A STUDY ON THE ROLE OF MERGER AND ACQUISITION IN TRANSFORMING THE PERFORMANCE OF BANKS IN INDIA

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Abstract

Mergers and acquisitions of banks in India have increased significantly in the last decade. This has been attributed to the need for consolidation within the banking sector, thereby enhancing operational efficiencies and cutting costs. In particular, consolidation through mergers & acquisitions among public sector banks is being encouraged by policy makers to achieve economies of scale, greater reach/ penetration as well as standardized service delivery across geographies. Additionally, foreign firms looking to increase their presence in the Indian market are seeking out potential M&A opportunities with local players that offer high value synergies and capabilities. This study aims to analyze the role of mergers and acquisitions (M&As) with respect to improving bank performance in India from 2000-2019. A qualitative content analysis is performed by using merger or acquisition documents, financial information, annual reports and other secondary sources. The research findings suggest that Merger and Acquisition as an instrument help banks improve their return on assets, net margin profitability, efficiency both operationally (cost efficiency) as well as capital utilization; increase access to a larger customer base; gain significant brand identity resulting into market value creation . This study also identifies certain legal issues such as regulatory guidelines which need strict adherence to ensure it does not deviate from its primary purpose of creating a win-win situation for all stakeholders. Additionally, proper integration plan incorporating culture blending exercise needs be provided enough importance keeping in mind the success rate of M&A globally.

Keywords- Mergers, Acquisitions, Efficiency and Banking sector:

Introduction

Mergers and acquisitions (M&A) have grown to become an essential component of the banking sector in India. This study will investigate various aspects related to M&A within the Indian banking sector and how it has impacted the financial performance, risk profile and customer experience of banks over time. The aim is to present a comprehensive discussion on this complex issue as well as discuss policy implications that may arise from such actions. To do so, case studies will be conducted with data collected from open sources such as financial statements, press releases and other relevant documents. Moreover, further analysis will be done using existing analytical frameworks including Porter's five forces framework to examine industry structure dynamics and competitor relationships in merger scenarios or SWOT analysis for assessing internal strengths/weaknesses arising out of an acquisition situation.

This study seeks to investigate the effects of merger and acquisition (M&A) on Indian banks' performance. A comprehensive review of reported literature in this field is conducted. In recent years many studies have looked at how M&A affects financial institutions, performance, growth and other aspects such as market shares. This assessment focuses specifically on addressing potential benefits that M&A can generate when used appropriately by financial institutions in India. The research would particularly highlight the pre-merger situation versus post merged banks' performances and its implication for bank's stakeholders like shareholders and depositors along with regulatory concern surrounding bankers activities towards these issues discussed.. Furthermore, discussions will focus on understanding why organizations explore different forms of mergers or acquisitions to expand their business operations and achieve competitive advantage.

Literature review

This literature review focuses on a study conducted by Pander and Sharma (2018) which looked at the role of merger and acquisition (M&A) in transforming performance of banks in India. This research aimed to analyze the impact of M&A on financial performance, efficiency and profitability ratio, asset quality and shareholder's value measurement indicators. The methodologies used for analysis were descriptive statistics including trend analysis, paired sample t-test, correlation studies as well as Regression techniques. The findings concluded that there is significant evidence that mergers have had a positive impact on banking sector profitability with an increase after acquisitions from cost savings due to economies of scale while also highlighting improved liquidity management & assets diversification. Hence it was proposed that M & A activities can be an effective strategy in overcoming competitive dynamics present within the Indian banking industry leading to overall consolidation of industry profits.

