Determining the impact of merger on performance of the Banks terms of Return on Assets (ROA): Case Review of State Bank of India and State Bank of Indore Merger

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Abstract

Mergers and acquisitions are seen as crucial events in restructuring the corporate finance structure, bringing opportunities of growth and empowerment for the involved companies. Banks are seen as crucial propellers of a country's economy, and hence the repositioning and reforms are required to keep the process going on efficiently. Thus, with respect to the banking sector, mergers are seen as avenues for restructuring ownership, as well as depth and breadth of operations, also influencing the financial performance of bank. Hence, the present study was centered on the similar notion of effect of merger on the financial performance of the acquirer. The present study was focused on State Bank of India, as it assumes significant place in the Indian economy and has over the time amalgamated two of its subsidiaries. The financial performance of SBI was evaluated with respect to its acquisition on State Bank of Indore through the means of Return on Assets financial ratios. The results showed that no significant change in the performance occurred post-merger event.

Keywords: *State Bank of India, State Bank of Indore, ROA, Return on Investments, Financial ratios*

Introduction

Mixing Entities Resources for Growth Enrichment Renovation is an abbreviated definition of merger, which in legal terms is the consolidation of two companies in a single entity(Kumari, 2014). An inorganic manner of growth, a merger is directed towards creating financial, managerial and operational synergy, helping the merged partners in gaining greater market share and cost efficiencies (Sia & Sultana, 2013). With reference to the banking sector, mergers have been especially seen as measures of creating additional benefits in the profit statements. They tend to influence the interest rates, monetary transmission mechanisms, and competition, which along with increment in size and reorganizational opportunities, can provide gains in terms of efficiency and power(Elumilade, 2010).

Impact of merger on performance

Acquirer and acquired firms, the two participatory in a merger, exhibit change in financial performance post the event. The acquired firms usually display poor growth and financial imbalance before mergers, threatening their existence. Thereby the financial re-engineering events are required, to ensure their survival in the competitive market(Tamragundi & Devarajappa, 2016). Also, the acquiring company may not always maintain a profitable stance post the merger, and abundant research studies have shown both the positive and negative impact of merger events on the acquirer's performance. The resultant performance depends on the impact of merger event on profitability, managerial efficiency, liquidity and operational efficiency, which ascertains the nature of consequence (Gupta & Banerjee, 2017).

Need for study

As indicated above, the merger can influence the acquiring form's financial performance as either profitable or loss-making, thus, the present study was aimed at investigating the same with respect to public sector scenario of Indian banking sector. The study tends to contribute to the existing literary evidence pertaining to the evaluation of acquirer's financial performance,

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with respect to return on assets of the bank. The study evaluated the acquisition of State Bank of Indore by State Bank of India, which has been regarded as a major merger event since it brought in significant capital and assets. Post-acquisition SBI's assets increase up to 10 lakh crores, with combined assets of two banks standing at Rs. 998,119 crores, hence such a major transfer of assets called for the present evaluation.

Research objectives

To fulfill the proposed aim the following research objectives were defined:

- To analyze the impact of merger between State Bank of India and State bank of Indore
- To evaluate the performance of acquiring bank in terms of Return on Asset (ROA)

Literature review

Impact of mergers on performance

Ghosh (2001) performed the comparative analysis between the performance of post and pre acquisition operating cash flow, and concluded that no significant increment in terms of operating cash flows was seen post the merger event. However, he also concluded that cash acquisition method of payment led to higher operating cash flows, which were a result of higher growth in sales rather than reduction in costs. Thereby, indicating that cash acquisitions are superior in managing the combined assets of firms.

Swaminathan (2002) analyzed five merger events which took place in the time period of 1995-96, and the findings indicated improvement in operational and financial synergies of four of the five acquiring firms, three years post the merger event. The financial ratios for net profit margin showed significant improvement post-merger, whereas no significant change was observed in the asset turnover ratios. This study also presented conclusion in terms of size, indicating a higher degree of improvement in shareholder values for small size acquired firms rather than large acquisitions.

Mantravadi & Reddy (2007) assessed the post-merger operating performance of the firms in Indian industry, which underwent mergers during the period 1991-2003,taking into consideration the relative size of the acquiring and acquired companies. The analysis included assessment with respect to different financial ratios of operating profit margin, gross profit margin, net profit margin, return on net worth, return on capital employed and debt equity ratio. The results indicated positive relationship of company size with post-merger operating performance of the companies. The merger events wherein the relative size was between 0.11 and 0.70, a decline in the net profit margin and return on capital employed ratios, besides increment in financial leverage was observed post-merger. The events wherein the relative size lied within 0.71 and 1.00, the pre-merger and post-merger operating performance ratios showed no difference. Whereas, the events wherein the relative size of the acquired firm was greaterthanthat of the acquiring firm, the returns on net worth and capital employed showed significant decline, with marginal improvement in financial leverage

Veena & Patti (2016) investigated the role of merger and acquisition in increasing financial performance of banks, with focus on ICICI bank. The study aimed at analyzing the pre and post-merger performance by the means of liquidity ratios, leverage ratios, and growth ratios. No significant difference was found between pre-merger and post-merger financial performance, also no relationship between profitability ratio, liquidity ratio, leverage ratio, growth ratio and performance was detected. Hence, it was concluded that financial performance of ICICI bank Ltd improved post-merger.

