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Study on Merger and Acquisition in Indian Banking Sector with reference to deal between ICICI Bank Ltd and Bank of Rajasthan

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Abstract
Before 1935 Indian Banking sector was completely dominated by private players and were managed and organized by individual people or industrial houses, which collected deposits from individuals and used them for their personal purposes. As there was no governing authority and regulatory framework, these private owners of banks have monopoly to use the funds in any manner which has resulted into bank failures.
Intention of nationalizing banks was to make banking services to have mass effects that can be attributed as "first- banking revolution". Commercial banks acted as an instrument for undertaking speedy branch expansion, deposits mobilization and credit creation. Therefore, 14 banks were nationalized in 1969 and further 6 more commercial banks were nationalized in 1980, so as to manage the economy in compliance with national objectives and strategies.
Mergers and acquisitions are strategic move that many organizations have engaged in either within a national domain or international region. Mergers and acquisitions are the tactical growth strategy adopted by most companies not only to survive in the competition, but also to expand their market share, margins and to be in control or become supremacy in the national and global market.
Keywords: *Merger and Acquisition, Synergies, Financial Synergies, Success and Failure of Mergers and Acquisitions*

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I. Introduction to Indian Banking System

Due to language barrier and inexperience native people, British traders who came to India during 17th century were unable to take advantage of indigenous bankers. So, the British Agency started conducting self-owned banking operations, along with their commercial business. These agency houses were governed, managed and operated by the retired European having civil and military background with commercial aptitude. Business organization form during 1834 to 1847 is recognized as managing agency. The principal operation of these agencies was to trade, but later they spread out into banking and gradually separated the operations of their core business activities. The English agency houses started serving East India Company as a banker but had no pre-owned capital owns and are dependent on deposits for their funds. Main business activities of agencies were to provide funds for the movement of crops, to issue paper money and to establish joint stock banks. Banking in India started in late 18th century. Bank of Bengal was the first bank to establish in Calcutta during the year 1786.

Indian banking system has evolved around various phases. These phases can be classified in below mentioned phases.

Early Phase (1786 to 1935)

Three banks namely Bank of Bengal, Bank of Bombay and Bank of Madras are established by an East India Company which established as an autonomous unit and termed them as Presidency Banks. Later these three banks were merged to form new entity named as Imperial Bank of India in 1925. Further, when India got its independence Imperial Bank was converted into State Bank of India. Thus, SBI is the oldest bank in India. Foreign banks also started functioning in India, predominantly in Calcutta during 1860s. Calcutta being the most

active and important trading port in India, became a banking center of India. HSBC was one of the earliest foreign banks to establish in Bengal in the year 1869.

Pre-Nationalization Phase (1935 to 1968)

Before 1935 Indian Banking industry was completely dominated by private players and was managed and organized by influential individuals or industrial houses, money was deposited from individuals and utilized for personal purposes. These private bankers were independent to utilize the funds, since there was the non-existence of any governing authority and regulators, which result in the failures of banking sector in India. To some extend Presidency banks was acted as apex bank. However, consolidation in the Indian banking sector was developing confidence in the investors but still apex regulatory authority was the need of an hour. Setting up of RBI was a major step in the history of India Banking system. However, establishment of RBI was not swift. It took almost nine, from the year 1926 when commission submitted its report. For the purpose of regulating and maintaining financial stability in the country, the Government on 20th December, 1934 made an announcement and on 14th January, 1935, RBI became the central bank of the country and was formally inaugurated on April 1, 1935.

Expansion Phase – Nationalization (1968-1984)

Nationalization of the scheduled bank was first banking revolution in India, with intent to make banking services to have mass reaching. Scheduled commercial banks played crucial role expanding operational branches, mobilization of deposits and through credit creation. Growth of commercial banks in rural areas was continued. In the first phase, 14 commercial banks were nationalized in 1969 and further 6 more commercial banks were nationalized in 1980, in order to regulate the monetary environment of the economy.

Modern Phase – (1991 till date)

Modern phase can be attributed as a “The Reforms Phase” in Indian banking system mainly because of two primary reasons, firstly establishment of the Committee on Banking Sector Reform which is also known as Narasimhan Committee which was headed by former Reserve Bank of India Governor M Narasimhan. Several recommendations were submitted by the committee to then Finance Minister Yashwant Sinha in 1991.The Committee was established to scrutinize the progress in the Indian Banking industry. Second major step was introduction of New Economic Policy of 1991. The main ingredient of New Economic Policy was Liberalization, Privatization and Globalization. As a result, Indian Banking industries gradually start getting momentum at national and international levels.

