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Mergers in Indian banking industry-A case study on ICICI bank and Indian Overseas bank

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Abstract
Mergers and acquisitions are the revolution strategies to restructure a business where the competitions are reduced and existing markets are protected. In the recent years Indian Banking industry had also adopted the strategies to increase the market share of the business and to control the competition. The study is an effort to analyse the financial performance and shareholder value of the select banks. The share holder value of the select banks are calculated through economic value added (EVA) tool. The performances of the banks are measured with profitability and productivity ratios. Paired t-test is used for testing the statistical significance of the ratios of the select banks. Mergers help banks to strengthen their financial base to expand their operation and reduce their cost of operation. The study covers a public sector bank and a private sector bank which were involved in merger during 2006-07 and 2010-11 respectively. The results suggest that banks had improved efficiency and increased the shareholders value through strategic mergers. Required data were collected from the Capitaline Plus Database. It was found that the in post merger period there is increase in the economic value added of the banks under the study.

Keywords: Strategy, mergers, performance, shareholder value

Introduction

Mergers and acquisitions have gained more importance in the Indian banking industry to restructure the banking business. In a globalized business environment mergers play a vital role for the expansion and growth of the economy. The main motive of merger and acquisitions is to create synergy and economies of scale. Merger and Acquisitions are business strategy for achieving larger size, increased market share, faster growth, synergy, diversification and financial planning for becoming more competitive through economies of scale. A merger is that when two or more entities join together to form a new entity with the existing owners. On the other hand, when one company takes over another company and clearly well-known itself as the new owner, this is known as acquisition. The Indian Economic reforms since 1991 had bought various challenges in all the aspects of the Indian economy. The increased competition in the globalised economy had promoted the Indian banks to accept mergers and acquisitions as the strategic choice. Banks have greatest responsibility in propelling the entire economy in any nation, where there is a need to restructure for efficient profit- service providers through a process to forestalling the bank distress. The fundamental motive of merger is to enhance the shareholder wealth and sustainable competitive advantage for the acquirer. The Indian Banking Sector showed a sign of improvement in performance and efficiency after the global crisis in 2008-09. Government has taken various initiatives to strengthen the financial system during the period. The economic recovery gained strength on the back of a variety of monetary policy initiatives taken by the Reserve Bank of India. During the year 2006-07 Indian Overseas Bank took the control of Bharat Overseas Bank on the basis of regulatory intervention by the RBI. The ICICI Bank took the control of Bank of Rajasthan during 2010-11 by a voluntary merger. The study focus on Indian Overseas Bank and ICICI Bank pre and post merger performance and the impact on shareholder value.

ICICI Bank Ltd

ICICI Bank Ltd is the leader among the private sector commercial banks and the second largest bank in India. ICICI Bank Ltd was incorporated in the year 1994 as a part of the

ICICI group as ICICI Banking Corporation Ltd. In September 10, 1999, the name of the bank was changed to ICICI Bank Ltd. In March 10, 2001, ICICI Bank acquired Bank of Madura, an old private sector bank, in an all-stock merger. In April 2007, Sangli Bank Ltd merged with the ICICI Bank with effect from April 19, 2007. In August 2010, as per the scheme of amalgamation, Bank of Rajasthan with its 463 branches was amalgamated with the ICICI Bank with effect from the close of business on 12 August 2010.

Indian Overseas Bank Ltd

Indian Overseas Bank (IOB) was founded in 10th February 1937.At the dawn of Independence, IOB had 38 branches in India and 7 branches abroad. In the year 1988, IOB acquired Bank of Tamil Nadu in a rescue. The Bank got autonomous status during the year 1997-98. During the year 2004, the Government of India selected IOB for channelising government credit to other countries, which runs into billions of dollars. In September 2006, Indian Overseas Bank had finally taken control of Bharat Overseas Bank. This is the first instance of a public sector bank taking over a strong private sector bank without resorting to the moratorium route.

