Evaluating the Financial Performance of Amalgamated Public Sector Banks in India

Dr. Priyanka J.Fulwala
Adhyapak Sahayak
Navyug Commerce College
RanderRoad, Surat
priyankafulwala@gmail.com

Abstract:

With reference to amalgamation made in Indian Banking Sector since years, the presented study emphasised on evaluation of profitability of those banks which were merged in Indian public sector during year 2019-20. The main aim of the study is to make analysis of profitability in these banks during pre merger period and post merger period. Afterwards comparative analysis has also been made between these two periods using paired T-Test. The study has been made with the help of secondary data. The study concluded that the amalgamated Indian Public sector banks have performed well in terms of profitability after being merged.

I. INTRODUCTION:

Amalgamation can be defined as a process where one or more enterprises are united into another enterprise which gives birth to a new institution. It is a 'share-swap' process in which shareholders of united enterprises are allotted certain number of shares in the new institution.

Any nationalised bank can be amalgamated with other nationalised bank as per the Banking Companies (Acquisition and Transfer of Undertakings) Acts of 1970 and 1980 in consultation with Reserve Bank of India (RBI). Consolidation of Public Sector Banks have been recommended by various committees, including Narasimhan Committee (1998) constituted by the RBI, Leeladhar Committee (2008) chaired by RBI Deputy Governor, and Nayak Committee (2014) constituted by the RBI.

History of Mergers in Indian Banking

Mergers of banks began in India in the 1960s in order to bail out the weaker banks and protect the customer interests. After that, in post liberalization period, the quest to create an Indian bank that would be in the league of global giants had been continuing since 1990.

Merger & Nationalisation during the period from 1961-1969 : The period is called pre-nationalization period because in 1969 the government nationalized 14 private banks.

The period from 1969-1991: The period was called post-nationalization period. It saw six private banks being nationalized in 1980. In this period, 13 mergers took place mostly between public and private sector banks. The post liberalization period, which stretches from 1991-2015, saw major economic reforms initiated by Government of India. Many new policies were framed. Greater FDI and foreign investment was allowed which saw resurgence in Indian Banking. As many as 22 mergers took place - some to save weaker banks and some for the sake of synergic business growth.

Bank Mergers (1993-2004) : The merger of Oriental Bank of Commerce with Global Trust Bank in 2004 saved the latter after its net worth had wiped off and also handed OBC a million depositors and a decent market in South India. Mergers of Punjab National Bank (PNB) with the then eroded New Bank of India (NBI) in 1993-94 and that of Benaras State Bank Ltd. with Bank of Baroda in 2002 also proved to be life saving for the weaker banks.

Bank Mergers & Consolidation 2008- 2010 : SBI first merged State Bank of Saurashtra with itself in 2008. Two years later in 2010, State Bank of Indore was merged with it. Post the merger, the SBI was in the process to rationalize its branch network by relocating some of the branches to maximize reach. This, according to SBI helped the bank optimize its operations and improve profitability.

Consolidation of Banks (2015-2020) This phase saw five associates of SBI and Bharatiya Mahila Bank getting merged in SBI. This resulted in SBI being one amongst the 50 largest banks in the world. Union Cabinet decided to merge all the remaining five associate banks of State Bank Group with State Bank of India in 2017. Five associates and the Bharatiya Mahila Bank became the part of State Bank of India (SBI) beginning April 1, 2017. In a first three-way amalgamation, Vijaya Bank and Dena Bank were merged with Bank of Baroda from **April 1, 2019.**

The largest ever merger in the public sector banking space in India has taken place on Wednesday April 1, 2020 when six Public Sector Banks were merged into four large banks in a bid to make them globally competitive. Customers, including depositors of the merging banks, will now be treated as customers of the banks in which they have merged. The total number of public sector banks in the country have come down from 18 to 12 effective April 1, 2020.

