Market-driven Indian Bank Merger Announcements and Stock Returns

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Abstract---The Government of India, Reserve Bank of India and bank managers, in general, favour bank consolidation for various reasons. They support consolidation to create a few large global banks, to achieve rapid growth and to gain from economies of scale and scope. However, international studies and Indian studies on bank mergers indicate that the evidence in favour of bank mergers is mixed, at best. Hence, this study was conceived to analyse the effect of market-driven Indian bank-to-bank mergers on stockholders during the post-reform period, 1999 – 2014. Event study analysis was performed using the 'market model' with the BSE-500 stock index as the reference index. Each merger announcement was considered as an event and daily stock returns in a 30-day time window were computed before and after the event. Overall, if the abnormal returns had been positive it could be implied that merger announcements have a positive impact on the stock prices. However, the results indicate that stock returns of acquiring banks and acquired banks generally declined in the time period around merger announcement. In the case of acquiring banks, adverse reaction was observed in six out of nine mergers that were analysed. Among the nine acquired banks, five were listed and adverse reaction was noted in three cases. Overall, merger announcements appear to have had an undesirable effect on stock returns of acquiring and acquired banks. Hence, future merger decisions should be taken only if other alternatives are not available and such decisions must be driven by due diligence.

Key words---Bank Mergers, Event Study, Indian Banks, Stock Returns

I. INTRODUCTION

Mergers determined by or responsive to market forces, termed as market-driven mergers, are common in developed economies. In the recent past, India has witnessed an increase in the number of mergers in the realm of the cement, power and steel industries, drugs, telecommunications, media & entertainment and banking (Prasad, 2011). Typically, such mergers are driven by managerial expectations such as synergy benefits, cost reduction, economies of scale and economies of scope (Murthy, 2007 and Sharma, 2002). However, the failure or poor performance of merged firms is not uncommon, in spite of perceived benefits and, more often than not, a diligent implementation process.

A wealth of literature exists on the pre and post-merger performance of banks and the evidence appears to be mixed.In general, studies on American bank mergers have indicated resultant gains. Whereas, a cross-country study by the Bank for International Settlements (2001) showed that, post-merger, return on assets had declined in 12 out of 16 countries and net interest margin had declined in 14 countries. The reason for the difference could be that the merger wave of the 90's in the US was driven by relaxation of restrictions on interstate and intrastate banking, and also their entry into securities market. Singh (2009) also observed that the US bank mergers had created value by eliminating built-in inefficiencies, which explains why the US evidence was favourable. However, these studies may not be entirely useful to understand the state of affairs in an emerging economy like India, where market-driven mergers are a relatively new phenomena.

Furthermore, differences in nature of the economy and institutional conditions make it rather difficult to generalize these implications. A few researchers such as Anand and Singh (2008) as well as Jayadev and Sensarma (2007) have evaluated the impact of Indian bank mergers on the wealth creation of acquirer and acquiring banks' shareholders. Few other researchers like Mann and Kohli (2009), and Selvam et al. (2006) restricted their analyses to one merger announcement.

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