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Impact of merger of banks on economy

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Abstract
Measured by share of deposits, 83 percent of the banking business in India is in the hands of state or nationalized banks, which are banks that are owned by the government, in some, increasingly less clear-cut way. Moreover, even the non-nationalized banks are subject to extensive regulations on who they can lend to, in addition to the more standard prudential regulations. Government control over banks has always had its fans, ranging from Lenin to Gerschenkron. While there are those who have emphasized the political importance of public control over banking, most arguments for nationalizing banks are based on the premise that profit maximizing lenders do not necessarily deliver credit where the social returns are the highest. The Indian government, when nationalizing all the larger Indian banks in 1969, argued that banking was "inspired by a larger social purpose" and must "subserve national priorities and objectives such as rapid growth in agriculture, small industry and exports. The current paper highlights the various aspect of banking reform in India.

Keywords: Banking, Reform, Merger, Bank.

Introduction
Bank in general terminology is referred to as an financial institute or a corporation which is authorized by the state or central government to deal with money by accepting deposits, giving out loan and investing in securities. The main roles of Banks are Economics growth, Expansion of the economy and provide funds for investment. In the resent times banking sector has been undergoing a lot of changes in terms of regulation and effects of globalization. These changes have affected this sector both structurally and strategically. With the changing Environment many different strategies have been adopted by this sector to remain efficient and to surge ahead in the global arena. One such strategy is through the process of consolidation of banks emerged as one of the most profitable strategy. There are several ways to consolidate the banking industry; the most commonly adopted by banks is merger.

Merger of two weaker banks or merger of one health Bank with one weak bank can be treated as the faster and less costly way to improve profitability then spurring internal growth. The main motive behind the merger and acquisition in the banking industry is to achieve economies of scale and scope. Mergers also help in the diversification of the products, which help to reduce the risk.

The Indian banking sector can be divided into two eras, the liberalization era and the post liberalization era. In the pre liberalization era government of India nationalized 14 banks as 19July 1965 and later on 6 more commercial Banks were nationalized as 15 April 1980. In the year 1993 government merged the new banks of India and Punjab National banks and this was the only merged between nationalized Banks after that the number of Nationalized Banks reduces from 20 to 19.In the post liberalization regime, government had initiated the policy of liberalization and licenses were issued to the private banks which lead to the growth of Indian banking sector. The Indian banking industry shows a sign of improvement in performance and efficiently after the global crises in 2008-2009. In the Indian banking industry having far better position than it was at the time of crises. Government has taken various initiatives to strengthen the financial system. The economic recovery gained strength on the bank of a variety of monetary policy initiatives taken by the RBI.

The cross-country evidence on the impact of bank nationalization is not very encouraging. For example, research find in a cross-country setting that government ownership of banks is negatively correlated with both financial development and economic growth. They interpret

this as support for their view, which holds that the potential benefits of public ownership of banks, and public control over banks more generally, are swamped by the costs that come from the agency problems it creates: cronyism, leading to the deliberate misallocation of capital, bureaucratic lethargy, leading to less deliberate, but perhaps equally costly errors in the allocation of capital, as well as inefficiency in the process of mobilizing savings and transforming them into credit.

The Indian Banking System

At the top of the Indian banking system is the central bank of India known as Reserve Bank of India. The Reserve bank of India is responsible for the Indian banking system since 1935, the commercial banks in India are segregated into Public sector banks, Private sector banks and Foreign banks. All these banks fall under Reserve Bank of India classification of scheduled commercial banks (SCBs).Public sector, Private sectors and Foreign banks as they are include in the second scheduled of the reserve bank of India Act 1934. The Public sector was wholly owned by the government of India before the reforms. The PSBs are the biggest player in the Indian banking system and they account for 70% of the assets of scheduled commercial banks in India.