Merger and Acquisition in Indian Banking Sector

Banking sector is the most comprehensively regulated and well-organized sector in Indian financial market. Reserve Bank of India as an apex financial institution has the responsibility of controlling, monitoring and supporting the banking companies in carrying out their core banking activities. Regulation enhances the performance, and business growth is the continuous pursuit for all companies, and banking companies are no exception. There are various drivers which drive consolidation in India, some research relates profits and performance after mergers and others look these mergers as banks overcoming their likely dissolution.
Over the years Government appointed several committees to suggest structural up gradation in the Indian financial system. Narasimhan Committee II (1998) was a major step in this direction.

Chronological list of Deals from the period January, 2006 to December, 2019

Acquirer Name	Target Name	Date Announced
Federal Bank Ltd	Ganesh Bank of Kurundwad Ltd	25-Jan-2006
ICICI Bank Ltd	Lord Krishna Bank Ltd	19-June-2006
ICICI Bank Ltd	Sangli Bank Ltd	12-Sept-2006
IDBI Ltd	United Western Bank Ltd	01-Dec-2006
Indian Overseas Bank	Bharat Overseas Bank	31-March-2007
ING Vysya Bank Ltd	Kotak Mahindra Bank Ltd	25-Sept-2007
HDFC Bank Ltd	Centurion Bank of Punjab Ltd	23-May-2008
Punjab National Bank	Danabank	23-Nov-2009
ICICI Bank Ltd	Bank of Rajasthan Ltd	13-August-2010
State Bank of India	State Bank of Indore	26-August-2010
Ratnakar Bank	Royal Bank of Scotland	09- August-2013
Kotak Mahindra Bank Ltd	ING Vysya Bank Ltd	20-Nov-2014

Figure 1.5 Mergers and Acquisition in Indian Banking industry (2019)

Sources

- Reserve Bank of India's Report and Progress of Banking in India
- Reserve Bank of India - RBI's Data Warehouse Indian Bank's Association

II. Review of Literature

Numerous studies are conducted on merger and acquisition in western countries, in last few decades. However, very limited research works have been done in Indian context. Literature review has been done on empirical studies in books, journals, published paper etc. From the review of literature, it is observed that Indian banking industry has witnessed a surge in the number of consolidation and restructuring particularly in the post liberalization period. Consolidation of the banks increases the competitive approach of Indian banks at both domestic and global level, it also enhanced operational aspects of the banks, and more stabilized capital structure to survive even in the toughest scenario. However, very limited literature work especially in Indian context was available in the field of synergies particularly financial synergy and the
way valuation needs to be done of synergy created from merger and acquisition. Review of key words has been listed down below in the paragraphs.

Review of Literature on Indian Banking industry

- Study by Kangasabapathy et.al. (2012) discuss about how the Indian banking system is facing quandary because of low availability of liquid resource, adequate capital and returns. According to the research paper banks were basically in a credit crunch situation.

- Success of banking sector depends on the quality of customer based as suggested by Goyal & Vijay (2012) that although Indian Banking industry going steady still the banks have to understand their customers behaviour and service provided should be reasonable. Goyal and Vijay also suggested on the product innovation in addition to their conventional services to be remain competitive in the market. Banks should also emphasis on technological front because the level of awareness among customers is much higher than before.

- Impact of technology was also noted by Zhao et al. (2007) that after early adjustment phase; the Indian banking industry experienced continuous productivity growth, driven mainly by technological progress. It was comparative research based on the growth of the banks in the Indian subcontinent region. Among the Indian Banks it was concluded by Gupta et al. (2008) that SBI and its associates have the highest effectiveness, followed by private sector banks and the other nationalized banks.

Review of Literature on Impact of Merger and Acquisition, Drivers, Success and Failure of Merger and Acquisition

- One of the most prominent research by Larsson, R., & Finkelstein, S. (1999) based on merger and acquisition concluded that, if the two firms have identical operation and product lines, then they can merge together to achieve multiply benefits arising out of synergy. Secondly, they suggested that consolidation of two organization followed by successful post deal integration will be to create for synergy as compared to the companies which fails to put significant efforts for integration. Lastly, it was concluded that if the sole purpose of Mergers and Acquisitions to earn more profits by integrating production and marketing operation, faced more disagreement from their employees in comparison to mergers which focused on gaining complementary earnings.

