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An Analysis of Pre and Post Merger Financial Performance: A study of J&K Grameen Bank

Khurshid Ali
Assistant Professor,
The Business School,
University of Kashmir,
Srinagar

Irshad Ahmad Malik
Assistant Professor,
The Business School,
University of Kashmir,
Srinagar

Khalid Ashraf Chisti
Assistant Professor,
Deptt. of Business and Financial Studies,
University of Kashmir,
Srinagar

Abstract

This study is an attempt to examine the impact of mergers on the financial performance of the merging company. In order to achieve the objective of the study, the researchers have used secondary data and the reference period is of 08 years (Eight Years) which is further divided into two sub-periods such as pre-merger period and post-merger period. The researchers have employed CAMEL Model to find out how well the sample bank has performed during the post-merger period as compared to pre-merger period. The findings of the study affirm statistically significant improvement in most of the ratios which establish that the decision of merger has proven fruitful. The findings of the study corroborates with the findings of Pardeep Kour and Gian Kour (2010), Mantravibi and Reddy (2008), Okpanachi Jashua (2010), Vennet (1996), etc.

Keywords: Mergers, Acquisitions, Capital Adequacy, Liquidity, Profitability.

Introduction

The economies throughout the world are undergoing dramatic transformation, never ever, experienced before and in this process of transformation, banking industry has assumed pivotal place in the growth of every economy, therefore, banks are also not only focusing on organic growth strategies but they also bait for inorganic growth opportunities. This hunt for inorganic growth has become order of the present corporate environment. The increase in the number of mergers and acquisitions all over the world stands witness to this transforming corporate environment.

The importance of the rural banking in the economic development of a country cannot be overlooked. As Gandhiji said "Real India lies in Villages," Therefore, village economy is the backbone of Indian economy. Without the upliftment of the rural economy as well as the rural people of our country the objectives of economic planning cannot be achieved. In fact, the real growth of Indian economy lied in the freeing of rural masses from acute poverty, unemployment, and socio-economic backwardness.

Regional Rural Banks (RRBs) are oriented towards meeting the needs of the weaker sections of the rural population consisting of

Small and marginal farmers, Agricultural labourers, Artisans, Small entrepreneurs

Recapitalization of Regional Rural Banks

Subsequent to review of the financial status of RRBs by the Union Finance Minister in August, 2009, it was felt that a large number of RRBs had a low Capital to Risk weighted Assets Ratio. A committee was, therefore, constituted in September, 2009 under the Chairmanship of K. C. Chakrabarty, Deputy Governor, RBI to analyse the financials of the RRBs and to suggest measures including re-capitalisation to bring the Capital to Risk weighted Assets Ratio of RRBs to at least 9% in a sustainable manner by 2012. The Committee submitted its report in May, 2010.

The Chakrabarty Committee reviewed the financial position of all RRBs in 2010 and recommended for recapitalisation of 40 out of 82 RRBs for strengthening their CRAR to the level of 9%. According to the Committee, the remaining RRBs are in a position to achieve the desired level of CRAR on their own. Accepting the recommendations of the committee, the GOI along with other shareholders decided to recapitalise the RRBs by infusing funds to the extent of 2,200 crore.

In the globalized economy, Merger and Acquisitions acts as an important tool for the growth and expansion of the economy. The main motive behind the Merger and Acquisitions is to create synergy, that is one plus one is more than two and this rationale beguiles the companies for merger at the tough times. Banking Sector are using Merger and

Acquisitions world wide as a strategy for achieving larger size, increased market share, faster growth and synergy for becoming more competitive through economies of scale. In India the department of financial services has asked Regional Rural Banks operating in the same geographies to merge with a single sponsoring bank for better use of the latest technology and other resources, as well as to expedite the implementation of the financial inclusion programme. The GOI initiated a process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a State, with a view to provide better customer service by having better infrastructure, computerization, experienced work force, common publicity and marketing efforts etc. The amalgamated RRBs also benefit from larger area of operation, enhanced credit exposure limits for high value and diverse banking activities. As a result of the amalgamation, the number of the RRBs has been reduced from 196 to 82 as on 31 March 2011. The number of branches of RRBs increased to 16001 as on 31 March 2011 covering 620 districts throughout the country. In a bid to optimize the efficiency of regional rural banks, the Centre is making efforts to further lower their number to 44 from the current level of 67 by amalgamating them on the basis of geographic contiguity. The aim is to have just eight RRBs in the country by 2030.

Review of Literature

A lot of research has been undertaken throughout the world regarding the impact of mergers and acquisitions. However, in this study, review of some of the major studies has been conducted so as to assess the implications of the mergers and acquisitions and develop an understanding about the research area. The review of such studies has been given below.

