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A Study on the Effect of Merger on the Performance of Oriental Bank of Commerce Using Accounting Ratios

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ABSTRACT

The financial services industry, particularly the banking industry, has undergone significant transformation all over the world since the early 1980s under the impact of technological advances, deregulation and globalisation. An important aspect of this process has been consolidation as a large number of banks have been merged, amalgamated or restructured. In this paper an attempt has been made to analyse the efficiency and performance of Oriental Bank of , before and after the merger with Global Trust Bank.

KEYWORDS: Mergers and acquisitions, globalisation, banking sector

INTRODUCTION :

Mergers and acquisition (M & A) can generally be defined as activities involving takeovers, corporate restructuring, corporate control as well as changes in the ownership structure of firms in any industry. The key driving force for merger activity is severe competition among firms of the same industry which puts focus on economies of scale, cost efficiency, and profitability along with technological change and deregulation. The financial services industry, particularly the banking industry, has undergone significant transformation all over the world since the early 1980s under the impact of technological advances, deregulation and globalisation. An important aspect of this process has been consolidation as a large number of banks have been merged, amalgamated or restructured which is evident in India also.

In this paper an attempt has been made to analyse the performance of Oriental Bank of Commerce, before and after the merger with Global Trust Bank.

Hypothesis :

The study seeks to test the following hypothesis:

Null Hypothesis H0 : There is no significant difference in the performance of Oriental Bank of Commerce pre and post merger with Global Trust Bank.

Alternative Hypothesis H1 : There is significant difference in the performance of Oriental Bank of Commerce pre and post merger with Global Trust Bank.

Literature Review :

The pace of bank mergers and acquisitions is increasing all over the world and it has given rise to an extensive economic research. Berger et.al (1999) provided a comprehensive review of studies evaluating mergers and acquisitions in banking industry. According to Amel (2002), between 1990 and 2001, more than 8000 bank consolidations has occurred globally. It has been argued that the rationale for consolidation of banking institutions through mergers and acquisitions is to improve cost and revenue efficiency that will in turn improve profitability, safety and soundness of these institutions (Berger, Hunter and Timme (1993)). Shanmugam (2003) described merger as a necessary pre-condition to create strong, efficient and competitive banking systems. Factors such as globalization, liberalization and information technology developments have contributed to the need for a more competitive, resilent and robust financial systems.

Guru, Avari and Balachandran (2003) the implicit assumption made at the outset is that banks would consider merging with other banks only if there are gains to be made. To this extent, there are two possible reasons for mergers even in an intra industry merger exercise such as bank mergers, namely (Joskow,1994) (a) to strengthen their industry positioning by expanding services offered and hence diversifying risk ; (b) to gain synergies related to economies of scale and X- efficiencies.

Hannan and Rhoades (1987), Moore (1997) and Wheelock and Wilson (2000) find that banks with low capital are relatively more attractive as acquisition targets. Allen and Boobai- Batchelor (2003) concluded that the banks that are consistently under performing are likely to become take over targets if potential acquiring banks can identify synergies that can lead to increased savings and efficiencies Vennet (1996) studied the impact of mergers on the efficiency of European Union banking industry by using some key financial ratios and stochastic frontier analysis for the period 1988-93 and found that merger improve the efficiency of participating banks. Akhavein et.al (1997) examined the price and efficiency effect of mega mergers on US banking industry and found that after merger banks have experienced higher level of profit efficiency than before merger. Gourlay et al. (2006) analyzed the efficiency gains from mergers among Indian banks over the period 1991-92 to 2004-05 and observed that the merger led to improvement of efficiency for the merging banks.

Data Source :

The information and data for the research was mainly collected from the Annual Reports of the respective banks i.e. Oriental Bank of Commerce and Global Trust Bank.

Tools used :

In order to examine the impact of merger on the performance of Oriental Bank of Commerce with Global Trust Bank, accounting ratios is being used.

Merger of Oriental Bank of Commerce with Global Trust Bank – A Study using Accounting Ratios Though Global Trust Bank started well, there seemed to be a lot of trouble behind the scenes which resulted in its merger with Oriental Bank of Commerce on 14th August, 2004.

The evaluation of the impact of mergers on the performance of Oriental Bank of Commerce in the post merger period has been undertaken on the basis of two types of performance measures, namely

1. Balance Sheet comparison and
2. Profitability and Efficiency comparison.

All ratios were analyzed for two years preceding the year of the merger and six years after the merger because the efficiency and profitability gains of merger should be realized within six years time frame.

While performing balance sheet comparisons, the variables on both liability as well as assets side have been analyzed. On the liability side, the ratio of time and saving deposits to total deposits has been analyzed to examine the availability of long term funds with the banks. Also, credit to deposit ratio has been analyzed to examine the credit creation ability of the banks. On the asset side, the major asset categories that have been examined included bank's holding of advances, government securities, and cash and bank balances. The ratio of advances to total assets, and the ratio of cash and bank balance to total assets have been analyzed to examine the areas where the banks are employing the funds raised through various sources. The balance sheet ratios were valuable because they were indicative of whether there had been basic balance sheet changes from the pre- to post-merger period that might be associated with and therefore help explain any observed performance change, rather than the changes being the result of the merger per se.

