A Study on Impact of Merger of Centurian Bank of Punjab on the Financial Performance of HDFC Bank

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Abstract: With the changing environment many different strategies have been adopted by banking sector to remain efficient and to surge ahead in the global arena. By the way of mergers and acquisitions in the banking sector, the banks can achieve significant growth in their operations, minimize their expenses to a considerable extent and also competition is reduced because merger eliminates competitors from the banking industry. The analysis of before and after merger of Centurion Bank of Punjab with HDFC bank indicates that after merger, Gross Profit Margin, Net Profit Margin, Return on Capital Employed, Return on Equity and Debt-Equity Ratio shows an increasing trend, but Operating Profit Margin shows mixed trend. The results also show that there is a significant difference in Gross Profit Margin, Net Profit Margin, Operating Profit Margin, Return on Equity and Debt-Equity Ratio between before and after merger.

Key Words: Financial Performance, Merger, Paired t-test.

I. Introduction

Bank in general terminology is referred to as an financial institution or a corporation which is authorized by the state or central government to deal with money by accepting deposits, giving out loan and investing in securities. The important roles of banks are economic growth, expansion of the economy and provide funds for investment. In the recent times banking sector has been undergoing a lot of changes in terms of regulation and effects of globalization. These changes have affected this sector both structurally and strategically. With the changing environment many different strategies have been adopted by this sector to remain efficient and to surge ahead in the global arena. One such strategy is through the process of consolidation of banks emerged as one of the most profitable strategy. There are several ways to consolidate the banking industry, the most commonly adopted by banks is merger (Devarajappa, 2012).

The banking system of India started in 1770 and the first Bank was the Indian Bank known as the Bank of Hindustan. Later on, some more banks like the Bank of Bombay-1840, the Bank of Madras-1843 and the Bank of Calcutta-1840 were established under the charter of British East India Company. These Banks were merged in 1921 and took the form of a new bank known as the Imperial Bank of India. For the development of banking facilities in the rural areas the Imperial Bank of India partially nationalized on 1 July 1955, and named as the State Bank of India along with its 8 associate banks. Later on, the State Bank of Bikaner and the State Bank of Jaipur merged and formed the State Bank of Bikaner and Jaipur, The Indian banking sector can be divided into two eras, the pre liberalization era and the post liberalization era. In pre liberalization era government of India nationalized 14 Banks on 19 July 1969 and later on 6 more commercial Banks were nationalized on 15 April 1980.

In the year 1993 government merged The New Bank of India and The Punjab National Bank and this was the only merger between nationalized Banks, after that the numbers of nationalized Banks reduced from 20 to 19. In post liberalization regime, government had initiated the policy of liberalization and licenses were issued to the private banks, which lead to the growth of Indian Banking sector. The second Narasimham Committee (1998) had suggested mergers among strong banks, both in the public and private sectors. The facts and figures of mergers in Indian banking sector is as follows. During pre-nationalization period from 1961 to 1968, 46 mergers have taken place, in the nationalized period from 1969 to 1992 the number of mergers were 13. During the post reform period i.e. starting from 1993 to 2006, 21 mergers have taken place out which 13 were forced mergers, 5 were voluntary merger, 2 were convergence of financial institution in to bank and 1 was due other regulatory compulsions.

The Indian Banking Industry shows a sign of improvement in performance and efficiency after the global crisis in 2008-09. The Indian Banking Industry is having far better position than it was at the time of crisis. Government has taken various initiatives to strengthen the financial system. The economic recovery gained strength on the back of various monetary policy initiatives taken by the Reserve Bank of India (Sai and Sultana, 2013). With this background, the present study is made to study the impact of Centurion Bank of Punjab on the financial performance of HDFC bank.

DOI: 10.9790/0837-20562831 www.iosrjournals.org 28 | Page
II. Review Of Literature

Jay and Kumar (2006) stated that there were multiple reasons for merger and acquisitions in the Indian banking sector and still contained to capture the interest of a research and it simply because of after the strict control regulations had led to a wave of merger and acquisitions in the banking industry and states many reason for merger in the Indian banking sector. While a fragmented Indian banking structure may be very well beneficial to the customer because of competition in banks, but at the same time not to the level of global Banking Industry, and concluded that merger and acquisition was an imperative for the state to create few large banks.

Pramod and Vidyadhar (2007) evaluated the impact of merger on the operating performance of acquiring firms in different industries by using pre and post financial ratio to examine the effect of merger on firms. They selected all mergers involved in public limited and traded companies in India between 1991 and 2003, result suggested that there were little variation in terms of impact as operating performance after mergers. In different industries in India particularly banking and finance industry had a slightly positive impact of profitability on pharmaceutical, textiles and electrical equipments sector and showed the marginal negative impact on operative performance.

