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Emperical Evidence Of Performance - From Merger Of State Bank Of India And Its Associates 2017

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Abstract

Mergers and acquisitions are inevitable for corporations to pursue when they want to restructure their business and become more competitive. The consolidation of banks through mergers and acquisitions constitutes an important outcome of the financial transformation process and contemporary trend in the Indian banking sector. SBI, India's largest public sector bank merged with its 5 associate banks and Bhartiya Mahila Bank on 1st April 2017. It is expected that with the merger SBI will enter in to the top 50 global banks in context of assets to compete in worldwide financial market. The objective of the study is to analyze the effect of SBI merger on the financial performance of bidder bank. The study is descriptive in nature and used secondary data for analysis. The data required for the analysis has been taken from the annual reports of SBI during the period 2012-13 to 2022-23 The CAMELS model is used to analyse the effect of SBI merger on the financial performance.

The result of the study reveals that the financial performance of SBI has changed significantly after merger. The bank could enhance its financial performance in terms of capital adequacy, asset quality, management efficiency, earning quality, liquidity, and sensitivity to market risk to a large extent. Now as per Forbes ranking, the position of SBI among global banks is 56 in terms of total assets. The results of the study have important practical implications and will help in resolving misconceptions regarding the implications of merger on merged entity.

Keywords: Bank Mergers& Acquisition, SBI merger, Financial performance, Non-Performing Asset, CAMELS Model.

1. Introduction

Banks and financial institutions are the key pillars of the economy, whichs plays a crucial role for the overall economic development of the country. In recent years, the Indian banking system is undergoing a significant transformation. As a result of economic reforms, Policy of deregulation, liberalisation and technological advancement, competition among the banking industry is also get increased. The growing competition leads the Indian Government to become relentless to strengthen banking system in order to strengthening the Indian economy. Various committees, constituted by the Reserve Bank of India (RBI), particularly the Committee (1998), Leeladhar Committee (2008), and the Nayak Committee (2014) recommended Merger as the strategic tool to improve the functioning of banking system (Qamar & Din, 2021).Merger refers the unification of two or more entities into one through pooling of interests, acquisition on the other hand involves purchasing the asset or stocks of the acquired company (Koi-Akrof, 2016). Enormous mergers have been taken place in Indian banking sector for expansion, diversification and overall growth as primary objective. Among this State Bank of India Merger 2017 is considered as the mega merger in its history. The State Bank of India undertook its first ever merger process of its associate with the smallest associate bank – State Bank of Saurashtra, which had 460 branches, in August 2008. Followed by State Bank of Indore merged with State Bank of India in August 2010 under the leadership of SBI Chairman Pratip Chaudhuri. After that, the collective merger proposal was first announced in the Union budget 2016 by finance minister Arun Jaitely. On June 15, 2016, the Central Government approved the merger of SBI with its five affiliate banks, namely, State Bank of Travancore (SBT), State Bank of Mysore (SBM), State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Patiala (SBP) and also the three-year old Bharatiya Mahila Bank (BMB). The rationale behind the horizontal merger are to achieve a better financial performance, greater market share, bring in economies of scale, reduce administrative overheads, channelise the trained manpower into business development, reduce avoidable competition from different streams

of the same group etc. A lot of oppositions and apprehension are raised by the stakeholders against the mega merger of SBI. They are eagerly waiting to know the effect of merger and to get information about what extend the merger is able to achieve the said objectives. Hence, it is worhful to conduct a study to know the effect of merger on financial performace of the bidder bank State Bank of India.

2. Literature Review And Background Of The Study

The impact of Mergers and Acquisition on bank performance were explored by various researchers in both national and international studies. Indian financial system requires very large banks to absorb various risks emanating from operating in domestic and global environment and merger waves leading to emergence of very large banks and financial institution(Jayadev & Sensarama, 2007). (Sai & Sultana, 2013) studied the financial performance analysis of both acquirer and acquired bank in Indian overseas bank merger and HDFC bank merger as a pre- and post-merger perspective on the basis of 6 financial ratios. One of the research study conducted in Pakistan (Fathima & Shehzad, 2014) also studied the impact of mergers and acquisition of financial performance of bank, 10 Pakistan banks were taken as sample and six financial ratios such profit after tax, return on asset, return on equity, debt equity ratio, deposit to equity ratio and EPS were used for analysis and conclusion was made as merger is not properly achieved the purpose in this era neither the synergy is created nor are the economies of scale achieved.