Literature Review

Mr. Debaprosanna Nandy (2010) [7] found the need for mergers in the banking sector with the analysis through various numerical techniques like ratios, percentage and rate of growth to measure the performance of the banks to support the merger programme. Azeem Ahmad Khan (2011) [9] had compared pre and post merger financial performance of merged banks with the financial ratios. Finally mergers and acquisitions resulted with the benefit to the equity shareholders in the form of dividend. Sinha Pankaj (2011) [10] had concluded merger and an acquisition has positive effect on the firm's profitability. S.S. Rajan (2011) [11] examined the technical efficiency and productivity performance of Indian scheduled commercial banks, for the period 1979-2008. Schiereck Dirk (2009) [6], had examined the relationship between bank reputation after Merger and Acquisitions and its effects on shareholder's wealth. Anand Manoj (2008) [5] states the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. The announcement of merger of Bank had positive and significant impact on share holder's wealth. The market value of weighted Capital Adequacy Ratio was analysed to measure the impact of merger announcement. Mr. Pawan Sharma (2012) [12] analyzed the pre and post merger impact on share price fluctuations with reference to ICICI Bank. Valeriya dingel (2011) found the impact of merger and market characteristics on the rigidity of bank interest rate in bank mergers. A.K. Vashisht (2012) [1] states the effectiveness of merger on shareholder wealth through Economic Value Added (EVA) as performance measurement tool in Indian banking industry. M.C. Sharma *et al.* (2012) [3], had stated the change in growth of shareholder value using EVA as a measuring tool for the select banks in the study. Pawan Sharma (2012) [12], had focused on banks perspective in mergers at select banks through the impact of share price fluctuations. Statistical method/tools are used for the analysis in the study. G. Santhiyavalli *et al*. (2014) [4], had examined the impact of merger in Indian banking industry taking into consideration the five banks last merger. To measure the shareholder value and performance of the banks, economic value added and financial parameters were used.

Objectives of the Study

Following are the objectives of the present study.

- To evaluate the impact of merger on the profitability and productivity of select banks.
- To analyze the merger impact on its shareholder value using EVA of the select banks.

Methodology

The impact of merger on the performance of select Banks-ICICI Bank Ltd and IOB Bank Ltd was studied based on the secondary data collected for a period of six years covering three years before and three years after the last merger. A set of profitability ratios and productivity ratios were analysed. The concept of Economic Value Added (EVA) was applied to understand the impact of merger on shareholder wealth. A set of profitability and productivity ratios are presented in Table 1.

Table 1: Profitability and productivity ratios of select banks with abbreviations and formulas

	Ratios	Abbreviations	Formulas
	Profitability		
1.	Return on equity	ROE	(Profit after tax/Net worth) x100
2.	Net interest margin to total assets	NIM to TA	(Net interest income/total assets)x100
3.	Non- interest income to total assets	NII to TA	(Non- interest income/total assets)x100
4.	Net profit to Total assets	NP to TA	(Net profit/total asset)x100
	Productivity		
5.	Advance to Deposits	Adv.to Dep.	(Advances/Deposits)x100
6.	Investments to Deposits	Invst to Dep.	(Investment/Deposit)x100
7.	Business per employee	-	(Revenue/No. of employees)
8.	Profit per employee	-	(Net income/No. of employees)

- ROE measures the profit of the bank generated with the money invested by the shareholders.
- NIM to TA ratio states the average interest margin of the bank.
- NII to TA measures the operational efficiency of the bank.
- NP to TA ratio is the strong indicator of profitability which helps the investors for the investment decisions.
- Adv. to Dep. ratio states banks lending out of the deposits mobilized.
- Invt. to Dep. ratio states the investments made out of the deposits mobilized.

- Business per employee states the average business done by an employee.
- Profit per employee is the average profit per employee made out of the business.

Economic Value Added

EVA method is the invention of the Stern Steward & Co launched in 1989 and it links the finance to the competitive strategy framework. It is also an indicator of the value which is created in the company. EVA is a measure which goes beyond the rate of return and considers the cost of capital (earnings after cost of capital).

EVA=NOPAT-(WACC*CE)

(NOPAT is the net operating profit after tax, WACC is weighted average cost of capital at the minimum rate of return on capital required to compensate equity and debt investors for bearing risk, CE is capital employed)

NOPAT=Net profit+ Interest expenses on borrowed funds

WACC= $(W_d*K_d) + (W_e*K_e)$

(W_d is weight of debt, W_e is weight of equity, K_d is cost of debt that includes the amount paid as interest for the borrowings from the outsiders (deposits, debentures and other borrowed funds).K_e is cost of equity, the return (often expressed as a rate of return) a firm pays to its equity investors).

Cost of debt (K_d) = (interest expenses*(1-tax rate))/total borrowings.

A tax rate of 30 percent per year was assumed to maintain consistency over years in the study.

Cost of equity (K_e) = Rf +Beta(Rm-Rf)

(where Rm is the average market return and Rf is the risk free rate). In the study Rf is taken as same for the select banks i.e.365 days Treasury bills rate.

Beta β=N $(\sum xy)-(\sum x)(\sum y) \div N(\sum x^2)-(\sum x)^2$.

Beta can be defined as a risk measuring factor. Higher the beta value, higher the risk and vice versa. Beta value in the study is calculated based upon the stock prices and NIFTY for each year. N refers to the number of observations. x is the variable of NIFTY index in the market, y is the variable of respective bank's share value in the market.

Capital employed=Net worth+ total debt+ other liabilities and provisions.