- Merger and acquisition can be considered as the best approach to make domestic and global presence, but to analyse most appropriate time for the deal is important task, Rajesh Kumar, B and Prabina Rajib (2007) study on the characteristics of merging firms particularly in India and analysed the unique financial uniqueness of the acquirer and the target firms in the period of merger. Research fundamentally focused on the traits of the acquirer and could be acquired, which will have a significant impact on the prospect that firms will be acquired. Based on the study they suggested that smaller firms with lower price-earnings ratio are more likely to be acquired. Subsequently, the acquired firms may also be undervalued by the stock market.

Review of Literature on Merger and Acquisition in Banking Sector

- Consolidation activity prevail in all sector and industry, some of the consolidations are forced, some are carried with mutual understanding; however, hostile takeovers are very uncommon in Banking Industry. Statement was supported by Piskula (2011) his literature that was actually comparative studies of merger and acquisition in banking Industry with other industries. Brewer et al. (1990) stated that the outlook of the

U.S. banking industry was changed dramatically by the bank consolidations in the 1990s, due to the mergers the total number of banks has been reduced significantly.

- Another comparative study was conducted by Deyoung (2010) analysed the different aspects of merger and acquisition in US and Europe banking. While efficiency gains are likely for both bidders and targets in the US in the post 90s because of a large-scale restructuring, however, results from Europe may be more valid for cross border acquisitions.

- Ya-Hui Peng & Kehluh Wang, (2004) study suggested that economies of scale exist at small and medium-sized banks. Whereas, government-owned or controlled banks are the most cost efficient. The study further observed that bank merger activity is more or less related with cost efficiency. They also pointed that merger can enhance cost efficiency, with the same number of workforces.

Review of Literature on Merger and Acquisition in Indian Banking Industry

- Ram Kumar Kakani and Jay Mehta, (2006) examined the motives for mergers and acquisitions in the Indian Banking industry through the international mergers & acquisitions scenario comparing it with the Indian scene. Give the increasing role of the economic power in the turf war of nations, the paper looks at the significant role of the state and the central bank in protecting customer's interest's vis- à-vis creating players of international size. While, gazing at the mergers & acquisitions in the Indian Banking industry both form an opportunity and as imperative perspectives, the paper also glances at the large implicative, the paper also glances at the large implications for the nation.

- Khan (2011) discovered diverse impulses for mergers & acquisitions in the banking sector of India. It also covers various features of mergers & acquisitions which occur in banking sector. Moreover, it judges against pre-merger and post-merger financial health of the merged banks using monetary constraints. The writer says that merger & acquisition is a helpful means for development and extension in the banking sector of India. It was analyzed that banks which are not performing well can only survive if it is merged with a larger bank.

Financial Synergy in Banking Industry, Parameters for the valuation and calculation of Synergies

- Financial synergies can be positive means favoring the merger and acquisition deals or negative synergy means not realizing desired outcome. Talha, M. and Sallehuddin, A. (2005) highlighted theory of shareholder wealth maximization. According to them three main ingredient of wealth maximization are financial, operational and managerial synergy, their study primarily focuses on Financial Synergy.
- Kristin Ficey, Tom Heard and Bill Pursche (2007) proposed that synergistic opportunities are time sensitive and in order to realize expected synergy integration need to be prioritized. According to literature cost and revenue synergy are micro part of financial synergy.
- Nourayi., M.M (1998) studied the merger between Bank of America and Security Pacific Bank and emphasized on financial synergy lies in mergers of banks. Study compared the cost and asset management aspects of the two entities by comparing costs and resources for the five-year period prior to the merger, and by looking at the surviving entity's (Bank of America, N.A.) cost and management of assets for the three-year period after the merger. He analyzed that source of financial synergy depends on cost cutting opportunities in expenses and seeing profitability opportunity in the loan portfolio of the combined entity through resource efficient optimization.

III. Research Methodology

Aim of the Study

This paper discussed about how the merger and acquisition takes place in the Indian banking sector, evolution of Indian Banking sector and current scenario of Indian Banking. Primary aim was to analyze post and pre financial impact of merger and acquisition deal of ICICI Bank Ltd and Bank of Rajasthan.

Objective of the study

The main objective of this study is to analyze the financial aspect of the mergers and acquisition deal between ICICI Bank Ltd. and Bank of Rajasthan

Source of Data

The study is based on secondary data. The financial and accounting data of banks is collected from the Annual report of the Bank and annual financial report published by RBI to examine the impact of Mergers and Acquisitions.

Data is also collected from the Bombay Stock Exchange, National Stock Exchange, Securities and Exchange Board of India, Centre for monitoring Indian economy (CMIE) etc. for the study.