The CAMEL approach is commonly used to assess the performance of banks as one of the most common methods for calculating banking performance. CAMEL is an international rating system used to rate financial institutions by regulatory banking authorities on the basis of the five factors represented by its acronym (Jha, 2021). The CAMELS acronym stands for Capital adequacy, Asset quality, Management, Earnings and Liquidity. Regulators created an additional measure, Sensitivity, to evaluate market risk associated with changing interest rates and other factors (Hays, Lurgio, & Arthur H. Gilbert, 2009). The Federal Financial Institutions Examinations Council (FFIEC) of the United States of America initially adopted this Uniform Financial Institutions Rating System (UFIRS) CAMEL on the 13th of November 1979. The Federal Deposit Insurance Corporation (FDIC) revised to include a sixth measure (sensitivity) to the UFIRS in 1997 to classify a bank's overall condition (soundness). This new component looks into how a bank responds to changes in interest rates, equity prices, commodity prices, and foreign rates (Boateng, 2019). In India, RBI adopted this approach in 1996 followed on the recommendations of Padmanabham Working Group (1995) committee (Karri, Meghani, & Mishra, 2015). Each of the component factors of CAMELS model is rated on a scale of 1 (best) to 5 (worst) (Mathur, 2021). (Ledhem & Mekidiche, 2020) made a study on performance Islamic banks with the help of CAMELS model with 8 financial ratios retrieved from different literature and investigates the link between financial performance of Islamic finance and economic growth empirically using CAMELS parameters within the endogenous growth model to provide robust information about this link based on a sample of the top pioneer Islamic finance countries. The study concluded that the financial performance of Islamic finance through profitability had a significant positive impact on economic growth. However, the financial performance of Islamic finance through capital adequacy, assets quality, management, liquidity, sensitivity to market risk, it was not significant to economic growth.

Several research were also conducted to study SBI merger impact. Furqan Qamar and Sayed Mohammad Minhaj Ud Din (2021) conducted a study entitled 'consolidation of state bank of India Effects on Performance and Policy Implications' which compares two-yearly averages of the pre-and post-merger performance of the SBI on thirty-one indicators, grouped into five broad performance parameters such as Financial Management and efficiency, growth and sustainability, productivity, profitability, size and scale and concluded that The effect of the merger on the size indicators like investment growth, income per employee, business per employee, deposit, advances, and other assets were found to be statistically significant a few indicators, like the business per employee, total income per employee, total deposits, total advances, and other assets, had significant positive effects. At the same time, most other indicators evincing positive or negative movement after the merger were not found to be statistically significant. (Mathur, 2021) used CAMEL performance measurement tool for pre- and post-merger impact SBI bank and evaluated pre & post-merger performance of SBI bank through the CAMEL Model from 2014-15 to 2018-19. It can be concluded from the study that Management efficiency, earning quality & Liquidity of SBI have improved post-merger. However, the bank needs to focus on improving its Capital adequacy ratio & Asset quality.

After analysing the previous literature related with the specific area, it reveals that CAMELS model is the best performance measurement tool, even though, few past literatures are available to study the impact of SBI merger, they all are analysing short term impact of merger and analysed financial performance of SBI using CAMEL model. This study measures the performance of SBI in the long run using the modified version of CAMEL incorporating the Sesnsitivity aspect.

3. Objectives Of The Study

The study aims to find out the long term effect of merger of SBI 2017 on financial performance of the bank . It also aims to identify the effect of merger on reducing level of Non Performing Assets of State Bank of India.

4. Methodology

The research design followed for this study is descriptive and analytical in nature and purely based on secondary data. The relevant secondary data were collected from annual reports of SBI and India stat database for a period of four years before merger (2013-2017) and four years after merger (2018-2022). The financial year 2017-2018 is taken as the base year for comparison The financial performance are measured based on various financial ratios coming under CAMELS model which covers six major constructs and twenty-four sub variables. The major constructs are Capital Adequacy, Asset Quality, Management Efficiency, Liquidity and sensitivity to market risk .The Capital Adequacy Ratio is a prominent indicator used to measure the financial strength of banking sector. The Gross NPA ratio, Net NPA ratio, Total investment to Total Asset ratio (Jha, 2021) and Slippage ratio (Mathur, 2021) were used to measure the Asset Quality. The Management Efficiency of bank was measured by using Profit per Employee , Business per Employee , Total Expenditure to Total Asset ratio (Jha, 2021) and Operating Profit to Total Asset ratio (Mathiraj & V.Ramya, 2014). The Earning capacity of the bank is the capability to maintain quality and earn consistently, which is measured by using the ratios such as Return on Equity, Return on Asset, Interest income to Total Income ratio, Non-Interest Income to Total Income ratio (Upadhyay & Kurmi, 2020)and Earning per Share ratio (Mathur, 2021). Liquidity is also an important aspect to determine the financial strength of bank, it is measured by using Cash Deposit ratio, Liquid Asset to Total Asset ratio, Liquid Asset to Deposit ratio (Upadhyay & Kurmi, 2020) and Liquidity Coverage ratio (V.S & V, 2022). Price Earnings Ratio, Beta (Upadhyay & Kurmi, 2020) and GAP ratio (Boateng, 2019) were used to measure Sensitivity to Market risk.

5. Results And Discussion

To measure the effect of merger, the performance of State Bank of India were analysed through the changes in the variables coming unders CAMELS framework in pre and post merger period. This model exclusively developed for measuring the performance of the banks in a comprehensive way. In this study, the performance are being analysed on the basis of mean values of CAMELS Variable before and after merger and the trend pattern of the movement of these varable during pre and post period. The influence of extreme values in any particular year may influence the mean values and hence an analysis based on mean values itself questions the real changes in the performance in the pre and post period of merger. Trend analysis overcome the limitations of this extreme influence. As per CAMELS ranking froame work, the expected movement of each variable for the better performance are clearly explained. If the movement of any of the variable are against the likelihood of improvements in the bank performance, it is considered as the performance of bank on that particular variable are not showing desired level.