(Net worth= sum of equity share capital and reserves, Total debt= deposits and borrowings).

Limitations of the Study

- The study takes into account only quantitative information. The qualitative aspects such as service delivery, management efficiency and customer satisfaction do not form part of the study.

Results and discussion

ICICI Bank Ltd

Generally the performance of a business entity is analysed based on its profitability and productivity. Table 2 present a set of profitability and productivity ratios of ICICI Bank Ltd to study the impact of merger. The results are tested using paired t-test.

Ho: There is no significant difference in the profitability and productivity ratios of ICICI Bank before and after merger.

Table 2: Profitability and Productivity ratios of ICICI Bank for the period 2007-08 to 2013-14

Year	ROE (%)	Ratio of NIM to TA (%)	Ratio of NII to TA (%)	Ratio of NP to TA (%)	Adv. to Dep. ratio (%)	Invst to Dep. Ratio (%)	Business per employee (Rs. in Crs)	Profit per employee (Rs. in Crs)
2007-08	8.95	1.82	2.22	1.04	92.30	45.59	10.08	0.10
2008-09	7.59	2.20	2.15	0.99	99.98	47.19	11.54	0.11
2009-10	7.79	2.23	2.06	1.11	89.69	59.84	7.65	0.09
Mean	8.27	2.01	2.18	1.01	93.99	50.88	9.76	0.10
SD	0.73	0.21	0.08	0.06	5.35	7.80	1.97	0.01
*2010-11	9.35	2.22	1.64	1.27	95.91	59.70	7.35	0.10
2011-12	10.70	2.19	1.53	1.32	99.31	62.45	7.08	0.11
2012-13	12.48	2.58	1.55	1.55	99.19	58.57	7.35	0.14
2013-14	13.39	2.76	0.80	1.64	102.04	53.33	7.47	0.14
Mean	12.19	2.51	1.29	1.50	100.18	58.11	7.30	0.13
SD	1.37	0.29	0.43	0.17	1.61	4.57	0.19	0.02
"t"-value	-3.46 (0.075***)	-8.14 (0.015**)	4.12 (0.054***)	-5.17 (0.035**)	-1.62 (0.246)	-1.03 (0.413)	2.07 (0.175)	-2.59 (0.122)

Source: Capitaline plus database, *merger period, fig. in the ( ) indicates the significance, ***significant at 0.10 percent level**. ****significant at 0.05 percent level.

Table 2, reveals the average ratios of return on equity, net interest margin to total assets, net interest income to total assets, net profit to total assets, advances to deposits, investments to deposits, business per employee and profit per employee of ICICI Bank during 2007-08 to 2013-14. From the analysis it has been found all the profitability ratios are statistically significant. Hence the H_0 is accepted for all the productivity ratios and rejected for all the profitability ratios of ICICI Bank before and after merger.

Economic Value Added (EVA) of ICICI Bank Ltd

The performance of every business entity is measured by its shareholders value. Tables 3 present the EVA of the select banks to study the impact of merger.

Ho: There is no significant difference in the EVA of ICICI Bank before and after merger.

Table 3: Economic Value Added of ICICI Bank during 2007-08 to 2012-13.

Year	NOPAT (Rs. in. Crores)	Cost of Capital employed (Rs. in. Crores)	EVA (Rs. in. Crores)
2007-08	27641.97	20501.36	7140.61
2008-09	26484.07	20245.98	6238.08
2009-10	21617.55	18484.43	3133.11
Mean	25247.86	19743.92	5503.93
*2010-11	22108.53	20293.24	1815.29
2011-12	29273.76	24035.58	5238.17
2012-13	34534.65	24284.28	10250.37
2013-14	37513.07	29426.29	8086.78
Mean	33773.83	25915.38	7858.44
Paired "t"-value			-1.09 (0.387)

Source: Capitaline plus database,*merger period, figures in () indicates significance.

Table 3 reveals, the EVA of ICICI Bank during April 2007 to March 2013.Bank of Rajasthan merged with ICICI Bank during the period 2010-11.An analysis of the EVA of ICICI Bank proves the post-merger, EVA of the Bank increased significantly compared to pre-merger period. During 2011-12 the EVA of the ICICI Bank increased to Rs.5238.18 Crs from Rs.1815.29 Crs in 2010-11. The mean values of EVA before and after merger were Rs.5503.93Crs and Rs.7858.44 Crs respectively. During 2012-13 and 2013-14, the EVA stood at Rs.10250.37 Crs and Rs.8086.78 Crs respectively. Thus the analysis proves that merger had positive impact on the shareholders value after the merger.

Indian Overseas Bank Ltd

Tables 4 present a set of profitability and productivity ratios of Indian Overseas Bank Ltd to study the impact of merger. The results are tested using paired t-test.