Expected Statistical Techniques Usage

In order to analyze if there is any significant difference in the pre-merger versus post-merger performance of the acquiring banks under study for the period of study, the Paired t-test is applied to the CAMEL performance evaluation parameters of the acquiring banks during the pre-merger and post-merger period at 95% level of confidence.

The pre-merger period and post-merger period consists of a period of five years pre and five years post-merger and acquisition. The research findings are tabulated and illustrated with the help of tables, charts and other graphical representation tools.

Financial Parameters

Financial reporting in the banking industry is significantly different than most other industries. The central objective of a bank is to attract funds at an acceptable cost and reinvest them earning a higher return. Therefore, to measure liquidity, asset management, capital maintenance, profitability and risk exposure requires industry specific financial ratios. Bank financial ratio analysis arose in response to this need. The performance of the Banks is made in respect of the financial parameters are as follows:

- Net NPA Growth
- Net NPA/Net Advances
- Credit Deposit Ratio
- Cash Deposit Ratio
- Ratio of operating profits to total assets
- Capital Adequacy Ratio
- Net Interest Margin
- Diluted EPS
- Return on equity

Research Aim

This research aims to analyze the impact on financial synergy created from mergers and acquisitions in Indian banking system and whether those synergies add any value to merged or acquired entities or not.

Research objectives

- An evaluation of financial synergies created through mergers and acquisitions.
- To assess implication of synergies on the return on equity and CAMELS (capital adequacy, asset quality, management, earnings, liquidity, system and control) of the bank.
- To understand the relationship among the financial variables relevant to banking industry and synergies created.
- To evaluate banks' health post consolidation with reference to synergies created in banks consolidation.
- To evaluate the overall effect of merger and acquisitions on private banks with reference to synergies created in banks consolidation.

Hypothesis 1

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Net NPA Growth

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Net NPA Growth

Hypothesis 2

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Net NPA/Net Advances

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Net NPA/Net Advances

Hypothesis 3

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on the Credit Deposit Ratio

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on the Credit Deposit Ratio

Hypothesis 4

H0 (Null Hypothesis) – There is no significance difference between the pre-merger, post-merger and acquisition on the Cash Deposit Ratio

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on the Cash Deposit Ratio

Hypothesis 5

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Ratio of operating profits to total assets

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Ratio of operating profits to total assets

Hypothesis 6

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Capital Adequacy Ratio

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Capital Adequacy Ratio

Hypothesis 7

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Net Interest Margin

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Net Interest Margin

Hypothesis 8

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Diluted EPS

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Diluted EPS

Hypothesis 9

H0 (Null Hypothesis) – There is no significant difference between the pre-merger, post-merger and acquisition on Return on equity

H1 (Alternative Hypothesis) - There is a significant difference between the pre-merger, post-merger and acquisition on Return on equity

Data Analysis and Interpretation

Case	Acquirer Bank	Acquired Bank	Date of Effective
Case 4	ICICI Bank Ltd	The Bank of Rajasthan	August 13, 2010

Pre and Post Financial aspect of ICICI Bank Ltd

Acquirer Bank - ICICI Bank Ltd Acquired Bank - The Bank of Rajasthan Date of Effective - 13-08-2010	Pre					Post				
	March, 2006	March, 2007	March, 2008	March, 2009	March, 2010	March, 2011	March, 2012	March, 2013	March, 2014	March, 2015
Quality of Assets										
Net NPA Growth	876.2	1,992.0	3,490.6	4,553.9	3,841.10	2407.4	1860.8	2230.6	3298	6256
Net NPA/Net Advances	0.72	1.02	1.55	2.09	2.12	1.11	0.73	0.77	0.97	1.61
Productivity and Efficiency										
Credit Deposit Ratio	88.54	84.97	92.30	99.98	89.70	95.91	99.31	99.19	102.05	107.18
Cash Deposit Ratio	5.41	8.12	12.02	8.03	13.62	9.27	8.01	6.51	6.57	7.10
Quality of Earning										
Capital Adequacy Ratio										
Basel-I	13.35	11.69								
Basel-II			13.96	15.53	19.41	19.54	18.52	18.74		
Basel-III									17.7	17.02
Net Interest Margin	2.25	1.89	1.96	2.15	2.19	2.34	2.40	2.70	2.91	3.07
Diluted EPS	31.45	30.75	39.15	33.7	35.99	45.06	55.95	71.93	84.65	19.13
Return on equity	14.33	5.89	7.21	6.82	5.48	4.71	5.95	6.16	5.72	5.85