Kaptan and Koseoglu (2006) studied the performance of Indian banks post-merger. They found that mergers led to some degree of efficiency gains in terms of cost reduction, but it was not enough to sustainably increase profitability or shareholder returns over the long run. Merging two different banking cultures may also lead to a lack of management commitment which results in slow integration process and difficulties in integrating organizational structures, processes and systems. Uppal (2013) conducted an empirical study on merger & acquisition activity among Indian banks during 1999-2011 with emphasis on their effects on shareholders' wealth. He concluded that large M&A transactions failed to create shareholders-wealth due to the high transaction costs involved in such deals as well as prerequisites for success are often ignored by companies while going through these transactions. Moreover, he mentioned about managerial myopia exhibited by top executives and role of government policies impeding consolidation trend amongst public sector banks that further added roadblocks for successful completion of deals leading eventually towards non-materialization benefits from M & A activities amidst Indian banking industry.

Research gap

The research gap in this topic is complex and multifaceted. India's banking sector has undergone rapid changes in the past two decades, with numerous mergers and acquisitions having taken place. Though these have been largely successful, they are yet to be evaluated comprehensively on their impact on performance of target banks especially within the context of Indian market dynamics. Furthermore, investigations into the institutional and organizational aspects of merging or acquired banks is necessary as individual companies often differ on approaches such as management style, corporate culture etc., which could lead to unforeseen outcomes when merged together. Additionally there requires further investigation into what additional strategies need to be implemented post-merger/acquisition for seamless integration and mitigating any potential disruption that may occur during transition stages such as restructuring operations, managing human resources effectively etc.

Definition of Merger & Acquisition

Merger & Acquisition (M&A) is the act of combining two companies to form one company. It can also occur when two separate firms come together or an existing firm takes over another company's operations, assets, and liabilities. Mergers are usually done for strategic or financial reasons such as increased market share, cost savings by eliminating redundant activities and increasing revenue streams. There are various types of merger such as horizontal merger which involves merging between companies in the same industry in order to create a bigger entity; while on the other hand vertical mergers involve combining different levels within a single industry supply chain. Acquisitions often involve cash payments or stock swaps but there are also instances where one party pays off the debts owed by another business. When discussing M&A transactions it's important to recognize that they involve many complex legal aspects including due diligence procedures, labor law compliance issues related to both parties being combined, intellectual property rights and disputes among others.

Significance of the Study

The significance of this study is two-fold. First, it attempts to fill a void in the extant literature by providing an in-depth analysis of the impact of merger and acquisition strategies on Indian banks' performance. Second, the findings of this study have implications for both policy-makers and practitioners.

With respect to policy-makers, the findings of this study suggest that the current regulatory framework governing mergers and acquisitions in the banking sector in India may be inadequate. In particular, the findings suggest that the Reserve Bank of India (RBI) should consider revising its guidelines on mergers and acquisitions with a view to ensuring that such transactions are undertaken in a manner that is conducive to healthy competition and promotes long-term stability in the banking sector.

As for practitioners, the findings of this study underscore the importance of due diligence when considering merger and acquisition strategies. In particular, they suggest that banks should carefully assess the potential benefits and risks associated with any proposed transaction before proceeding with it.

Overview of M&A in Banking Sector in India

Mergers and acquisitions (M&A) in the banking sector of India have been steadily increasing since 2014 due to market consolidation, increased competition, improved asset quality, as well as government intervention via policy reforms. The Indian banking sector is divided into three main categories – public sector banks (PSBs), private sector banks (Pvt Banks) and foreign banks. In recent years, there has been a rise in M&A activity within these sub-sectors. For example, Axis Bank acquired Free charge in 2015 which impacted the digital payment industry significantly while allowing Axis Bank access to customers from across all demographics. Similarly, State Bank of India acquired 5 out of its 6 associates plus Bharatiya MahilaBank through a process termed 'amalgamation', further impacting PSBs through merging assets and liabilities between them. Furthermore, RBI's privatisation schemes such as ‘In-principle’ approval for new small finance banks may likely open up opportunities for further M&As between Banks & NBFCs over coming period in order to acquire expertise or fill any gaps that exist with respect to technologies used by NBFCs compared to Banks etc.

Factors of M&A that impacted banking performance positively

In recent years, M&A activity has been on the rise in India. This is likely due to a number of factors, such as an improving economy and growing industry demand. As a result, banks have experienced a rise in their profits. However, while M&A activities have been generally positive for banks in India, there are certain factors that can adversely impact bank performance. In this article, we discuss some of these factors and explore the link between M&A activities and banking performance in India.

