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Merger and Acquisitions in Banking Industry: A Case Study of HDFC & Centurion Bank of Punjab

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Abstract:

The Indian Banking industry has been undergoing rapid changes reflecting a number of economic changes. Liberalization and deregulation witnessed in the Indian markets in the 1990s have resulted in a spurt in banking activity in India. The world of competition is like a jungle where monsters gobble smaller ones therefore one has to be competent enough to win the opposition. There are evidences that large enterprises have merged smaller competitors in themselves. This review article on mergers in banking industry has been ignited from the case of the HDFC Bank and Centurion Bank of Punjab. The aim of this paper is to explore the motives of banks for mergers and acquisition with reference to Indian Banking Industry. This article is divided into three parts. The first part includes introduction and theoretical structure of mergers and acquisition. The second part discusses the review of literature and followed by historical background of Bank. The third part discusses analysis in pre and post merger in HDFC Bank. The fourth part discusses the conclusion. This article leaves footprints on the way of further studies on mergers and acquisitions from a different outlook.

Keywords: Mergers and Acquisitions, Indian Banking Industry, Motives

1. INTRODUCTION:

The banking sector which plays a very imperative role in the economic development of India has been witnessing tremendous change. The various players in the banking arena have already begun to feel the heat of the extreme competition merger and acquisition is one among the various modes of restructuring restored by banks to ensure a better growth prospect. Remaining small may be beautiful but becoming big would make you powerful is the underlying principle behind the Merger & Acquisition business strategy. Every business strives for survival in this growing era of core competence. It is here merger and acquisition is looked upon as an immediate mode for external growth. This phenomena has been prevailing both in the developed and developing economies. It is believed that by undergoing such merger and acquisition deals banks will enable them to emerge stronger, increase their earning capacity and strengthen their capital base.

The banking sector has seen a tremendous change in the post liberalization era i.e. in the early 1991; the then Narasimha Rao government embarked the policy of liberalization. Licences were given to small number of private banks like Global Trust Bank, which later merged with Oriental Bank of Commerce, Axis Bank (earlier UTI Bank), ICICI Bank and HDFC Bank. This move had improved the growth in Indian Banking.

Indian banking sector has witnessed two types of mergers- forced and voluntary mergers. In the first type that is forced merger the major objective is to defend the interest of depositors of the weak bank. The second type of mergers is voluntary merger which is done with the motive of increasing size, diversification of portfolio and spreading the geographical and functional reach. In all these cases the acquirer banks have gained the advantage of branch network and customer clientele of the acquired bank.

When two or more companies combines together to form a single entity, it is known as merger. The merger happens when the acquiring company buys the part of the stock or the complete stock of the target company.

For example: HDFC bank and Centurion bank of Punjab merger that happened in 2008. HDFC bank was the acquiring company and Centurion bank was the target company.

2. REVIEW OF LITERATURE:

Schuler and Jackson (2001) proposed a three-stage model of mergers and acquisitions that systematically identified several human resources issues and activities. Numerous examples were offered to illustrate the issues and activities in each of the three stages. The article concluded with a description of the role and importance of the HR department and leader has its presence in business environment, in order to get competitive advantage the acquirer must consider the HR perspective to bring effectiveness in a deal of a merger.

Sergio & Olalla (2008) finds that financial deregulation and technological progress has an important role in the process of mergers and acquisitions in the banking sector during the period 1995-2001. They used Multinomial logit analysis to conclude the characteristics of continental European financial institutions and observed that size is an important factor in mergers and acquisitions.

DeYoung, Evanoff & Molyneux (2009) have found in their study that the changes in deregulation, allowed commercial banks and other financial services firms to expand through mergers and acquisition into geographic markets and product markets.

Cartwright and Schoenberg (2006) assessed three primary streams of enquiry within the strategic and behavioural literature. They studied the issues of strategic fit, organizational fit, and the acquisition process itself. They briefly reviewed the recent achievements within each of these research streams. However, in parallel to these research advances, the failure rates of mergers and acquisitions have remained consistently high.

3. METHODS OF ACQUISSITION:

An acquisition may be affected by i) Agreement with the persons holding majority interest in the company management like members of the board or major shareholders commanding majority of voting power; ii) Purchase of shares in open market; iii) To make takeover offer to the general body of shareholders; iv) Purchase of new shares by private treaty; v) Acquisition of share capital through the following forms of considerations viz. Means of cash, issuance of loan capital, or insurance of share capital.