The banking industry is one of the rapidly growing industries in India. The growth rate of this sector is remarkable and it has become the most preferred banking destinations for International Investors. After economic reforms, 1991, there have been paradigm shift in Indian banking sectors. A relatively new dimension in Indian banking industry has accelerated through Mergers and Acquisitions. It is observed in the study that, the finance and banking industries contributes highest number of M&As deals during the study period 2008 to 2014 were also found the same) and the trends of consolidation in Indian Banking Industry is so for restricted to merger of small and weak banks with large and public sector banks. To this backdrop, the present study examined the 'Impact of Mergers on Performance of selected commercial banks in India'. The impact of mergers on performance of the banks has been evaluated from three prospective i) Physical Performance of merged banks, ii) Financial Performance of Merged Banks and iii) Share price performance.

Analysis of physical performance of merged banks emphasizes that, there is a significant improvements in Deposits, Advances, Businesses and Number of Employees of all selected banks. Therefore, this result indicates that Mergers can help commercial banks to achieve physical performance. While the analysis of financial performance of merged banks yields mixed results, the results indicates that, a significant improvement in Assets Quality, Management Efficiency, Earnings quality and liquidity of the selected banks and Capital Adequacy of Public sector banks did not indicate improvements, this may be the policy matters of public sectors banks but on an average the overall financial performance of merged banks increased after the merger. So Merger could be considered as a useful strategy in order to achieve financial performance of commercial banks by achieving economies of scale, competitiveness, and increased efficiency and Market share. Further the analysis of share price performance of merged banks shown that, there is no consistent pattern of Abnormal Returns of selected merged banks, Market positively reacted only in case ICICI Bank and Federal Bank. The rest of the cases market negatively reacted for merger announcement. Therefore from this result it can be said that, Merger is not a preferable tool to achieve shareholders wealth of banks in short term.

Review of related literature

Several studies have been conducted to examine the impact of mergers and Acquisition. Berger and Humphery (1997) [1] in their study provide on extensive review on the efficiency of baking sector. They pointed out that majority of studies focused on the banking markets of well developed countries with particular emphasis on US market.

Anand Manoj & Singh Jagandeep (2008) [2] studied the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. These mergers were the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank, the ICICI Ltd with the ICICI Bank, the Global Trust Bank merged with the Oriental Bank of commerce and the Bank of Punjab merged with the centurion Bank. The announcement of merger of Bank had positive and significant impact on share holder's wealth. The effect on both the acquiring and the target banks, the result showed that the agreement with the European and the US Banks Merger and Acquisitions except for the facts the value of share holder of bidder Banks have been destroyed in the US context, the market value of weighted Capital Adequacy Ratio of the combined Bank portfolio as a result of merger announcement is 4.29% in a three day period (-1, 1) window and 9.71 % in a Eleven days period (-5, 5) event window. The event study is used for proving the positive impact of merger on the bidder Banks.

Lehto Eero & Bockerman Petri (2008) [3] evaluated the employment effects of Merger and Acquisitions on target by using match establishment level data from Finland over the period of 1989-2003. They focused cross border Merger and Acquisitions as well as domestic Merger and Acquisitions and analyzed the effect of employment of several different types of Merger and Acquisitions. They evaluated that the cross border Merger and Acquisitions lead to downsizing the manufacturing employment and the effects of cross border Merger and Acquisitions on employment in non-manufacturing are much weaker and change in ownership associated with domestic Merger and Acquisitions and internally restructuring also typically causes employment losses.

To look the effects of cross border Merger and Acquisitions (M&As), Hijzen Alexander *et al*., (2008) [4] studied the impact of cross border Merger and Acquisitions (M&As) and analyzed the role of trade cost, and explained the increased in the number of cross border Merger and Acquisitions (M&As) and used industry data of 23 countries over a period of 1990 -2001. The result suggested that aggregate trade cost affects cross border merger activity negatively, its impact differ importantly across horizontal and non-horizontal mergers. They also indicated that the less negative effects on horizontal merger, which is consistent with the tariff jumping agreement, put forward in literature on the determinant of horizontal FDI.