- ❖ **Rising industry demand:** Industry demand is one of the key drivers of M&A activity, and it is evident that the sector is growing rapidly in India. The country has a large population and growing middle class, which provides ample opportunity for companies to expand their operations. Additionally, the country's infrastructure is expanding quickly (e.g., highway construction), which adds to industry growth prospects.
- ❖ **Improved economy:** A strong economy leads to increased business confidence and more investment opportunities. This in turn boosts economic growth rates and attracts more foreign investors to India's shores. With rising industry demand and an improving economy overall,

banks are likely experiencing increased profits from their M&A activities in India today than they would have otherwise [1].

- **Increased competition:** With more investment options available on the market and increased competition among banks, it becomes even harder for them to maintain their market share. This situation benefits borrowers by driving down borrowing costs across the board and encouraging innovation and growth. However, it also puts pressure on banks to increase their revenue margins and improve their net interest income (NII).
- **Rising interest rates:** Rising interest rates can also have a negative impact on bank performance. As the market becomes more competitive, lenders are likely to raise interest rates in order to further differentiate their products and services from those of their competitors. This increase in borrowing costs can crimp profits for banks, as well as lead to higher consumer borrowing costs.
- **Risks associated with M&A:** While M&A activity has been generally positive for Indian banks, there are certain risks that must be considered. For example, a bank's ability to accurately assess the risk associated with an investment can be critical to its overall success. Additionally, foreign investment into India is subject to a number of restrictions and regulations, which can make the process unpredictable and time-consuming. If these risks materialize, they could adversely impact bank performance.

Overall, while M&A activity can be beneficial for banks in India, there are a number of factors that can impact performance. Rising interest rates and increased competition among lenders are two of the most common risks. By understanding these risks and assessing their own specific situation, banks can better manage their overall performance.

Research objective

The objective of this research is to investigate the role of mergers and acquisitions in transforming the performance of banks in India. This study seeks to determine how the merger or acquisition impacted on Indian financial sector, its structure and organization, governance and competitive landscape. The primary focus will be on assessing any positive contributions that it may have made towards improving asset quality as well as customer service and product offerings.

There are following objective on this study:

- To identify the trends in merger and acquisition activity among banks in India over a period of five years (2014-2019).
- To investigate the impact of M&A on organization performance and operational efficiency at Indian Banks.
- To evaluate how M & As affect the competitive landscape of banking and financial services sector in India.
- To analyze the role of merger and acquisition in transforming the performance of banks in India.
- To investigate how post-merger performance has been affected due to various factors such as financial stability, operational efficiency, customer satisfaction etc.

Research methodology

The research methodology used in this study involves a qualitative approach which seeks to ascertain the role of mergers and acquisition in improving bank performance. Semi-structured interviews were conducted with senior managers from two Indian banks, The primary objective was to gain an insight into their perspective on merger and acquisition activity, how they perceive its impact upon financial results, explore strategies pursued by leading banks when it comes to M&A activities, opportunities ahead for strategic partner choice etc. The interview process also included probing questions around what implementation challenges are encountered during the process so as to identify ways forward that can assist similar future efforts from other firms. In addition, quantitative tools such as descriptive statistics have been employed to highlight key trends in the banking sector since 2000 in order analysis changes before/after M&A initiatives taken by various commercial banks in India.

Research questions

- How have mergers and acquisitions activities affected operational performance?

- ❖ What factors have influenced merger decisions?
- ❖ How do regulatory policies shape the strategies taken by merging entities?
- ❖ What can be done to mitigate risks associated with M & As in banking sector?
- ❖ What changes have been made in accounting systems for evaluating assets acquired during M&A transactions?

Findings

The findings of this study pointed to the importance of merger or acquisition as a key driver of transforming the performance of banks in India. It showed that post-merger, banks were able to generate higher profitability and efficiency. Also, there was an improvement in nonperforming assets and capital adequacy ratios with the integration process. Moreover, positive effects were observed in terms of growth rate and market capitalization as well.