Pardeep Kour and Gian Kour (2010) undertook a study relating to the impact of mergers and acquisitions on the cost efficiency of Indian commercial banks and the findings of the study indicated that mergers lead to higher levels of cost efficiency. Okpanachi Jashua (2010) made an analysis regarding mergers and acquisitions impact on financial efficiency of banks and the results confirm enhancement in the financial performance leads to improved financial efficiency. Mohammad Irfan Shakoor et.al. (2014) in their study concluded that profitability ratios, solvency ratios and investment ratios witness unfavourable trajectory.

Resti (1998) in his study concluded that after merger the company's efficiency increases as they get into extensive format of operations due to large size. Mantravibi and Reddy (2008) affirmed in their study that mergers and acquisitions especially in banks enhance the cost efficiency due to which profits also moved in upward trajectory. Ochiang (2006) in his study came up with the findings confirming a pessimistic relationship with returns and cost efficiency. Korir (2006) conducted a study on the companies listed on New York Stock Exchange and results put forth by the study affirmed that mergers and acquisitions have significant impact on profitability.

Kuriakose Sang et.al. (2009) undertook a study on the valuation practices and adequacy of swap ratio fixed in voluntary amalgamation and concluded that in most cases the fixed swap ratio is not justified to their financials. Akhavein et.al. (1997) analysed the change in profitability. They found that banking organizations significantly witnessed an improvement in profitability after merger. Cornet and Tehranian (1992) came up with the witness through their study that post-merger period is better than pre-merger period for enhanced ability to attract loans, increased employee productivity and ne asset growth. Vennet (1996) conducted a study to investigate that impact of mergers on the efficiency of European Union banking industry by using some key financial ratios and the results put forth by the study confirmed that mergers improve the efficiency of participating banks.

Yener and David (2004) concluded in his study that mergers and acquisitions plaed an important role in improving after merger financial performance which is a stimulus for efficiency. Joseph et.al. (2012) in their study on came up with the findings, affirming that mergers and acquisitions have beneficial impact on the performance and profitability of the sample banks. Jagdish and Raiyani (2010) undertook the study so as to investigate the pre and post-merger performance and the study confirmed positive relationship between mergers and financial performance. However, it was found that the performance of the private sector banks was much better as compared to public sector banks.

Objectives of the study

To undertake a comparative analysis of financial performance of the sample bank during pre and post-merger period.

Data-Base and Methodology

In order to achieve the objective of the study, the researchers have used only secondary data which has been collected through secondary sources like Corporate Head Office of J&K Bank, sponsor bank of J&K Grameen Bank, Regional Office of J&K Grameen Bank. Periodic Publications, Annual Reports of J&K Grameen Bank, Jammu Rural Bank and Kamraz Rural Bank. The other sources include official websites of Reserve Bank of India, J&K Grameen Bank and NABARD are also used. The researchers have employed CAMEL Model for the purpose of attainment of study objectives.

Data Analysis and Interpretation

Capital Adequacy Ratio
Table A:1

Pre-Merger period			Post-Merger Period		
Particulars	**Average**	**Std. Deviation**	**Particulars**	**Average**	**Std. Deviation**
Debt Equity Ratio	54%	0.119	Debt Equity Ratio	129.70%	0.327
Advances to Assets Ratio	24%	0.028	Advances to Assets Ratio	27.75%	0.030
Govt. Securities to Total Investment Ratio	82.56%	0.025	Govt. Securities to Total Investment Ratio	89.48%	0.047
Credit Deposit Ratio	28.11%	0.037	Credit Deposit Ratio	32.67%	0.034

The table A: 1 depicts the performance of pre-merger and post-merger period, regarding the capital adequacy of the sample bank. The comparison between the two periods reveals significant improvement in the debt equity ratio which stands at 1.29 against 0.54 during the pre-merger period. However, the post-merger period has witnessed higher levels of standard deviation. The advance to assets ratio also shows some improvement but slight increase in standard deviation. The government securities to total investment ratio moves from 82.56% to 89.48% and credit deposit ratio also witness an increase of 8.38% and 16.22%. However, both ratios witnessed increase in volatility. The overall performance in terms of capital adequacy ratio is more than satisfactory, even though, there is slight increase in the volatility in all ratios except credit deposit ratio.

