The Net Profit Margin of Private Sector Banks is significant higher than Public Sector banks. This is could be due to the low Total Expenditure to Total Income Ratio that has led to a corresponding significant increase in Net profit Margin of Private Sector Bank as against Public Sector banks.

However when it comes to Return on Equity, Net Interest Margin and Interest Spread , there is no significant difference in the performance of Public Sector Banks vis-à-vis Private Sector Banks. From the above analysis, it can be concluded that there seems to be no significant difference in the Earnings Quality of Public Sector Banks vis-à-vis Private Sector Banks and that Public Sector Banks seems to perform significantly equal to the Private Sector banks on Total Earnings Quality.

While analyzing the Liquidity in banks the Cash to Deposit Ratio, Government Securities to Total Asset Ratio, Total Investment to Total Deposit Ratio and Interest Expended to Interest Earned Ratio show that of these four parameters, there is a significant difference in Total Investment to Total Deposit Ratio of Public Sector Banks vis-à-vis Private Sector Banks which shows that it is significantly higher for Private Sector banks as against Public Sector banks. This clearly indicates that Private Sector Banks seem to be liquid in meeting its obligation towards the depositors of the bank.

The Cash to Deposit Ratio, Government Securities to Total Asset Ratio, and Interest Expended to Interest Earned Ratio shows no significant difference in the performance of Public Sector Banks vis-à-vis Private Sector Banks. It can be concluded that there is no significant difference in the LIQUIDITY performance of Public Sector Banks vis-à-vis Private Sector Banks and that Public Sector Banks seem to perform significantly equal to the Private Sector banks on Total LIQUIDITY.
10.4 INTERVIEW DISCUSSIONS:

The in-depth interviews with top level banking executives to collect actual information about the motives of the acquiring bank to enter into the mergers and acquisitions as well as to analyze the impact of mergers and acquisitions on the performance of the acquiring bank resulted into the following conclusive points:

i. Indian banks need to grow in size, which is possible through acquisitions, amongst other structural policy changes. India has many banks; however these banks don’t have the size and scale. India will need all banks to merge with each other and use each other’s skills to compete with banks on global level. With this happening, India will move from the regime of larger number of small bank to smaller number of large banks.

ii. There has been a momentous shift in the motives for acquisition which were dominated by forced merger and amalgamation as a tool to provide relief to ailing banks besides protecting public and depositors confidence in the banking system, today there are more voluntary efforts of banks to merge. However the voluntary acquisitions in the Indian banking sector are preferred as method of restructuring only by private sector banks in India. The Public Sector Banks are very disinclined towards this type of restructuring mechanism voluntarily.

iii. In the past most of the acquisitions were initiated by the financial regulators in order to protect and safeguard the interest of the stakeholders of weak banks. In such forced acquisitions which were a result of RBI’s decision, whereby the weak and loss making bank was acquired by a financial healthy bank, the asset quality of the target bank being very poor did affect the Asset Quality of the Acquiring Bank. Presently, market led mergers are gaining pace, leading to combining of strong banks and financial institution’s that make more financial and economic sense.

iv. Private sector bank acquirers have far better performance than the public sector bank acquirer in profitability, earnings and liquidity although there is no major changes in
the liquidity performance but in case of capital adequacy and NPAs, the results are divergent, wherein public sector bank acquirers perform better than private sector bank acquirers. The basic reason being the underlying purpose for which the acquisitions are undertaken, wherein private sector banks acquired for business reasons and public sector banks acquired on the basis of RBI directives.

v. Liquidity of the bank is not majorly affected, even in case of forced acquisitions; since RBI defines the acquirer keeping in mind the liquidity strength of the acquirer to bear the losses of the target bank. The earnings quality has also shown a sharp improvement. There is also an improvement in the Asset Quality caused due to reduction in the Net Non-Performing Assets. Management Efficiency definitely has a positive impact on performance in the post-acquisition period. This holds well for both public sector bank acquirers as well as private sector bank acquirers, just that the positive impact on performance of private sector bank acquirers in voluntary acquisition can be seen immediately after the year of acquisition.

vi. The performance enhancement of acquirer in the post-acquisition period indicate that the performance of the acquirer does improve in voluntary acquisitions immediately, however it takes some period of 3 years at least for banks to show results in case of forced deals. A prominent feature of post-acquisition performance is that irrespective of motives of the deal, almost all acquisitions show improved performance on the Capital Adequacy Ratio and Management Efficiency variables especially Diversification Ratio and Business and Profits per employee however it is also true that the Debt Equity Ratio is high in the post-merger period since target banks are more levered than the acquiring banks.

vii. The current banking environment is extremely dynamic, challenging and exciting. Such an exciting environment will have no space for weak banks to function. The equipped banks will find the future holding out several challenges in terms of increasing competition, technological advancement, changing regulatory framework,
stringent regulatory policies etc. This requires all banks to grab the growth opportunities that will come their way or else the banking environment would make it difficult for banks to survive. The regulatory authorities should also set in such norms that are stringent enough to ensure control and discipline and facilitating enough to build a strong and vibrant banking system which is looked up as an example by other banks the world over.

viii. Mergers and Acquisitions is an important tool for restructuring of Indian Banks as well as an important tool to enhance the performance of both public sector Indian banks as well as private sector Indian banks. Indian Banks can adopt mergers and acquisitions as an important tool to enhance the performance of both public sector Indian banks as well as private sector Indian banks in the case of voluntary mergers and acquisitions.

In conclusion banking mergers and acquisitions can be considered as a major strategy for banks to combat competition, meet growth targets and implement international standards in the Indian context. However for this strategy to be implemented seamlessly, it becomes imperative for the regulators and financial authorities to create policies that are conducive for the adoption of this strategy by Indian banks.

For banks looking to grow through Mergers and Acquisition, regulatory restrictions seem to continue as a major hurdle, although increased clarity may also bring increased confidence. Indian banks seem to be also increasingly looking at acquiring fee based businesses that are not capital-intensive. Few of the Indian banks are also moving into wealth management business. However since this requires scale as banks would need capital to acquire the assets under the banking management, this would limit the number of banks that consider entering wealth management business. Apart from enhancing the performance of the banks, mergers and acquisitions seem to also have proved to be more efficient way to attain technology improvements than developing them in-house.

In addition, it could assist banks to acquire the necessary capabilities to strengthen data management functions and deliver more accurate, consistent, timely, and secure information.
Indian banks have also started using mergers and acquisition as an offensive rather than a defensive strategy to build size and seek growth and business scale. Engaging the regulators actively right from the inception of the acquisition strategy would assist bank to combat regulatory issues and transform mergers and acquisitions from a reactive model to a proactive strategy.