Similarly, the impact of mergers on earnings, expenditure as well as overall profitability of the merging banks have been examined to know whether mergers have added value to the overall profitability of the merging banks by reducing the expenditures and increasing the revenues. For this purpose various profitability ratios such as total interest earned to total assets ratio, interest earned on advances to total asset ratio and fee based income to total asset ratio have been analyzed. Similarly, the ratio of operating expenses to total assets has been analyzed to examine the impact of merger on the efficiency of the merged banks. Also the ratios of total interest expended to total assets; and interest on time and saving deposits to total assets have been analyzed. In order to know the impact of bank mergers on the overall profitability, the Return on Assets (ROA) and Return on Net Worth ratio (RONW) have been analyzed.

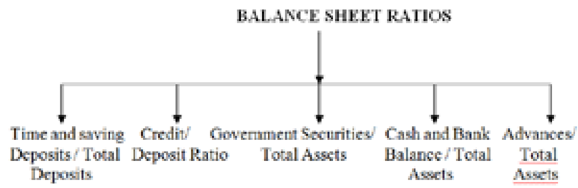

Figure 1

Table 1 :

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Time & Saving Deposits / Total Deposits	0.92	0.91	0.91	0.91	0.90	0.90	0.90	0.92	0.92
Credit / Deposit Ratio	49.70	52.59	55.17	52.87	66.89	68.97	70.09	69.64	69.43
Government Securities / Total Assets	0.27	0.30	0.30	0.27	0.23	0.22	0.23	0.22	0.24
Government Securities / Total Assets	0.27	0.30	0.30	0.27	0.23	0.22	0.23	0.22	0.24
Advances / Total Assets	0.43	0.46	0.48	0.47	0.57	0.60	0.60	0.61	0.61

From the above ratios we find that the ratio of Time and Saving Deposits / Total Deposits has decreased marginally in the post merger period. At the same time the Credit / Deposit ratio has increased in the post merger period implying that in the post merger period , lesser funds have been raised in the form of time and savings deposits, but they have served better the needs of the customers by advancing more loans from existing funds. The ratio of Government Securities to Total Assets has decreased implying that in the post merger period they have invested less funds in the government securities. The ratio of cash and bank balance to Total Assets have made a mild improvement, but the ratio of Advances to Total Assets has increased from. It implies the presence of low cost funds in the form of time and savings deposits in the portfolio of Oriental Bank of Commerce, enabling it to advance more loans to their customers which improved their credit creation capacity as depicted in the improved credit deposit ratio.

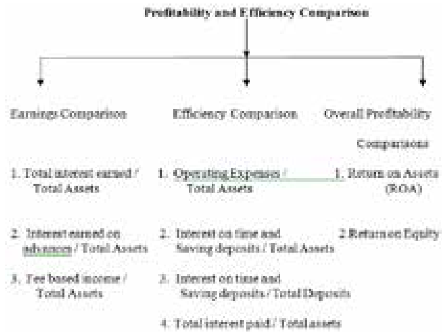

Figure 2 :

Table 1 :

FARNINGS RATIOS	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Interest earned / Total Assets	10.25	9.95	8.80	7.51	7.29	7.77	8.29	8.71	8.21
Interest Earned on Advances / Total Assets	0.04	0.05	0.04	0.03	0.04	0.04	0.05	0.06	0.06
Fee Based Income / Total Assets	1.60	1.63	1.92	1.06	0.98	0.91	0.76	1.05	0.96
EFFICIENCY RATIOS	2002	2003	2004	2005	2006	2007	2008	2009	2010
Operating Expenses / Total Assets	0.016	0.017	0.016	0.015	0.016	0.013	0.012	0.012	0.012
Interest on Time and Saving Deposits / Total Assets	0.063	0.060	0.044	0.036	0.041	0.045	0.054	0.058	0.051
Interest on Time and Saving Deposits / Total Deposits	0.071	0.060	0.050	0.041	0.048	0.052	0.063	0.066	0.058
Total Interest Paid / Total Assets	0.064	0.061	0.045	0.038	0.043	0.047	0.057	0.061	0.053
PROFITABILITY RATIOS	2002	2003	2004	2005	2006	2007	2008	2009	2010
Return on Assets	1.00	1.30	1.70	1.40	1.39	1.21	1.02	0.88	0.91
Return on Equity	20.23	24.51	28.67	25.34	13.11	10.78	6.21	13.74	14.51

The ratio of Total Interest earned / Total Assets and Fee Based Income / Total Assets depicts a declining trend post merger. The Interest Earned on Advances / Total Assets ratio has remained constant pre and post merger. The ratio, of operating expenses to total assets, Total Interest Expenditure to Total Asset, interest on time and saving deposit to total asset and interest on time and saving deposits to total deposits which measures the change in efficiency has decreased in the post merger period showing that Oriental Bank of Commerce have made a mild contribution towards reduction of overall interest expenditure burden. The ratios depicting overall profitability have also declined post merger.

CONCLUSIONS

he study attempts to determine whether horizontal bank mergers result in efficiency improvements relative to other firms. The study reflects that the merger of sick banks with the healthy banks for the purpose of rehabilitation do not bring about any significant improvement , instead they burden the acquiring banks by way of creating mounting non-performing assets, negative net worth and negative profitability as is evident in the merger of Oriental Bank of Commerce with Global Trust Bank.

BALANCE SHEET RATIOS Time and saving Credit/ Government Securities/ Cash and Bank Advances/Deposits / Total Deposit Ratio Total Assets Balance / Total Total Deposits Assets Assets

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