4. HISTORICAL BACKGROUND:

HDFC BANK:

The Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector, as part of the RBI's liberalisation of the Indian Banking Industry in 1994. The bank was incorporated in August 1994 in the name of 'HDFC Bank Limited', with its registered office in Mumbai, India. HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995. Currently it has a nationwide network of 2,544 Branches and 8,913ATM's in 1399 Indian town and cities. In a milestone transaction in the Indian banking industry, Times Bank Limited (another new private sector bank promoted by Bennett, Coleman & Co. /Times Group) was merged with HDFC Bank Ltd., effective February 26, 2000. As per the scheme of amalgamation approved by the shareholders of both banks and the Reserve Bank of India, shareholders of

Times Bank received 1 share of HDFC Bank for every 5.75 shares of Times Bank

CENTURION BANK:

1994 Centurion Bank was incorporated on 30 June 1994 and received its certificate of Commencement of Business on 20 July. It was a joint venture between 20th Century Finance Corporation and its associates and Keppel Group of Singapore through Kephinance Investment (Mauritius). Centurion had a network of ten branches, which grew to 29 branches the next year. 1995 Centurion Bank amalgamated 20th Century Finance Corporation. 2005 On 29 June 2005, the Boards of Directors of Centurion Bank and Bank of Punjab agreed to a merger of the two banks. The combined bank took as its name Centurion Bank of Punjab. Bank of Punjab had been founded in 1995. 2006 Centurion Bank of Punjab acquired Kochi-based Lord Krishna Bank. Lord Krishna Bank had been established at Kodungallur in Thrissur District, Kerala in 1940. During the 1960s, Lord Krishna acquired three commercial banks: Thiyya Bank, Josna Bank and Kerala Union Bank. The Centurion Bank of Punjab (formerly Centurion Bank) was an Indian private sector bank that provided retail and corporate banking services. It operated on a strong nationwide franchise of 403 branches and 452 ATMs 180 Locations. 2008 HDFC Bank acquired Centurion Bank of Punjab.

- ✓ HDFC Bank, Centurion boards approved 1:29 share swap ratio - Mumbai, Feb. 25 2008
- ✓ Centurion Bank shareholders had got one share of HDFC Bank for every 29 shares held by them.
- ✓ The merger created an entity with an asset of Rs. 1,09,718 Crore (7th largest in India)

5. BENEFITS OF MERGER:

- ✓ Sick banks survived after merger.
- ✓ Enhanced branch network geographically.
- ✓ Larger customer base (rural reach).
- ✓ Increased market share.
- ✓ Attainment of infrastructure.

6. MOTIVES OF MERGER:

Mergers and acquisitions are tactical decisions leading to the maximization of a company's growth by enhancing its production and marketing operations. A number of motives are endorsed for the occurrence of mergers and acquisitions.

Accelerated Growth: A company may expand and/or diversify its markets internally or externally. If the company cannot grow internally due to lack of physical and managerial resources, it can grow externally by combining its operations with other companies through mergers and acquisitions. Mergers and acquisitions may help to accelerate the pace of a company's growth in a convenient and inexpensive manner.

Increased Market power: A merger can increase the market share of the merged firm. The increased concentration or market share improves the profitability of the firm due to economies of scale. The bargaining power of the firm with labour, suppliers and buyers is also enhanced. The merged firm can also exploit technological breakthroughs against obsolescence and price wars.

Increased managerial skills: A firm will have good potential that it finds itself unable to develop fully because of deficiencies in certain areas of management or an absence of needed product or production technology. If the firm can not hire the management or develop the technology it needs, it might combine with a compatible firm that has the needed managerial personnel or technical expertise.

Early entry and market penetration: An early mover strategy can reduce the lead time taken in establishing the facilities and distribution channels. So, acquiring companies with good manufacturing and distribution network or few brands of a company gives the advantage of rapid market share.

Reduction in tax liability: Under Income Tax Act, there is a provision for set-off and carry forward of losses against its future earnings for calculating its tax liability. A loss making or sick company may not be in a position to earn sufficient profits in future to take advantage of the carry forward provision. If it combines with a profitable company, the combined company can utilize the carry forward loss and save taxes with the approval of government.

