IMPACT OF MERGER ON PRODUCTIVITY AND ASSET QUALITY OF SBI

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ABSTRACT: In 2016, the Government of India approved the longest awaited merger of State Bank of India with its 6 banks. The banks that were merged into State Bank of India with effect from 1st April, 2017, were- State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP) and State Bank of Travancore (SBT) and Bhartiya Mahila Bank. The vision behind the move is to have strong banks rather than having large number of banks. The merger on one hand was expected to bring about much opportunity to SBI, mainly in the area of operational efficiency, it would also give rise to challenges related to non performing assets, provisioning and human resources related issues. It's interesting to see the effects of such mergers whether these mergers helped in the growth of acquirer or pulled it down. The objective of this study is to check the effect of SBI merger on its few selected financial parameters that depicts profitability and stressed asset management by SBI. The study employs Independent t test technique on SPSS to find out if the selected parameters improved after the merger or not. The study covers a period of six year from 2014 to 2020 divided into 3 before merger and 3 years after merger. The data for study has been acquired from the annual reports of SBI and moneycontrol.com.

Key words: Mergers and acquisition, financial performance, profitability, stressed asset management.

I. INTRODUCTION

According to Prof. L.H.Haney, merger is, "a form of business organization which is established by the outright purchase of the properties of constituents, organizations and the merging or amalgamating of such properties into a single business unit". In simpler words, it is a business strategy where one company combines with another company and work as a single legal entity forever. The culture, technology, financials and identity of the company that has been acquired is lost and gets merged in the acquiring company. Like in the case of merger with SBI, the six banks merged are now working as SBI and their individual identities have been lost.

Lately Indian Government and the regulatory authorities have realized the positive outcomes of synergy effects and economies of scale that consolidation in the banking industry could bring about. The basic underlying reason for this consolidation spree by Government is to move Indian Economy from a state of large number of small banks to a state of few numbers of large banks. In Indian banking sector we currently have two type of ownership formats - Public sector banks, the private banks. As of now the results of PSU banks in India are not at all at desired levels due to reducing market share and rise of NPA's at an alarming level. Some of these banks are unable to maintain capital adequacy ratio as per Basel III, and are under RBI scanner. Because of scrappy nature of Indian Banking system, banks face difficulty in fund mobilization, credit disbursal and investment are not able to compete globally.

REASONS FOR SPREE OF MERGERS IN BANKING SECTOR IN INDIA

- Rising non performing assets: Rise in non-performing assets (NPAs) of public sector banks has become a serious enigma in our banking sector. The major causes of NPAs in Indian banks are wilful defaulters, improper due diligence, fraud, political interference, Government schemes like Mudra, agriculture loans and misappropriation of funds. The Indian economy bears the burden of these NPAs at the cost of economic development.
- High losses: The 14 public-sector lenders, posted an aggregate loss of Rs 74,277.77 crore for financial year 2018-19 against Rs 65,723.52 crore in financial year 2017-18, based on figures available on the CapitaLine Database. With losses swelled up because of a dubious loan and provisioning against them, the consolidation seems to be the only way out for banks to improve their profitability and performance.
- Shortage of Capital: Introduction of Basel III norms in banking sector requires banks to maintain a certain percentage of capital against bank's risk-weighted credit exposures. Few of these banks are unable to meet this minimum requirement as a result of which Prompt Corrective Action norms by RBI trigger leading to distortion of lending powers of banks. Merger is one way to infuse the required capital in banks that are unable to maintain their capital adequacy ratio.
- Need for stronger and larger banks with global presence: After merger, SBI is ranked at the 54 position among the top 1,000 global banks, as per the global ranking by "The Banker" in July 2017(As per SBI Annual report 2017-18).
- D-SIB Framework: The Reserve Bank of India had issued the Framework for Domestic Systemically Important Banks (D-SIBs) on July 22, 2014. The D-SIB framework requires the Reserve Bank to disclose the names of banks designated as D-SIBs starting from 2015 and place these banks in appropriate buckets depending upon their Systemic Importance Scores (SISs).Based on data collected, the Reserve Bank has declared State Bank of India, ICICI Bank and HDFC Bank as D-SIBs. The Government wants more banks to be eligible to fall in the list of D-SIBs and merger of banks could be a way to it.