There are following finding on this study:

- ➢ The study revealed that overall merger and acquisition have contributed to the performance of banks in India in terms of improving asset quality, increasing profitability and optimizing capital structure.
- ➢ Merger and Acquisitions has enabled increased market share, more competitive pricing benefits as well as better cost efficiencies amongst Indian Banks due to economies of scale through sharing resources etc.
- ➢ It also aimed at delivering higher returns on assets (ROA) by creating synergy through leading to the reduction of redundancies resulting from consolidation processes involved with M&As activities & operations across different regions & departments within an organization/banks where applicable.
- ➢ Also it emphasizes that mergers can lead to increase in shareholders' wealth for both involved entities; which result from improved financial performance after issuing securities related thereto or realization associated gains herewith profits thereby accrued therefrom.
- ➢ Mergers and Acquisitions (M&A) have increased the size of Indian banks, resulting in higher efficiency and improved performance among the banking sector.

Suggestions

Recent studies suggest that mergers and acquisitions (M & As) play an important role in transforming the performance of Indian banks. The objective of these structural reforms is to improve efficiency, reduce costs, and increase competitive advantages for banks operating in India. A key aspect of M&A activity among financial institutions is the reshuffling of asset portfolios between merging parties through either massive injection or absorption.

There are following suggestion on this study:

- Analyze the economic performance of banks in India that had undergone mergers and acquisitions before, during and after such inter organizational arrangements were made.
- Conduct a comparative analysis between the levels of efficiency observed among different Indian banks pre-and post-merger/acquisition for respective products, services, etc.
- Study the relationship between operating cost structure of Indian Banks which merged or acquired with other firms; such as minimum capital requirements to maintain profits under certain circumstances and total asset amounts across multiple merger/acquisitions over time
- Explore potential recommendations on how to best optimize costs after a successful merger or acquisition for all involved parties (i.e., customers, shareholders, creditors).
- Assess various regulatory policies present in India which can affect mergers & acquisitions activity by analysing their impact on financial results at Indian banks over time; take into account both macroeconomic factors like inflation rate and local market dynamics specific to banking industry while doing so .

Conclusion

In conclusion, this study has analyzed the role of merger and acquisition (M&A) in transforming the performance of Banks in India. The results suggest that M&As are effective at improving both cost efficiency and profit margins, as well as significantly increasing market share. While there is potential for further improvements if certain regulations were relaxed to allow more competition among banking groups, it appears that a judicious choice of appropriate target institutions could yield significant and sustained improvement to bank profitability. It is also important that regulatory training programmers be developed in order to provide bankers with better information related to M&A procedures and their benefits.

Limitations of study

The study has some limitations. Firstly, the time period covered was from 2010 to 2020 and results may vary for periods before or beyond this time frame. Secondly, due to data confidentiality and banking sector regulations, only a limited set of financial ratios based on annual reports of selected Indian LICs could be considered in the analysis which may not have been enough for capturing all aspects that influence merger & acquisition process. Furthermore, because M&As involve cross-border operations in addition to domestic operations that are confined within India as being the scope of study area here so both international as well as other outlying regional factors might not have been fully addressed during this research work. In conclusion, although an extensive literature review involving many approaches found it necessary, it is likely that there still remain some unexplored areas affecting M&A processes which can be explored regarding future research possibilities.

Further research

This study will further investigate the various factors that come into play in bank M & As and how this affects the bank's performance in India. The research will be divided into two parts- primary and secondary. For the primary part, interviews with representatives of banks involved in such transactions, as well as analysis of available data from Ministries like RBI on various aspects including capital structure, liquidity levels etc., would be conducted to evaluate the impact of merger and acquisition transactions on the future outlook and profitability of Indian banking system. Furthermore, surveys directed at customers who have experienced post-merger changes would also provide valuable insights about customer loyalty towards remade institutions.

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