Manoj and Jagandeep (2008) studied the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. These mergers were the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank, the ICICI Ltd with the ICICI Bank, the Global Trust Bank merged with the Oriental Bank of commerce and the Bank of Punjab merged with the centurion Bank. The announcement of merger of Bank had positive and significant impact on share holder’s wealth. The effect on both the acquiring and the target banks, the result showed that the agreement with the European and the US banks merger and acquisitions except for the facts the value of share holder of bidder Banks have been destroyed in the US context, the market value of weighted Capital Adequacy Ratio of the combined bank portfolio as a result of merger announcement is 4.29% in a three day period (-1, 1) window and 9.71 % in an Eleven days period (-5, 5) event window.

David, et. al., (2010), analyzed the stock market bubble effect on merger and acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investor take more risk. Merger of banks through consolidation is the significant force of change took place in the Indian Banking sector.

Pankaj and Sushant (2011) studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions(M&As) it came to the point that companies may have been able to leverage the synergies arising out of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency.

Dutta and Dawn (2012) investigated the performance of merged banks in terms of its growth of total assets, profits, revenue, deposits, and number of employees. The performance of merged banks was compared taking four years of prior-merger and four years of post-merger. The study findings indicated that the post-merger periods were successful and saw a significant increase in total assets, profits, revenue, deposits, and in the number of employees of the acquiring firms of the banking industry in India.

Nidhi Tanwar(2013) evaluate the effectiveness of mergers and acquisitions of the CBOP and the HDFC bank Ltd. on 23 May, 2008on the basis of selected variables (like Gross-Profit Margin, Net- Profit Margin, Operating Profit Margin, Return on Capital Employed, Return on Equity and Debt- Equity Ratio) prior & after mergers and acquisitions. The t-test is used for testing the statistical significance and this test is applied to test the effect of merger and acquisitions on the performance of banks. The result of the study indicates that the banks have been positively affected by the event of merger and acquisitions and can also obtain efficiency and gains through merger and acquisitions.

III. Methodology

The financial and accounting data of banks is collected from banks annual reports to examine the impact of merger on financial performance of the banks. The performance of the banks has been evaluated based on the following financial measures:

- Gross Profit Margin = Gross Profit/Sales × 100
- Net Profit Margin = Net Profit/Sales × 100
- Operating Profit Margin = Operating Profit/Sales × 100
- Return on Capital Employed (ROCE) = Net Profit/Total Assets × 100
- Return on Equity (ROE) = Net Profit/Equity Share Holder’s Funds × 100
- Debt Equity Ratio = Total Debt/ Share Holder Equity

In order to analyze the impact of merger, pre and post merger data of the above ratios is considered excluding the year of merger in each case. The pre merger (five years prior) and post merger (after five years) of the financial ratios being compared. In order to examine the difference in financial ratios before and after merger of the banks, the paired t-test has been applied.

IV. Results And Discussion

4.1. Merger of HDFC Bank Ltd. (Acquirer Bank) and Centurian Bank of Punjab (Acquired Bank)

In 1994, as a part liberalization of banking industry by RBI the Housing Development Finance Corporation Limited (HDFC) was the first private bank to receive approval in principle. The bank was incorporated in August 1994 in the name of ‘HDFC Bank Limited’. HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995. The Bank provides a wide range of banking and financial services including commercial banking and treasury operations. The Bank has one overseas wholesale banking branch in Bahrain, a branch in Hong Kong and two representative offices in UAE and Kenya. The Bank has two subsidiary companies, namely HDFC Securities Ltd and HDB Financial Services Ltd. The Bank has three primary business segments, namely banking, wholesale banking and treasury.

The retail banking segment serves retail customers through a branch network and other delivery channels. This segment raises deposits from customers and makes loans and provides other services with the help of specialist product groups to such customers. The wholesale banking segment provides loans, non-fund facilities and transaction services to corporate, public sector units, government bodies, financial institutions and medium-scale enterprises. The treasury segment includes net interest earnings on investments portfolio of the Bank. The Bank’s shares are listed on the Bombay Stock Exchange Limited and The National Stock Exchange of India Ltd. The Bank’s American Depository Shares (ADS) are listed on the New York Stock Exchange (NYSE) and the Bank’s Global Depository Receipts (GDRs) are listed on Luxembourg Stock Exchange.

In the year 1999, the Bank launched online, real-time Net Banking. In February 2000, Times Bank Ltd, owned by Bennett, Coleman & Co. / Times Group amalgamated with the Bank Ltd. This was the first merger of two private banks in India. The Bank was the first Bank to launch an International Debit Card in association with VISA (Visa Electron). In the year 2001, they started their Credit Card business. Also, they became the first private sector bank to be authorized by the Central Bank of Direct Taxes (CBDT) as well as the RBI to accept direct taxes. During the year, the Bank made a strategic tie-up with a Bangalore-based business solutions software developer, Tally Solutions Pvt Ltd for developing and offering products and services facilitating online accounting and banking services to SMEs. During the year 2001-02 the bank was listed on the New York Stock Exchange. Also, they made the alliance with LIC for providing online payment of insurance premium to the customers. During the year 2006-07, they commenced direct lending to SHGs, in Thudiyalur village (Tamil Nadu).