Table No. 1 Mergers taken place in 2019-20

Anchor Bank	Banks Merged
Punjab National Bank	Oriental Bank of Commerce&United Bank of India
Canara Bank	Syndicate Bank
Indian Bank	Allahabad Bank
Union Bank of India	Andhra Bank &Corporation Bank
Bank of Baroda	Dena Bank &Vijaya Bank

Advantages of Merger

Competitive: The consolidation of PSBs helps in strengthening its presence globally, nationally and regionally.

Capital and Governance: The government's intention is not just to give capital but also give good governance. Hence, post consolidation, boards will be given the flexibility to introduce the Chief General Manager level as per business needs. They will also recruit Chief Risk Officer.

Efficiency: It has the potential to reduce operational costs due to the presence of shared overlapping networks.

Technological Synergy: All merged banks in a particular bucket share common Core Banking Solutions (CBS) platform synergizing them technologically.

Self-Sufficiency: Larger banks have a better ability to raise resources from the market rather than relying on State exchequer.

Recovery : The loan tracking mechanism in PSU banks is being improved for the benefit of customers.

Monitoring : With the number of PSBs coming down after the process of merger - capital allocation, performance milestones and monitoring would become easier for the government.

Cost Saving : Multiple posts of CMD, ED, GM and Zonal Managers will be abolished, resulting in substantial financial savings and cost of banking operation.

Diversification of Activities: Mergers also help in the diversification of the products. The improvement in capital base enables the banks to take up new and diversified activities such as financing equity underwriting insurance products, issuing asset based security providing new delivery channels, etc.

Disadvantages of the Merger

Decision Making : The banks that are getting merged are expected to see a slowdown in decision making at the top level as senior officials of such banks would put all the decisions on the back-burner and it will lead to a drop in credit delivery in the system.

Geographical Synergy: During the process of merger, the geographical synergy between the merged banks is somewhat missing.

Slowdown in Economy: The move is a good one but the timings are not just apt. There is already a slowdown in the economy and private consumption and investments are on a declining trend.

Weak Banks: A complex merger with a weaker and under-capitalized PSB would stall the bank's recovery efforts as the weaknesses of one bank may get transferred and the merged entity may become weak.

Change of Culture: Banks are merged only on papers. Their people and culture are difficult to change. It is a recipe for disaster as it leads to poor culture not ideal for the organization or the economy.

Risk of loss of customer base: Banking policies sometime change, along with technological platforms and that may not go down well with customer base, especially with long term and elderly customers.

Discontent among employees: Despite new positions being created, a considerable number of positions are abolished with the merger, resulting in a number of people becoming jobless.

II. REVIEW OF LITERATURE

Khushalani D. & Sinha M. (2021) inspected financial performance of banks before and post the merger. The study analysed merger taken place 2007 to 2014 using financial ratios such as dividend per share, net profit margin ratio etc. The paper concluded that the consolidation proved boon for the acquired bank due to its state of distress.

Patel R. (2018) compared the before and after merger position of long term profitability with respect to selected Indian Banks for a period of 2003-04 to 2013-14. The State Bank of India has a positive impact of the merger on the majority of the variables.

Dhingra K. (2018) made a study on impact of merger on performance analysis of banks. For this purpose, it two mergers, one was Public Business Banks' Merger and other was Private Business Banks' Merger during period of 2004 to 2016. The outcome of the analysis suggested that the merger has increased the efficacy and functioning of banks apart from better return on equity.

Sudha B. (2013) made a study on application of CAMEL model in analysing the profitability of commercial banks in India with reference to selected public and private sector banks. Ten banks from public sector bank group and ten banks from private sector bank group had been selected on the basis of their total assets. The study found only two banks HDFC and Jammu & Kashmir Bank as sound in all aspects and ranked first.

Srinivas K. and Saroja L. (2013) made comparative financial performance of two private sector banks namely HDFC Bank and ICICI Bank for the period of 2003 to 2012 using CAMELS rating model. The study revealed that the performance of HDFC Bank was better than ICICI

Bank and it made suggestion to ICICI Bank to control its non-performing assets and spread of interest while HDFC Bank should control its burden of non – interest expenses.