- Note : Capital adequacy ratios is Total of Tier I and Tier II
- Diluted Earnings Per Share (EPS) pursuant to the issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) – 20 (Earnings Per Share)

Summary of Hypothesis Testing

Financial Parameters	Sig.(2-tailed) P Value	Hypothesis
Net NPA Growth (Rs. in crores)	0.744	Null Accepted
Net NPA/Net Advances	0.143	Null Accepted
Credit Deposit Ratio	0.025	Null Rejected
Cash Deposit Ratio	0.359	Null Accepted
Ratio of operating profits to total assets	0.001	Null Rejected
Capital Adequacy Ratio	0.104	Null Accepted
Net Interest Margin	0.013	Null Rejected
Diluted EPS	0.134	Null Accepted
Return on equity	0.29	Null Accepted

Key findings of the Deal:

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value - 0.744) resulting no significant difference in NPA Growth, however mean value changes to (-259.8). Thus, we can conclude that post consolidation ICICI Bank cash flow reduces, resulting in decreased profit and increased loan loss provision which further reduce the capital available to provide subsequent loans. Result in inadequate progress in the financial health of the company

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value 0.143) resulting no significant difference in Net NPA as a percent of Net Advances, however mean value changes to (0.462), which results a positive outlook post consolidation for the ICICI Bank, it can be concluded that in lieu of increased nonperforming assets advances made by bank are also increasing

• As per the Paired T Test and statistical analysis, Null Hypothesis was rejected Sig. (2-tailed - P Value - 0.025) resulting significant difference in Credit Deposit Ratio, and mean value changes to (-9.63), which result positive outlook post consolidation for the ICICI Bank. Improvement in Credit deposit ratio indicates efficiency of banks in operating core activity and it also shows how much of a bank's core funds are being used for lending. An increase in ratio indicates more reliance on deposits for lending and vice-versa.

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value is 0.359) resulting no significant difference in Cash Deposit Ratio, also mean value changes to (1.948), reflects negative outlook post consolidation of ICICI Bank in term of liquidity and it also indicates that for doing bank’s main banking activity, bank’s core funds are used.

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value is 0.104) resulting no significance difference in Capital Adequacy Ratio, however, mean value changes to (-0.874), reflects positive outlook post consolidation of ICICI Bank. Continuous improvement in the Capital Adequacy Ratio of the bank indicates and ensures the efficiency and stability of a bank’s financial system by lowering the risk of banks becoming insolvent. Progressive rate of ratio of the bank also indicates strong financial foundation of the bank.

• As per the Paired t-test and statistical analysis, Null Hypothesis was rejected Sig. (2-tailed - P Value is 0.013) resulting no significance difference in Net Interest Margin, however mean value changes to (-0.596), slight increase in the mean value of the margin indicating positive return, which implies that ICICI has invested efficiently post consolidation as contrasted to its debt situations

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value is 0.134) resulting no significance difference in Diluted EPS, however, mean value changes to (-21.36), showing positive prospect of the ICICI Bank post consolidation, Increased Diluted EPS ratio indicates strong financial health of the bank even after consolidation, it also signifies progressive income growth of outstanding shares. Positive EPS ratio also build strong brand value for the bank

• As per the Paired t-test and statistical analysis, Null Hypothesis was accepted Sig. (2-tailed - P Value is 0.290) resulting no significance difference on Return on Equity, however, mean value changes to (- 2.268), resulting positive impact of consolidation on the Return on equity of the bank. Return on equity states that how much after-tax profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. Increased Return on equity of ICICI Bank post consolidation also reflects effectiveness of management in utilization of profit after tax.

IV. Conclusion

Conversion rate at the time of consolidation was 25, ICICI Bank shares per 118 Bank of Rajasthan shares. In summary, the implied share exchange ratio: 0.212, ICICI Bank shares per Bank of Rajasthan share. The implied offer price is INR 174.9, using the last trading price of INR 825 of Bank of Rajasthan share before announcement. It values the entire share capital at INR 28.22bn (USD 619.7m), using the closing exchange rate of INR 45.54 per USD on 19-May-10). The implied term represents a 46.48% premium over INR 119.4, the closing price of Bank of Rajasthan on 19-May-10, the last trading day before the announcement (announcement made after market closed). It also represents a 75.8% premium over INR 99.5, the closing price of Bank of Rajasthan on 18-May-10, the trading day when ICICI Bank board approval the merger.

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