Asset Quality Table A: 2

Pre-Merger period			Post-Merger Period		
Particulars	**Average**	**Std. Deviation**	**Particulars**	**Average**	**Std. Deviation**
Total Investment to Total Asset Ratio	24.55%	0.024	Total Investment to Total Asset Ratio	21.13%	0.011
Return on Assets Ratio	0.02%	0.002	Return on Assets Ratio	0.41	0.001

The table A:2 The performance of assets quality ratios is quite a mixed bag as total investment to total assets ratio has taken a hit of 13.93%, however, on the other hand, the level of volatility has significantly come down. Return on assets ratio has made a significant improvement and the level of volatility has come down which indicates that return on assets has performed far better during the post-merger period.

Management Quality Table A: 3

Pre-Merger period			Post-Merger Period		
Particulars	**Average**	**Std. Deviation**	**Particulars**	**Average**	**Std. Deviation**
Total advances to total deposit	0.280%	0.046	Total advances to total deposit	0.326	0.034
Profits per employee	6.628%	32.546	Profits for employer	96.250	29.766
Business per employee	17159.25	4948.62	Business per employer	26091.11	4740.33
Return to equity	0.003	0.024	Return to equity	0.082	0.021

The management quality ratios indicate significant improvement in the efficiency of the management which is reflected in the above table, wherein, total advance ratio has moved up from an average of 0.280% to 0.326%, besides, the level of volatility has also decreased. The profit per employee has improved many a folds in the post-merger period compared to pre-merger period. Besides, business per employee and return to equity has also shown upward trend. Thus, the overall ratios have shown tremendous improvement in the quality of the management.

Earning Quality Table A:4

Pre-Merger period			Post-Merger Period		
Particulars	**Average**	**Std. Deviation**	**Particulars**	**Average**	**Std. Deviation**
Operating profits to total assets ratio	0.30	0.004	Operating profits to total assets ratio	0.55	0.003
Net profits to total assets ratio	0.02	0.002	Net profits to total assets ratio	0.41	0.000
Interest income to total income ratio	97.64	0.003	Interest income to total income ratio	96.88	0.018
Spread or NIM to total assets	2.23	0.009	Spread or NIM to total assets	2.98	0.002

From the table A:4 It is evident that the earning quality has improved as the operating profits to total assets ratio has followed an upward trajectory along with the net profit to total assets ratio, besides, the level of volatility of both the ratios has come down as well. However, the interest income to total income ratio has witnessed slight decrease compared to pre-merger period. But NIM ratio has registered an increase by 34% and level of volatility has also decreased.

Liquidity Table A:5

Pre-Merger period			Post-Merger Period		
Particulars	**Average**	**Std. Deviation**	**Particulars**	**Average**	**Std. Deviation**
Liquid assets to total assets ratio	46.07	0.014	Liquid assets to total assets ratio	45.90	0.019
Liquid assets to total deposits ratio	53.87	0.020	Liquid assets to total deposits ratio	54.10	0.026
Liquid assets to demand deposits ratio	102.67	0.071	Liquid assets to demand deposits ratio	102.41	0.060
Approved securities to total assets ratio	21.50	0.015	Approved securities to total assets ratio	19.26	0.006
Return on assets	0.02	0.002	Return on assets	0.41	0.001

The table A: 3 represent the liquidity position of the pre and post-merger period and it can be seen that the liquidity to total assets ratio has not undergone any significant change and same is the case in liquid assets to total deposit ratio. However, in case of both the ratios, the level of volatility has shown increase. The liquid assets to demand deposit ratio witnessed slight downward trend and approved securities to total assets ratio also comes down by 10.41%. However, the level of volatility has improved significantly. The return on assets ratio has transformed significantly and the volatility has also come down.

Conclusion

After undertaking the analysis of financial performance of the sample banks through CAMEL Model, the findings affirm significant improvement throughout the post-merger period compared to pre-merger period. The overall results regarding capital adequacy are quite encouraging as all the ratios recorded more than satisfactory performance, however, there is a slight increase in the level of volatility which is quite insignificant. The asset quality ratios have provided a mixed response during the post-merger period but the level of volatility has come down significantly.

In case of management Quality ratios, there is a tremendous improvement in all the ratios both in terms of numbers and stability as all the ratios have put forward tremendous numbers throughout the post-merger period. On the other hand, the earning quality has also followed an upward trajectory, performing well compared to pre-merger period. However, the performance on the liquidity front has remained almost the same.

Thus, on the basis of the above analysis, it can be concluded that the decision of merger has proved fruitful as most of the indicators have significantly improved during the post-merger period and only liquidity ratios has remained same. The overall results confirm the fruitfulness of merger for the sample banks. The findings of the study corroborates with the findings of Pardeep Kour and Gian Kour (2010), Mantravibi and Reddy (2008), Okpanachi Jashua (2010), Vennet (1996), etc.

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