MERGER OF ASSOCIATE BANKS WITH STATE BANK OF INDIA – A FINANCIAL PERSPECTIVE

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Abstract : Mergers and acquisitions (M&A) are becoming an integral part of the Indian business model these days as many companies resort to this measure. Merger means combining two companies, while an acquisition is the scenario where one company buys another. A number of small and medium sized companies fail to withstand the tough competition of the mammoth companies. Also, lack of capital in such companies adds to the woe. That is where M&A comes to the picture. When a bigger company absorbs smaller ones, there is more scope for productivity and profitability. This paper deals with the M&A in the Indian banking sector and specifically the recent merger of associate banks with State Bank of India. Financial analysis of State Bank of India, both before and after merger, is done using the secondary data collected from various sources. Results show that overall performance of the bank has improved after merger and all the ratios are indicating an upward trend, which is a good sign for the bank.

***Index Terms* – Merger, Finance, Indian Banks, State Bank of India.**

I. INTRODUCTION

With changing business trends every second, the demand for newer and newer strategies to survive the competitive clutter is ever growing and organizational restructuring is one such strategy. There are three interrelated sources of organizational restructuring, namely, mergers and acquisitions, downsizing and privatization. These sources have common attributes in that they are all induced by economic recession and they continue to exist to enhance productivity (Gowing et al., 1997). Several reasons given to justify a merger or acquisition include: to obtain synergies, economies of scale, cost savings, increased products and rationalisation of distribution channels (Harari, 1997). However numerous reasons attribute the failure of such a merger or acquisition, for instance over-emphasis on short term financial and legal issues at the neglect of the strategic direction of the company.

The banking industry is an important area in which mergers and acquisitions do make enormous financial gains. As a result of changes in the expectation of the corporate customer, banks are now constrained to rethink their business and devise new strategies. The Indian banking sector is going through a process of restricting, mainly driven by pervasive trends such as deregulation, disintermediation, technological progress, innovation and severe competition. To gain competitive cost advantage, consolidation of operation in the form of M&A is one of the effective strategies widely adopted by the bankers.

Mergers in banks are considered for the purpose of:
1. Expansion/diversification
2. Upgradation of technology
3. Loss making bank merged with another healthy bank for revival
4. Healthy bank merged with another healthy bank to become financially stronger, to meet competitive pressures
5. Growth in profits
6. Increase market share, etc.

Banks allocate resources and control internal processes by effectively managing their employees, facilities, expenses, and sources and uses of funds while working to maximize earning assets and total income. M&A are not new to the Indian banking sector. Between 1961- 2004, 71 mergers took place among various banks in India.

II. MERGER IN STATE BANK OF INDIA

According to a gazette notification dated 22 February 2017, the government said that all shares of these associate banks would cease to exist as individual entities and would merger with SBI. On April 1, 2017 SBT, SBM, SBH, SBBJ and SBP were merged with SBI. This merger has catapulted SBI to top 50 banks in world. It will join the league of top 50 banks in the world in terms of assets. The total customer base of the bank will reach 37 crores with a branch network of around 24,000 and nearly 59,000 ATMs across the country. The merged entity will have a deposit base of more than INR 26 lakh crore and advances level of INR 18.50 lakh crore. Post-merger, the bank will rationalize its branch network by relocating some of the branches to maximize reach. This will help the bank optimize its operations and improve profitability. As per the bank the merger will enhance productivity, mitigate geographical risks, and increase operational efficiency and driver synergies across multiple dimensions while ensuring increased levels of customer delight.

III. Literature Review

Merger of two weaker banks or merger of a healthy Bank with a weak bank is the cheapest and faster way to increase the profitability, than driving internal growth (Franz, H. Khan 2007). Anand Manoj & Singh Jagandeep (2008) found that the announcement of merger of Bank had positive and significant impact on shareholder's wealth. Mantravadi Pramod & Reddy A Vidyadhar (2007) studied the impact of mergers in all the public companies in India between the years 1991 and 2003, and stated that operational performance did not show much variance after merger.