Ho: There is no significant difference in the profitability and productivity ratios of IOB Bank before and after merger.

Table 4: Profitability and Productivity ratios of Indian Overseas Bank for the period 2003-04 to 2009-10.

Year	ROE (%)	Ratio of NIM to TA (%)	Ratio of NII to TA (%)	Ratio of NP to TA (%)	Adv. to Dep. ratio (%)	Invst to Dep. ratio (%)	Business per employee (Rs.in Crs)	Profit per employee (Rs.in Crs)
2003-04	26.56	3.38	1.74	1.08	48.92	48.63	2.33	0.02
2004-05	26.77	3.65	1.57	1.28	56.97	42.98	2.69	0.03
2005-06	25.64	3.48	1.23	1.32	68.78	37.51	3.55	0.03
Mean	26.32	3.50	1.51	1.22	58.23	43.04	2.86	0.03
SD	0.59	0.13	0.26	0.13	9.99	5.56	0.63	0.01
*2006-07	26.04	3.11	1.08	1.22	68.46	34.88	4.67	0.04
2007-08	25.30	2.40	1.06	1.18	71.63	33.77	5.83	0.05
2008-09	22.31	2.37	1.41	1.09	74.79	31.18	6.89	0.05
2009-10	11.13	2.42	0.87	0.54	71.30	33.98	7.12	0.03
Mean	19.58	2.39	1.11	0.94	72.58	32.98	6.61	0.04
SD	7.46	0.02	0.28	0.35	1.93	1.56	0.69	0.01
Paired "t"-value	1.689 (0.233)	12.158 (0.007**)	2.596 (0.122)	1.122 (0.378)	-2.360 (0.142)	2.972 (0.097***)	-16.87 (0.003**)	-1.89 (0.199)

Source: Capitaline plus database, *merger period, fig. in the ( ) indicates the significance, ***significant at 0.10 percent level**,** **significant at 0.05 percent level.

It is observed from Table 4, the average ratios of net interest margin to total assets, investment to deposits and business per employee of Indian Overseas Bank are proved to be statistically significant after the merger with Bharat Overseas Bank during 2006-07.Hence the H_0 is rejected for the ratios of net interest margin to total assets, investment to deposits ratio and business per employee of Indian Overseas Bank pre and post-merger. But the H_0 is accepted for the other financial parameters of Indian Overseas Bank in the study.

Economic Value Added (EVA) of Indian Overseas Bank (IOB) Ltd

Ho: There is no significant difference in the EVA of Indian Overseas Bank before and after merger.

Table 5: Economic Value Added (EVA) of Indian Overseas Bank during 2003-04 to 2009-10.

Year	NOPAT (Rs. in. Crores)	Cost of Capital employed (Rs. in. Crores)	EVA (Rs. in. Crores)
2003-04	2667.45	1907.07	760.37
2004-05	2746.89	2129.15	617.73
2005-06	3122.44	2455.63	666.80
Mean	2845.59	2163.95	681.63
*2006-07	4279.70	3331.40	948.29
2007-08	6491.13	4888.21	1602.91
2008-09	8097.60	6477.42	1620.17
2009-10	7784.87	5925.34	1859.53
Mean	7457.87	5763.66	1694.20
Paired "t" value			-10.004 (0.010**)

Source: Capitaline plus database,*merger period, figures in () indicates the significance at 0.05 percent.

It is evident from Table 5, EVA of Indian Overseas Bank had increased during post-merger. Bharat Overseas Bank merged with Indian Overseas Bank during the period 2006-07.An analysis of the EVA of Indian Overseas Bank indicates the post-merger EVA of the bank increased significantly compared to pre-merger period. During 2007-08 the EVA of the Indian Overseas Bank increased to Rs.1602.91 Crs from Rs.948.29 Crs in 2006-07.The EVA of the Bank showed an increasing trend after the merger in 2006-07 and stood at Rs.1859.53 Crs during 2009-10. The average values of pre and post-merger EVA of the bank were found to be Rs.681.63Crs and Rs.1694.20Crs respectively. Thus merger had resulted in creating value to the Indian Overseas Bank and it is statistically significant at 5 percent.

Conclusion

Merger is one of the important strategies for the business firms to improve profitability, ensures better productivity and to create shareholder value. The study documents the EVA of Indian Overseas Bank had showed a significant change in the shareholder value after the merger choice taken by the bank during 2006-07. In ICICI Bank the profitability ratios have been found statistically significant after the merger during 2010-11. The result states the performances of the select banks are in increasing trend by reducing the competition and business expansion in the market. On the analysis of EVA and other performance metric of select banks under the study, it is found that merger has positive impact on the select banks.

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