7. ANALYSIS:

A. Management Capability: The measurement of management capability is a qualitative and subjective perception. The management capability is précised with ratios given below:

Credit Deposit Ratio: This ratio indicates the total advances as a proportion of total deposits. It shows the management's aggressiveness to improve income by higher lending operations. It indicates the deployment of bank resources by way of loans and advances. In HDFC Bank pre-merger period, credit-deposit ratio was 68.74 percent in 2006-07 which declined to 62.94 percent in 2007-08. Credit Deposit Ratio increased to 69.24 percent in base period. In post-merger period, credit deposit ratio increased to 75.17 percent in 2009-10 which further increased to 76.69 percent in 2010-11. Average of credit deposit ratio is 70.56 percent

Profit per Employee*:* Net Profit implies the balance of profit as per profit and loss account. This ratio shows net profits earned per employee. Higher value of this ratio indicates better productivity per employee of a bank and lower value of this ratio indicates lower productivity per employee of a bank. In HDFC bank profit per employee in pre-merger period is Rs. 6.13 lacs in 2006-07 which declined to Rs.4.97 lacs in 2007-08. In base period profit per employee was Rs. 4.18 lacs. In post-merger period increased to Rs. 5.98 lacs in 2009-10 and which further increased to Rs.7.37 lacs in 2010-11. This indicates better productivity per employee in post-merger period as compared to pre-merger period. Average of profit per employee is Rs. 5.726 lacs.

(Source: Annual Report of HDFC Bank, Various Issues and articles)

B. Asset Quality*:* Asset Quality is another significant feature of the evaluation of bank's performance. The main motive in measuring asset quality is to determine the proportion of non-performing assets as a percentage of the total assets. Following ratios are intended in order to determine asset quality of the bank.

Net NPAs as percentage of Net Advances: - The Net NPA levels help us to know the efficiency of Credit Risk Management system of the bank. In HDFC Bank in premerger period, Net NPAs as percent of Net Advances increased from 0.43 percent in 2006-07 to 0.47 percent in 2007-08. It further increased to 0.63 percent in base period. In post-merger period, it declined to 0.31 percent in 2009-10 to 0.19 percent in 2010-11. This shows that proportion of NPAs declined in post-merger period as compared to pre-merger period. This indicates favourable sign of improvement in asset quality. Average of Net NPAs as percent of Net Advances is 0.41 percent.

Priority Sector Advances as a percentage of Total Advance: The formal definition of 'Priority Sector' came into existence in 1972 when retail trade, small business, professional and self employed persons and education loans were also declared as priority sector in addition to Small Scale Industries, agriculture and allied agricultural activities and transport operators. The bank has been all along making sincere efforts to achieve the benchmark for priority sector advances. In HDFC Bank in pre-merger period, this ratio declined from 37.67 percent in 2006-07 to 27.47 percent in 2007-08. In base period, it was 30.12 percent and which in post-merger period increase to 35.09 percent in 2009-10 which declined to 34.24 percent in 2010-11. In both pre-merger and post-merger period, the bank is unable to achieve the RBI target of 40 percent. Average of priority sector advances as percent to total advances is 32.92 percent and the ratio shows fair level of consistency over a period of 5 years.

(Source: Annual Report of HDFC Bank, Various Issues and articles)

C. Earning Quality: Earning is one of the conventional indicators of measuring financial performance of bank.

Operating Income as a percentage of Working Funds*:* This is arrived at by dividing the operating profit by average working funds. Working Funds is the daily average of the total assets during the year which indicate how much operating income is generated from average working funds. Higher ratio indicates good performance of bank. In HDFC Bank in pre-merger period, this ratio increased from 2.98 percent in 2006- 07 to 3.13 percent in 2007-08. It declined to 2.94 in the base period. In post-merger period, it further increased to 3.33 percent in 2009-10 and declined to 3.12 percent in post-merger period. Performance of HDFC Bank in terms of operating profit as percent of working funds is to some extent same in pre-merger and post-merger period. Average of this ratio is 3.1 percent.

(Source: Annual Report of HDFC Bank, Various Issues and articles)

CONCLUSION:

Indian economy has witnessed fast pace of growth post liberalization era and banking is one of them. Merger in banking sector has provided evidences that it is the useful tool for survival of weak banks by merging into larger bank. It is found in our study that small and local banks face difficulty in bearing the impact of global economy therefore, they need support and it is one of the reasons for merger. Some private banks used mergers as a strategic tool for expanding their horizons. There is huge potential in rural markets of India, which is not yet explored by the major banks. Thus, as per the above debate we can say that Mergers and acquisitions (M&As) are considered as corporate events which helps an organization to create synergy and give sustainable competitive advantage, but, simultaneous these sorts of corporate events have the potential to create severe personal disturbance and stress which can result in psychological, behavioural, health, performance, and survival problems for both the individuals and companies. The post-merger integration process is a difficult and complex task. It comes along with long lists of activities and tasks that have to be fulfilled within a short time and partly with incomplete information (e.g. formation of new teams and departments). There are many opportunities to exploit and many decisions to take. The present study concluded that financial performance of HDFC Bank improved in post merger Period. Merger has significant impact on the financial performance of HDFC Bank. Merger of CBOP and HDFC Bank highlights the fact that two successful banks merged to form the strong entity that could match Public sector banks in size and strength.

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