- Better monitoring by regulatory authorities - When small and weak banks are larger in number, regulation by government and banking authorities becomes difficult. For a regulatory authority it is always easy to monitor 12 nationalised banks than 27 in numbers. Monitoring lesser number of banks would be more efficient thereby reducing chances of failure of banks.
- Cost cutting using economies of scale – After merger total expenses of merged entity increases but cost incurred per customer decreases as the customers of acquired bank becomes customers of the acquiring bank due to which same costs are now spread over a large number of customers.
- Technology cost is too high for small banks.
- Flow of information between lenders is smoother in case of reduced number of banks thereby reducing the number of fraudulent proposals getting approved due to disconnected information.
- Bargaining power of banks is stronger with less number of banks competing in the market.

II. REVIEW OF LITERATURE

Gupta (2015) in her paper "Merger and Acquisitions in the Indian Banking Sector: A Study of Selected Banks" has concluded that there is a positive impact of merger and acquisitions on the financial performance of the bank with significant improvements.

Singh and Gupta (2015) "Impact of Merger and Acquisitions' on Productivity and Profitability of Consolidation Banking Sector in India" that studies the impact of merger on the profitability and productivity of the selected banks of India concludes that after merger the financial performance of the banks has increased.

Jeelanbasha and Arun (2016) conducted a study on "Financial Performance Analysis of Post Merger and Acquisition (A Case Study of ICICI Bank)" which concludes that post merger profitability has increased from the reduction in operating expenses and increase in non-interest income. Hence, bank is focusing its business from aggressive policy to conservative policy of lending.

Honey Gupta (2016) "pre and post merger financial analysis of State Bank of India" reveals that the State Bank of India (SBI) does not shows significant improvement in the financial performance in the post merger period.

III. RESEARCH GAP

Not just the process of merger but also the evaluation of change in performance of the acquiring bank after merger is equally important. There have been many international and national studies done on comparative study financials of pre and post integration of banks. Out of those studying the change in financials in pre and post merger of SBI, the period of annual financial results have been not been sufficient to analyse the clear effect of merger. This study covers the span of six years divided into three years pre merger and three years post merger. The studies previously done have not touched upon stressed asset management by the acquired bank. In this research paper, various parameters have been checked to see how good stressed asset got managed by SBI.

IV. OBJECTIVES OF THE STUDY

To ascertain the changes in few selected financial parameters pre and post the merger of SBI associates with SBI and Bhartiya Mahila Bank.

V. RESEARCH METHODOLOGY

Research Method: In the study analytical research method has been used to assess the financial performance of SBI by considering the study period of 6 years with the use of selected 15 financial parameters. Parameters selected to be studied are as follows:

- Net interest income (Rs. in crores)
- Net profit (in crores)
- Operating Profit as % of working funds
- Return on average assets (%)
- Return on equity (%)
- Earnings per Share
- Profit per employee (in 000)
- Business per employee (Rs..in crores)
- Net non performing assets (NPA) (%)
- Provision for NPA (Rs in crores)
- NPA written off (Rs in crores)
- Gross NPA (%)
- Provision coverage ratio (PCR)
- CASA (current account saving account)
- Capital adequacy ratio (CAR)

Period of the study: the study period considered 6 years from 2014to 2020 divided into three years premerger (2014-15, 2015-16, 2016-17) and three years post merger (2017-18, 2018-19, 2019-20).

Source of data: The required data for the study have been collected mainly from the annual reports, journals, research paper, articles, books and websites.

Tools for the Study: In order to analyse the overall performance of SBI Independent t-test has been used to compare the pre and post financial performance of SBI. The total period of the study has been divided into two groups. Group one is named as pre merger group and group two is named as post merger group. Independent t test have been applied on these two groups to check whether the mean of group one is equal to the mean of group two. Descriptive statistics have also been done to study the changes in selected financial parameters. Levene's test has been used to check the variability of the data and to find out if the two groups have the equal variance or not. The data analysis has been done on SPSS

Hypothesis: The hypothesis that has been put to test in the study is:

H0: There is no significant change in pre and post merger values of selected financial parameters of SBI

H1: There is a significant change in pre and post merger values of selected financial parameters of SBI