III. RESEARCH METHODOLOGY:

i) Objectives of the study

- To analyse performance of amalgamated / merged public sector banks with respect to profitability.
- To Compare performance of amalgamated/ merged public sector banks for pre and post merger period.

ii) Sample Selection

The public sector bank merger for the period of 2019-20 has been considered for the study. During this period, total five mergers have been taken place which is given in table 1.

iii) Scope of the study

The present study focuses on analysing profitability performance of amalgamated/merged public sector banks. It has considered big five merger taken place during period of 2019-20. Pre merger period has been taken from 31st March, 2018 to 31st March, 2020 and post merger period is taken from 31st March 2021 to 31st March, 2023.

iv) Data Collection

The secondary data has been used for the purpose of the study. The data has been collected from annual report of banks, magazines, newspapers, report of Reserve Bank of India and website of topic related institutions.

v) Conceptual Framework

The study has analysed performance of merged public sector banks using following profitability ratios as per RBI.

1) Return on Asset (ROA)

Return on Assets (ROA) ratio is a profitability ratio which indicates the net profit (net income) generated on total assets. It is computed by dividing net income by average total assets. Average total assets are obtained by taking assets on beginning and end of the year. It indicates how effectively a bank can earn a return on its investment in assets (Srinivas and Saroja, 2013). It shows how efficiently a bank can convert the money in form of assets into profits. High ratio is more favourable for investors and it explains better capacity of a bank in managing its assets to generate more profits (Sudha, 2013).

Return on Assets ratio = $\frac{Profit\ after\ tax}{Average\ total\ assets} \times 100$

2) Return on equity (ROE)- After Tax

Return on equity (ROE) is calculated by net profit divided by capital and reserves and surplus. Net profit means operating profit minus provisions and contingencies. It measures the profitability of bank in earning profits by utilising funds provided by shareholders (Prasad and Reddy, 2011; Tatuskar, 2010). The higher the ratio, the more efficiently the funds are used.

Return on Equity ratio = $\frac{Net\ Profit}{average\ (capital+reserves)} \times 100$

3) Net Interest Margin ratio

Net interest margin (NIM) ratio is the net interest income divided by average interest earning assets (Tatuskar, 2010). In this ratio, numerator is taken as difference of Interest earned and interest expended and denominator is taken as average total assets. Banks accept deposits and pay interest on it. On the other hand, Banks advance loans and earn interest on it. This is a primary function of bank. Bank having positive net interest margin indicates that firm is making optimal investment decisions. The higher the ratio, the more favourable earnings the bank makes from traditional function. (Misra and Aspal, 2013).

Net Interest Margin ratio = $\frac{Interest\ Earned - Interest\ Expended}{Average\ total\ assets} \times 100$

4) Cost income ratio (Efficiency ratio)

Reddy (2012) used this ratio to measure earnings in CAMEL model. Cost to income ratio is the ratio of non-interest expenses to total income net of interest expenses. It reflects the extent to which non-interest expenses of a bank make a charge on the net total income (total income - interest expense). The lower the ratio, the more efficient the bank is (Sudha, 2013).

Cost to income ratio = $\frac{Non-interest\ expenditure}{Net\ Total\ Income} \times 100$

IV. ANALYSIS AND INTERPRETATION

The calculated selected profitability ratios have been collected for selected merged five banks for pre and post merger period taken for the which are presented as under:

(1) Punjab National Bank:

Table 2 Profitability ratios of Punjab National Bank

Profitability Ratios	Pre-merger			Post-merger		
	2018	2019	2020	2021	2022	2023
Return on Assets (ROA)	-1.60	-1.25	0.04	0.15	0.26	0.18
Return on Equity (ROE)	-29.54	-23.24	0.63	2.29	3.71	2.57
Net Interest Margin	2.01	2.23	2.17	2.43	2.23	2.48
Cost Income ratio (Efficiency ratio)	0.57	0.47	0.45	0.47	0.49	0.52

From the above table 2, it can be that Return on Assets ratio which was negative for first two years of pre-merger period has been increased positively after merger. Besides Return on Equity ratio and Net Interest Margin ratio have also been increased persistently after merger. Cost to income ratio shows very marginal difference after merger.