Müslümov Alövsat (2002) stated that one of the main reasons behind merger is synergy. Cost synergies -cutting costs by taking advantage of overlapping operations or resources and consolidating them in one entity. Revenue synergies-alter the competitive balance of power and create opportunities to change market dynamics, sell more products, or raise prices. Sinha Pankaj & Gupta Sushant (2011) carried out a pre and post analysis of organizations and concluded that merger had positive effect on the firm's profitability. Cornett and Tehranian (1992) surveyed the performance of large bank merger between 1982 and 1987, post-acquisition, Results revealed that performance of bank was better post-merger, because of the capacity of the firm to attract customers for deposits and loans, profitability and higher employee productivity.

Operating performance of the merged firms show significant improvement (Ghosh, 2001). Ramaswamy and Waegelein (2003) found an improvement in the financial performance, post-merger, which was measured by industry-adjusted return on assets. Rahman and Limmack (2004) found the improvement in operating cash flow performance of the companies, in the long run. Kumar and Rajib (2007a) evaluated that effect on the value of shareholder, post-merger, had been done with the help of accounting measure. Using book value of asset and sales model, corporate performance was found to be improved after merger. Kukalis (2007) found that performance of the acquirer company before merger partially outperformed the performance of merged company, post-merger. Vanitha and Selvam (2007) also stated that financial performance of merged companies improves. Ramakrishnan(2008) shows that mergers in India have resulted in improved operational performance of the firm, post-merger.

IV. Financial Analysis

Banking sector plays a key role in the progress of any country. It has now become a customer oriented market. Globalization and liberalization has had a heavy impact on the Indian banking sector both strategically and structurally. To cope with the changes and demands, the banking sector adopted the concept of consolidation- a very profitable strategy indeed. A merger is uniting two players into one entity. The Narasimham Committee II recommended that a merger between financially strong banks would make better sense in terms of profit. SBI and its associates are the largest commercial banks in the country. SBI merged all its five banking associates into parent with effect from April 01, 2017. We expect the merger will lead to synergy and increase balance sheet strength as well as profitability from a long-term perspective

4.1 SBI & Centurion Bank

In 2008, SBI was merged with The Centurion Bank, Punjab. Before merger from 2005, 2006, 2007 and 2009 it has given very good return to investors (i.e. 40.70%, 37.90%, 71.91% and 71.23% respectively) but in 2008 given around 42.9% negative return. And at the time of merger (2010) SBI has given 25.13% return, after merger the SBI giving negative return to the investor except 2012. In the year 2011, 2013, 2014 and 2015 continuously giving negative return. In the year 2005 there is decrease with -0.9, in 2006 it has shown positive by 0.10, for the year 2007 & 2008 there is positive indication that is 2.97 & 3.58, in 2009 there is negativity of - 2, 3 then in the year 2010 there is increase by 0.63, again decrease in 2011 by -2.5 in the year 2012 there is positive indication with 0.05. From the year 2013, 2014% 2015 shows negative by -3.5,-7.9,& -2.2.

4.2 The Camel Approach

Camel approach is being used widely these days to determine the various factors that contribute to the growth and downfall of any bank. Below are the outcomes and financial performances of SBI received using the camel approach.
2013 – (Analysis of state bank group) – ranking of ratios different for different State Bank groups, but, no statistical significant difference in Camel ratios.
2014 – (Mergers & Acquisitions) – increase in ratio of gross profit by 54%, but declined by 64%.
2016 – (Financial analysis of select banks with ref to Indian banking) – profit per employee, debt-equity ratio, total advanced to total deposits ratio, net NPA to total advances are the factors affecting performance.
2017 – (Financial performance of SBI) – significant difference between camel ratios of all public sector banks in India.

4.3 Capital Adequacy Ratio

It is Tier I and Tier II capital / risk weighted assets. Tier I includes permanent shareholders' equity, perpetual non-cumulative preference shares, disclosed reserves and innovative capital instruments. Tier II includes undisclosed reserves of fixed assets and long term holdings of equity securities, general provisions/general loan-loss reserves, hybrid debt capital instruments and subordinated debt. Banks are required to maintain CAR of 9% as stipulated by RBI. Car in 2008 of SBI was 13.54. CAR in 2012 was 13.86.

4.4 Investment - Deposit Ratio

This signifies the amount invested by the bank with respect to its deposits. SBI is leading with a mean of 34.16.

4.5 Cash – Deposit Ratio

This measures the liquidity of the bank. SBBJ has highest mean of cash – deposit ratio.

4.6 Credit – Deposit Ratio

This ratio measures the efficiency of management for advancing the fund vis-a-vis deposits of banks. SBI has highest mean of 78068% along with highest SD.