VI. DATA ANALYSIS & INTERPRETATION

Table1 : Descriptive Statistics of Financial Parameters

Parameters	Groups	N	Mean	Std. Deviation	Std. Error Mean	% change
Net Interest Income (in Crores)	Pre Merger	3	58023.33	3496.87	2018.92	50.11%
	Post Merger	3	87096	11666.07	6735.41	
Net Profit (in Crores)	Pre Merger	3	11179	1686.55	973.73	-73.75%
	Post Merger	3	2934.33	10669.52	6160.05	
Return on Avereage Assets (%)	Pre Merger	3	0.51	0.14	0.08	-86.45%
	Post Merger	3	0.07	0.28	0.16	
Return on Equity (%)	Pre Merger	3	8.72	2.13	1.23	-83.03%
	Post Merger	3	1.48	5.82	3.36	
Profit per Employee (in 000)	Pre Merger	3	527.66	67.55	39.00	-76.69%
	Post Merger	3	122.99	418.31	241.51	
Earning per Share	Pre Merger	3	14.65	2.51	1.45	-78.32%
	Post Merger	3	3.17	12.10	6.98	
Capital Adequacy Ratio (%)	Pre Merger	3	12.74	0.64	0.37	0.39%
	Post Merger	3	12.79	0.23	0.13	
Provision for NPA (in Crores)	Pre Merger	3	25713	7253.50	4187.81	117.77%
	Post Merger	3	55995	14009.64	8088.47	
NPA Writtenoff (in Crores)	Pre Merger	3	21611	6002.55	3465.57	133.66%
	Post Merger	3	50496	9496.76	5482.96	
CASA (%)	Pre Merger	3	44.1	1.36	0.79	9.60%
	Post Merger	3	48.33	0.13	0.07	
Gross NPA (%)	Pre Merger	3	6.62	2.43	1.40	23.82%
	Post Merger	3	8.19	2.44	1.41	
Net NPA (%)	Pre Merger	3	3.21	0.94	0.54	13.80%
	Post Merger	3	3.65	1.83	1.06	
PCR	Pre Merger	3	63.78	4.64	2.68	19.53%
	Post Merger	3	76.24	9.084	5.24	

Table 1 shows the descriptive statistics of the data collected from the annual reports of SBI, interpreted as below:

- Post merger net interest income increased by 50% but operating profit as a percentage of working funds decreased by almost 16% post merger. Net profit also decreased by 73% post merger due to higher provisioning requirements on NPAs, MTM (Mark to Market) losses in HFT (Held for Trading) and AFS (Available for Sale) portfolio, additional employee benefits provisions etc.

- Return on average assets, return on equity and earnings per share also showed the decrease of more than 75% post merger. It could be due to expansion of assets base, increase in share capital, high provisioning norms and write offs. Net assets taken over by SBI at the time of merger is worth 11,314.75 crores in consideration for 13,63,52,740 shares of face value of Rs 1 each of SBI and 0.25 crore paid in cash towards fractional entitlements.

- Productivity of employees in terms of business per employee increased by 32 percent in post merger period but profit per employee witnessed a sharp decrease of around 75% in post merger period. Highest fall in profit per employee was in the transaction year of merger i.e F.Y 2017-18 which showed speedy recovery in 2018-19 and 2019-20. The merger also witnessed the addition of around 71,000 new employees to the existing work force of around 2,00,000 employees. Increase in number of employees due to merger and decrease in net profits pulled the ratio down.

- The main challenge in a merger in banking sector is to manage stressed assets (Non Performing Assets) of the target banks. After merger SBI's asset quality deteriorated significantly. The substantial rise in Gross NPAs is partly due to the merger wherein a total of Rs.65,523 crore of NPAs were added to the portfolio. Provisions for NPA shot up by whooping 117% after merger and written off NPAs increased by 133% post merger which pretty much explains the reasons for a steep fall in net profits of the bank.

- Provision coverage ratio has improved by almost 20% in post merger period it being 83% in financial year 2019-20 showing a strong management on NPAs.

- CASA ratio is the ratio of deposits in current and saving accounts to total deposits. This ratio has improved by 9% post merger which means cost of funds are falling.

- Capital adequacy ratio hasn't shown much difference in pre and post merger periods. Basel III requirements have been fully met by SBI even after the merger.