(2) Canara Bank

Table 3 Profitability ratios of Canara Bank

Profitability Ratios	Pre-merger			Post-merger		
	2018	2019	2020	2021	2022	2023
Return on Assets (ROA)	-0.75	0.06	-0.32	0.23	0.48	0.81
Return on Equity (ROE)	-12.19	0.97	-5.92	4.62	9.09	15.18
Net Interest Margin	2.03	2.21	1.85	2.18	2.22	2.44
Cost Income ratio (Efficiency ratio)	0.50	0.50	0.55	0.49	0.46	0.45

From the above table 3, it can be seen that Return on Assets ratio and Return on Equity ratio which were negative for pre-merger period have increased positively after merger. Besides Net Interest Margin ratio has also been increased persistently after merger. Cost to income ratio also decreased persistently after merger, which show positive impact of merger.

(3) Indian Bank

Table 4 Profitability ratios of Indian Bank

Profitability Ratios	Pre-merger			Post-merger		
	2018	2019	2020	2021	2022	2023
Return on Assets (ROA)	0.53	0.12	0.26	0.50	0.63	0.77
Return on Equity (ROE)	7.07	1.70	3.63	8.21	9.61	11.52
Net Interest Margin	2.66	2.63	2.58	2.63	2.58	2.93
Cost Income ratio (Efficiency ratio)	0.42	0.45	0.40	0.48	0.46	0.44

From the above table 4, it can be seen that all three ratios that is, Return on Assets ratio, Return on Equity ratio and Net Interest Margin ratio havepersistently increased over years after merger. Cost to income ratio shows very marginal difference after merger.

(4) Union Bank of India

Table 5 Profitability ratios of Union Bank of India

Profitability Ratios	Pre-merger			Post-merger		
	2018	2019	2020	2021	2022	2023
Return on Assets (ROA)	-1.07	-0.59	-0.53	0.27	0.47	0.69
Return on Equity (ROE)	-21.39	-11.43	-9.62	4.68	7.75	11.33
Net Interest Margin	1.98	2.08	2.19	2.36	2.46	2.65
Cost Income ratio (Efficiency ratio)	-0.52	0.49	0.45	0.47	0.46	0.46

From the above table 5, it can be seen that Return on Assets ratio and Return on Equity ratio which were negative during pre-merger period have increased considerably after merger. Moreover, Net Interest Margin ratio have also increased after merger. Cost to income ratio shows very marginal difference after merger.

(5) Bank of Baroda

Table 6 Profitability ratios of Union Bank of India

Profitability Ratios	Pre-merger			Post-merger		
	2018	2019	2020	2021	2022	2023
Return on Assets (ROA)	-0.34	0.06	0.06	0.07	0.60	1.03
Return on Equity (ROE)	-5.81	0.97	0.84	1.11	8.93	15.33
Net Interest Margin	2.19	2.46	2.45	2.49	2.68	3.02
Cost Income ratio (Efficiency ratio)	0.46	0.46	0.50	0.50	0.49	0.48

From the above table 6, it can be seen that all three ratios that is, Return on Assets ratio, Return on Equity ratio and Net Interest Margin ratio have persistently increased over years after merger. Cost to income ratio shows very marginal difference after merger.

V. Conclusion

The study demonstrates a positive impact of mergers on the profitability performance of merged banks taken for the study during post merger period. The findings reveal that amalgamation has led to a significant enhancement in operational efficiencies, cost reductions, and an expanded customer base, thereby driving the profitability margins upward. This study underscores the strategic importance of mergers in the banking sector as a catalyst for financial stability and growth. It is imperative, however, that these institutions continue to refine their integration strategies and operational frameworks to sustain and build upon these gains. Furthermore, the research highlights the need for regulatory bodies to support such transitions, ensuring they align with the broader financial ecosystem's health and stability. In conclusion, the positive outcomes of the mergers analyzed in this study advocate for a continued exploration of strategic consolidations within the public sector banking domain in India, as a pathway to bolstering the resilience and competitiveness of the sector in the global financial landscape.

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