On May 23, 2008, the merger of Centurion Bank of Punjab with HDFC Bank which is considered as one of the biggest merger in domestic banking was formally approved by Reserve Bank of India to complete the statutory and regulatory approval process. The shareholders of Centurion Bank of Punjab received 1 share of HDFC Bank for every 29 shares of CBoP. The merger has been advantageous to HDFC Bank in terms of increased branch network, geographic reach, and customer base, and a bigger pool of skilled manpower (Sai and Sultana, 2013).

4.2. Financial Ratios of HDFC Bank

The various financial ratios of HDFC bank were calculated and the results are presented in Table-1.

<table>
<thead>
<tr>
<th>Financial Ratios</th>
<th>Before Merger</th>
<th>After Merger</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003 (-5)</td>
<td>2004 (-4)</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>78.49</td>
<td>76.52</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>25.74</td>
<td>23.35</td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>52.18</td>
<td>55.35</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>1.34</td>
<td>1.42</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>98.79</td>
<td>158.64</td>
</tr>
<tr>
<td>Debt-Equity Ratio</td>
<td>68.17</td>
<td>95.54</td>
</tr>
</tbody>
</table>
In before merger periods, the Gross Profit Margin and Net Profit Margin show a declining trend. The Return on Equity and Debit-Equity Ratio exhibit an increasing trend. But, Operating Profit Margin and Return on Capital Employed show a mixed trend.

In after merger periods, Gross Profit Margin, Net Profit Margin, Return on Capital Employed, Return on Equity and Debit-Equity Ratio show an increasing trend, but Operating Profit Margin shows a mixed trend.

In order to examine the difference in financial ratios before and after merger of the banks, the mean, standard deviation and t-values are worked out and the results are presented in Table-2.

Table-2. Mean, Standard Deviation and t-Values of Financial Ratios of HDFC Bank Before and After Merger

<table>
<thead>
<tr>
<th>Financial Ratios</th>
<th>Merger</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>t-Value</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
<td>Before</td>
<td>74.05</td>
<td>3.58</td>
<td>75.066</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>77.00</td>
<td>2.58</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>Before</td>
<td>21.33</td>
<td>3.53</td>
<td>15.815</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>19.41</td>
<td>3.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Profit Margin</td>
<td>Before</td>
<td>50.92</td>
<td>3.84</td>
<td>54.473</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>53.55</td>
<td>1.76</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>Before</td>
<td>1.30</td>
<td>0.09</td>
<td>0.919</td>
<td>0.382</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>1.43</td>
<td>0.16</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Equity</td>
<td>Before</td>
<td>221.53</td>
<td>100.89</td>
<td>4.805</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>784.58</td>
<td>193.83</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt-Equity Ratio</td>
<td>Before</td>
<td>142.70</td>
<td>64.70</td>
<td>4.853</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>After</td>
<td>487.13</td>
<td>126.19</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The results show that the mean values of all the ratios except Net Profit Margin are found to be more after merger compared to before merger. This indicates that the financial performance of HDFC bank has improved in terms of Gross Profit Margin, Operating Profit Margin, Return on Capital Employed, Return on Equity and Debit-Equity Ratio in the after merger periods.

The results reveal that the t-values are significant at one per cent level for all the financial ratios except Return on Capital Employed. It shows that there is a significant difference in Gross Profit Margin, Net Profit Margin, Operating Profit Margin, Return on Equity and Debt-Equity Ratio between before and after merger.

V. Conclusion

Merger is a highly useful tool for growth and expansion in banks. Mergers in banking sector are a form of horizontal merger because the merging entities are involved in the same kind of activity. By the way of mergers and acquisitions in the banking sector, the banks can achieve significant growth in their operations, minimize their expenses to a considerable extent and also competition is reduced because merger eliminates competitors from the banking industry. The analysis of before and after merger of Centurion Bank of Punjab with HDFC bank indicates that after merger, Gross Profit Margin, Net Profit Margin, Return on Capital Employed, Return on Equity and Debit-Equity Ratio shows an increasing trend, but Operating Profit Margin shows a mixed trend. The results also show that there is a significant difference in Gross Profit Margin, Net Profit Margin, Operating Profit Margin, Return on Equity and Debt-Equity Ratio between before and after merger. It is concluded that the financial performance of bank has increased after merger.

References


DOI: 10.9790/0837-20562831  www.iosrjournals.org 31 | Page