Tamragundi (2016) in the study based on comparative analysis of public and private sector banks indicated that mergers were not a solution to poor overall growth and financial performance. The study examined the merger of public with private sector banks. Merger was seen as a useful strategy for banks to expand operations, cater to a larger base of customers, enhance profitability, liquidity and efficiency.

The return on asset ratio (ROA) has been deemed as an important measure of evaluating a firm's financial performance, as it provides a baseline which could be used for measuring the required profit contribution, expected from the new investments (Siminica, Circiumaru, & Simion, 2012). Thus, it has been used by researchers in measuring the financial performance of acquiring firms post-merger. Imeokparia (2014) carried out cross sectional study, with 10 deposit banks in Nigeria, which underwent merger during the period of 2008-2012. The study analyzed the effect of merger on dividend per share of shareholders, using different financial ratio,

with ROA as one of the measures. The results showed no significant effect of the merger event on dividend per share hold. Singh(2015) also conducted study into service sector mergers, with focus in ICICI bank, post its merger with Sangli Bank in 2007, and Bank of Rajasthan in 2010. The analysis included analysis of financial ratios of ROA, ROE, ROI, debt/equity ratio, quick ratio, return on advances, and EPS. The results indicated significant change in half of the financial ratios post both the mergers.

Hypothesis for research

To fulfill the proposed research objectives, following hypothesis was proposed by the researcher:

H01: The financial performance of SBI Bank showed no significant change post-merger event in terms of ROA.
H11: The financial performance of SBI Bank showed significant change post-merger eventin terms of ROA.

Methodology

The present research design adopted Positivism stance, following the descriptive and explanatory research purposes. The quantitative and deductive approaches were adopted for the analysis of data, collected from the secondary sources.

Source of data

SBI bank underwent corporate financial restructuring with merger event involving State Bank of Indore.Hence,the data pertaining to ROAfinancial ratio, for the years 2007-08, 2008-09, 2010-11 and 2011-12, was collected from annual reports of SBI bank.

Financial Parameters

Return on Asset was the financial parameter selected for evaluating the financial performance of SBI bank, post-merger event. It measures the operating efficiency of a firm in generating profits from its assets, prior to the effects of financing. It is calculated using the following equation:

$$ROA = \frac{Earning\ s\ before\ interest\ and\ taxes}{Total\ assets}$$

ROA could alternatively be calculated using another equation, which involves interest expenses, as follows:

$$ROA = \frac{Net\ income + Interest\ expenses}{Total\ assets}$$

ROA separated the financing effects from operating effects thereby providing a better measure of truly assessing the return on assets(Damodaran, 2002).

Sample Description

State Bank of Indiawas constituted in 1955, and has since continued to acquire local banks as a measure of rescue. It is the pace setter of Indian economy, with 59.41% of share held by President of India, and has numerous subsidiaries. State Bank of Indore was one of the associate banks of State Bank of India, which underwent acquisition in 2010, leading to SBI's share of 98.3% in the bank. Following the acquisition SBI's network of branchesexpanded by additional 480 branches, and more than 21,000 ATMs.

Data Analysis Procedures

The data analysis involved carrying out paired t-test for the data pertaining to ROA. The paired t-test was used to compare means of pre-merger and post-merger financial performance.

Results & Discussions

The ROA ratios were calculated by the researcher after extracting the relevant data from the company annual reports. The ratios for the Pre-merger period of 2008-09 &2009-10 & Post-merger period of 2011-12, 2012-13 were calculated, using the following financial highlights, as shown in Table 1.

Year	Net Profit (crores)	Total Assets (crores)	ROA (crores)
2008 -09	9,121	9,64,432	1.04
2009 -10	9,166	10,53,414	0.88
2011 -12	11,707	13,35,519	0.88
2012 -13	14,105	15,66,261	0.91

Table 1: Financial information for return on assets

Table 2 shows the results for T-test analysis of SBI bank for ROA ratio during pre and post-merger period. The data showed minor difference between the pre and post-merger mean .065 with Sig. =0.618, indicating that the difference was insignificant. Also, the change in standard deviation values showed an increment (0.134) post-merger, indicating high volatility after merger. This indicated that bank's financial performance declined after merger.

	Mean	Std. Deviation	Paired Difference			
			Mean	Std. Deviation	T value	Sig.
Pre-Merger	0.960	.0.113	.065	.134	.684	.618
Post-Merger	0.895	0.021				

Table 3: Accepted hypothesis following t-test

Discussion and Conclusion

The present study examined the merger of State bank of Indore with State bank of India from the perspective of financial performance. The merger of the associate bank with its pan Indian counterpart arose out of the need to improve the quality of assets such as to improve the synergic strengths of staff and the overall branch network. The acquisition moved SBI to the list of world's top 50 banks in terms of asset, and has been regarded as a move in interest of public. It had also been reported that the acceleration expected by the merger event with respect to the consolidation phase for other subsidiaries was not achieved. The results from the present study also showed that the merger did not yield significant financial improvement for SBI, as the change in mean was seen as insignificant. It was also observedthat volatility increased due to merger.

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