4.6 Ratio of Secured Advances to Total Advances

It indicates the quality of advances by the bank, higher ratio indicates better quality. SBP has remarkably leading GM in this ratio with mean of 94.73% while SBI is consistently lagging in GM with mean of 78.24% with higher SD.

4.7 Return on Equity

This is the ratio of net income to equity, reserve and surplus. SBT was leading till 2011. SBI has always underperformed GM with lowest mean of 15.39%.

4.8 Return on Assets

The ratio of net profit to total assets of the bank. It helps measure the efficiency of capital employed. SBP has highest mean of return on assets.

4.9 Business per Employee

This ratio measures the efficiency and productivity of manpower that bank has. Higher ratio means better productivity of manpower. SBP has highest mean with lowest GSD while SBI has always underperformed GM with lowest mean.

4.10 Profit per Employee

This is calculated by dividing profit after tax with total number of employees. SBH is growing every year with highest mean and SD.

4.11 Ratio of Operating Profit to Total Assets

It is calculated by subtracting operating expenses from operating income. Ratio is obtained by simply dividing operating profit with total assets. SBI and SBH have outperformed GM frequently, while SBI has mean of 2.14.J with mean of 2.74.

4.12 Ratio of Net NPA to Net Advances

NPA is non-performing assets. Net NPA to Net advances signify the quality of assets. Higher NPA erodes profitability of bank. SBI has the highest mean of 1.74 with highest SD.

4.13 Investment Rational

Over the last 5 years, there has been a steady growth with 12 %CAGR in total assets, 14%total deposits, 13% total advance and 7% net interest income. The bank now gives priority to retail advances and high rated clients in corporate loan book which is helping the bank improve asset quality.

It is expected that SBI's advances would grow at a healthy CAGR of 12%the bank has been focusing on maintaining low cost retail deposit as a result of which the bank is sustaining current savings account ratio over 40% consistently. Also SBI s deposits will continue to grow at a CAGR of 13% mainly led by retail deposits. The consequence of deteriorating asset quality that affected the return ratios is being taken care of by improving operating efficiency. This will help increase RoE to 9% and RoA to 0.6% by FY19E.The bank's asset quality happened to deteriorate over FY16-17 owing to RBI's asset quality review. Henceforth, gross NPA ratios are expected to improve to 5.7%/2.7% by FY19E. Branch rationationalization will be one of the key synergy benefits from merger in a short term perspective.

4.14 Post-Merger Analysis

SBI's advances have grown at a CAGR of 13% over FY12-17 driven by 15% growth in domestic corporate advances. Retail growth is 17% CAGR over FY12-17 driven by housing/mortgage and auto loans. In Agriculture/SME advances, SBI has remained conservative with 5%/9% CAGR over FY12-17. Overseas loan grew faster with 16% CAGR over FY12-17 compared to 13% CAGR over the same period in domestic loan book.

With 24,017 branches spanned over our country, the traction in CASA deposits are expected to continue. Also, about 20% of banked population has their accounts with SBI. Net Interest Margin has been declining in a steady manner in the last 5 years due to higher slippages along with low credit to deposits ratio. NIM may decline further in the coming years and it will stabilize with around 2.7% on account of steady CASA, thereby improving C/D ratio and lower slippages. SBI has one of the smallest watch list of stressed accounts, 1.6% of advances as of FY17 as compared to 2.3% as of FY16 which means lower stress. Higher provision coverage ratio is an added comfort. The bank's Captial Adequacy Ratio as per Basel III norms has remained strong at 13.1% with Tier I capital ratio of 10.4%. This will henceforth help in a faster growth compared to other public sector banks.

V. CONCLUSION

Merger aims at synergy and increase in balance sheet strength and profitability in the long run. SBI may go on to become a major beneficiary of economic recovery and is perfectly positioned at capitalizing growth chances due to its strong capital base and relatively lower NPAs amidst other public sector banks. Net profit is expected to gain strong traction with 31% CAGR by FY19E aided by controlled credit cost and pick-up in loan growth. The bank has an upper hand in the market with superior business growth. Hence, it is expected to stay positive on SBI and maintain BUY rating on the stock with a target price INR 325 based on sum of the parts method where we value standalone business at INR 272 (P/ABV of 1.4x for FY19E) and subsidiaries at INR 53(holding company discount 20%).

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