TABLE 2- Independent Samples Test

	Levene's Test for Equality of Variances			t-test for Equality of Means		
Parameters		**F**	**Sig.**	**t**	**df**	**Sig. (2-tailed)**
Net Interest Income (Rs. In Crores)	Equal variances assumed	2.44	0.19	-4.14	4.00	0.01
Net Profit (in Crores)	Equal variances assumed	4.90	0.09	1.32	4.00	0.26
Operating Profit as % of Working Funds	Equal variances assumed	7.563	0.051	3.98	4.00	0.016
Return on Average Assets (%)	Equal variances assumed	1.31	0.32	2.40	4.00	0.07
Return on Equity(%)	Equal variances assumed	2.31	0.20	2.02	4.00	0.11
Earning per Share	Equal variances assumed	4.09	0.11	1.61	4.00	0.18
Profit per Employee (in 000)	Equal variances assumed	5.21	0.08	1.65	4.00	0.17
Business per Employee (Rs.in Crores)	Equal variances assumed	0.02	0.893	-2.73	4	0.052
Net NPA (%)	Equal variances assumed	2.09	0.22	-0.37	4.00	0.73
Provision fo NPA (Rs. In Crores)	Equal variances assumed	0.98	0.38	-3.33	4.00	0.03
NPA Written off (Rs In Crores)	Equal variances assumed	0.76	0.43	-4.45	4.00	0.01
Gross NPA (%)	Equal variances assumed	0.02	0.89	-0.79	4.00	0.47
PCR (%)	Equal variances assumed	1.70	0.26	-2.11	4.00	0.10
CASA	Equal variances assumed	5.62	0.08	-5.33	4.00	0.01
Capital Adequacy Ratio (%)	Equal variances assumed	5.45	0.08	-0.13	4.00	0.91

Table 2 shows the Independent T test results of SBI done on 15 parameters extracted from Financial statements of SBI comparing pre and post merger period. Out of 15, 10 parameters have been found to be statistically insignificant at 95% of confidence level where value of alpha is 0.05.

Net profit, return on average assets, return on equity, earning per share, business per employee, profit per employee are found to be statistically insignificant, which means there is not much difference between means of pre and post merger values of these profitability related parameters at alpha level .05.

Out of next set of parameters assessing the stressed asset management skills of the bank net NPA, gross NPA, provision coverage ratio, capital adequacy ratio also resulted statistically insignificant.

Parameters that resulted statistically significant and where the null hypothesis is rejected at alpha level 0.05 are net interest income, operating profit, CASA, provision for NPA, and NPA written off.

VII. RESULTS AND DISCUSSION

From the study following results have been drawn:

- Due to merger there have been sudden decline in net profits owing to higher provisioning policies and written offs in the year of transaction. But it started a speedy recovery in 2018-19, and by 2019-2020 it reached to its normal level of profitability again.
- Due to increase in net profits and increase in number of employees profit per employee also showed the same pattern of falling off in the transaction year and later catching up the speedy recovery before reaching to normal level of profit per employee in 2019-2020.
- ROA, ROE, and EPS declined largely due to asset base expansion and increase in issued equity capital.
- Stressed asset management of SBI is improving looking at the provision coverage ratio which has reached to 83% in 2019-20 as compared to 60% in 2015-16.
- CASA has improved resulting in the lower cost of funds for SBI which in turn will help in profitability of the bank.
- SBI has been able to manage meeting Basel III requirements of minimum CAR even during the transaction year.

VIII. CONCLUSION

The study undertaken attempts to evaluate the pre and post merger profitability of SBI and its asset management tactics applied to overcome the most challenging part of integration i.e. integration of non performing assets of acquired banks into the balance sheet of acquiring banks. From the results, it is evident that most of the parameters selected did not show any significant change from pre merger state to post merger state. The reason behind this could be that the profits of SBI fell sharply in the year of transaction but started recovering at a faster rate and reached to their normal range of profitability by 2020. For example net profit margin of SBI in 2016-17 was 5.97% which fell to -2.96 % in the year of merger (moneycontrol.com). A year after merger net profit margin recovered to 0.35% and finally in year 2019-20 it reached to 5.63%. The net interest income and operating profit have shown a significant change in pre and post merger periods but the same could not be seen for net profits. The reason could be due to high provisioning requirements during the transaction year, profits fell sharply. SBI has now started to reap the benefits of merger. SBI reduced 1,805 branches and rationalized 244 administrative offices after merger which saves around 1,099 crore per annum (SBI Annual Report 2017-18). The long-term benefits of the merger will significantly outweigh the near term challenges and the efficiencies generated through the merger will help the bank to increase its performance in the long run.

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