Table 1

EFFECT OF MERGER ON FINANCIAL PERFORMANCE OF STATE BANK OF INDIA

CAMELS parameter	Before Merger (4 years average ratio)	After Merger (4 years average ratio)	Expected effect on the likelihood of improvements in the bank's performance	Actual effect on the likelihood of improvements in the bank's performance	Performance trend after Merger

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Capital Adequacy: 1.Capital Adequacy Ratio	12.67	13.34	Increase	Increase	Increasing
2.Debt Equity Ratio	1.77	1.59	Decrease	Decrease	decreasing
3.Total Advances to Total Asset ratio	0.63	0.57	Increase	Decrease	Decreasing
4. Govt Secturites to total investment ratio	0.79	0.79	Increase	No change	Stagnation
Asset Quality Ratios: 1.Gross NPA ratio	6.20	5.66	Decrease	Decrease	Decreasing
2.Net NPA ratio	3.05	1.94	Decrease	Decrease	Decreasing
3.Slippage ratio	4.14	1.58	Decrease	Decrease	Decreasing
4.Total Investment to Total asset ratio	24.63	28.07	Increase	Increase	Increasing
Management Efficiency: 1.Profit per Employee	0.55	6.83	Increase	Increase	Increasing
2.Business per Employee	114.89	2232.25	Increase	Increase	Increasing Trend
3.Total Expenditure to Total Income ratio	0.94	0.95	Decrease	Increase	Decreasing
4. Operating profit to total asset	1.97	1.62	Increase	Decrease	Decreasing
Earning Capacity: 1.Return on Equity	10.33	6.76	Increase	Decrease	Increasing
2.Return on Asset	0.67	0.39	Increase	Decrease	Increasing
3.EPS	14.91	18.89	Increase	Increase	Increasing
4.Interest income to total income ratio	85.95	86.24	Increase	Increase	Increasing
5. Non-Interest income to total income	14.05	13.76	Increase	Decrease	Decreasing

Liquidity: 1.Cash to deposit ratio	6.72	5.84	Increase	Decrease	Increasing
2.Liquid Asset to Total Asset ratio	7.00	6.97	Increase	Decrease	Increasing
3.Liquid Asset to Deposit Ratio	9.25	8.61	Increase	Decrease	Increasing
4. Liquidity coverage ratio	97.24	141.85	Increase	Increase	Increasing
Sensitivity to Market risk: 1.Price Earning ratio	16.07	93.16	Increase	Increase	Decreasing
2.GAP Ratio	1.03	0.97	Increase	Decrease	Stagnation
3. Beta	1.47	1.30	Decrease	Decrease	Decreasing

Source: Researcher's calculation based on India stat database

The Table No. 1 shows the Results of CAMELS model analysis. From the table it is evidently clear that financial performance of SBI has improved significantly in respect of Asset Quality and Liquidity which shows a favourable performance trend for all respective ratios. The Management efficiency and Earning Capacity aspect also showing a positive movement after merger except in case of Operating Profit to Total Asset ratio and EPS. However, in respect of Capital Adequacy and Sensitivity to market risk aspect the respective ratios shows an insignificant improvement.The Capital Adequacy shows improvements in respect of CAR and DE ratio, while in respect of remaining two ratios the bank does not show a favourable trend after merger. Similarly, Sensitivity to market risk aspect, bank shows an improvement in terms of Beta only, while the remaining two ratios doesn't show a favourable trend after merger. The decline in performance in some of the ratio of SBI after merger is mainly due to the inability of the bank after merger to mobilise loans and advances in a significant manner.

6. Conclusion

The results of the study reveals that the State Bank of India has attained better financial performance in terms of asset quality, management efficiency, earning capacity, and liquidity.The analysis of financial data before and after merger shows that the bank is able to

maintain proper CAR after merger as per norms.The Asset quality of the bank has improved, specifically the level of NPA has decreasedto a great extend. Reduce the level of NPA was one of the major objectives of merger. The productivity of the employees has increased to a significant manner after merger.In contrary, the efficiency of management in reducing the expenses in proportion theirincome was not up to the satisfactory level. While analyzing the Liquidity position of the bank, the bank has enough investment to meet the liquidity position but the cash in hand and liquid assets to meet their liquidity crisis are not satisfactory as well as not in proportion to their deposits.The sensitivity of the shares to move in accordance with the stock market is comparatively less during post- merger period. If the bank can mobilise loans and advances in a significant manner, definitely most of its parameter indicators will show a substantial change leading to increasing performance trend.

7. Limitations Of The Study And Scope For Future Research

Even though the study examined the long-term impact of merger on the bank's financial performance, only 8 years data could be taken for analysis. The analysis of 18- or 20-years data may give a comprehensive idea regarding its long-term impact. The present study could evaluate the impact of merger on bank's performance aspect only. The impact of merger on other aspects such as shareholder wealth, human, technological resources, opportunities and threats of bank are other unexplored area of research.

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