Mantravadi Pramod & Reddy A Vidyadhar (2007) [5] evaluated that the impact of merger on the operating performance of acquiring firms in different industries by using pre and post financial ratio to examine the effect of merger on firms. They selected all mergers involved in

public limited and traded companies in India between 1991 and 2003, result suggested that there were little variation in terms of impact as operating performance after mergers. In different industries in India particularly banking and finance industry had a slightly positive impact of profitability on pharmaceutical, textiles and electrical equipments sector and showed the marginal negative impact on operative performance. Some of the industries had a significant decline both in terms of profitability and return on investment and assets after merger.

Coming down on the various motives for Merger and Acquisitions, Mehta Jay & Kakani Ram Kumar (2006) [6] stated that there were multiple reasons for Merger and Acquisitions in the Indian Banking Sector and still contains to capture the interest of a research and it simply because of after the strict control regulations had led to a wave of merger and Acquisitions in the Banking industry and states many reason for merger in the Indian Banking sector. While a fragmented Indian banking structure may be very well beneficial to the customer because of competition in banks, but at the same time not to the level of global Banking Industry, and concluded that merger and Acquisition is an imperative for the state to create few large Banks.

R. Srivassan *et al*., (2009) [7] gave the views on financial implications and problem occurring in Merger and Acquisitions (M&As) highlighted the cases for consolidation and discussed the synergy based merger which emphasized that merger is for making large size of the firm but no guarantee to maximize profitability on a sustained business and there is always the risk of improving performance after merger.

Sinha Pankaj & Gupta Sushant (2011) [8] studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions(M&As) it came to the point that companies may have been able to leverage the synergies arising out of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency etc.

Aharon David Y *et al*., (2010) [9], analyzed the stock market bubble effect on Merger and Acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investor take more risk. Merger of banks through consolidation is the significant force of change took place in the Indian Banking sector.

Kuriakose Sony *et al*., (2009) [10], focused on the valuation practices and adequacy of swap ratio fixed in voluntary amalgamation in the Indian Banking Sector and used swap ratio for valuation of banks, but in most of the cases the final swap ratio is not justified to their financials.

Merger of banks in India

Merger can be defined as a mean of unification of two players into single entity. Merger is a process of combining two business entities under common ownership. According to Oxford Dictionary the expression "merger means combing two commercial companies into one" Bank merger is an event of when previously distinct banks are consolidated into one institution.

A merger occurs when an independent bank loses its charter and becomes a part of an existing bank with one headquarter and unified branch network.

Merger occurs by adding the active(bidder) bank assets and Liabilities to the target(Passive)banks balance sheet and acquiring the bidder's bank name through a series of legal and Administrative measures. Merger and Acquisition in Indian banking sectors have been initiated through the recommendations of Narasimham committee II. The committee recommended that "merger between strong bank / financial institutions would make for greater economic and commercial sense and would be case where the whole is greater than the sum of its parts and have "force multiplier effect".

It is also suggested to Government of India and RBI to liberalize their policies in connection with Mergers and Acquisitions to increase number of deals between the banks. To conclude, Merger is a useful strategy, through this Banks can expand their operations, serve larger customer base, increases profitability, liquidity and efficiency but the overall growth and financial illness of the bank can't be solved from mergers.

Conclusion

Merger is the useful tool for growth and expansion in Indian Banking Sector. It is helpful for survival of weak banks by merging into larger bank. This study shows that impact of merger on financial performance of Indian Banking sector. For this a comparison between pre and post merger performance examined in terms of Gross Profit margin, Net Profit margin, Operating Profit margin, Return on Capital employed, Return on Equity and Debt equity ratio.

In the present case study, the return on equity, debt –equity ratio and Gross Profit margin has shows the improvement after the merger and for the purpose and objective of the study, investigator apply t-test for analyzing the pre and post merger performance of banks and result suggested that after the merger the financial performance of the banks have increased. The most important is that to generate net higher profit after the merger in order to justify the decision of merger undertaken by the management to the shareholders.

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