Mergers & Acquisitions And Their Impact On Corporate - Values : Pre And Post-Merger Analysis Of Indian Banks

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ABSTRACT

Primarily, the focus of the present study is on Mergers & Acquisitions, and how they have impacted Indian banks' corporate-values by analyzing both their pre & post-merger-performance. The period of the study ranged between the years 2000 and 2010. The researchers applied the techniques of Economic Value Added (EVA of Stern Stewart & Co.) to evaluate the performances of the chosen institutions in both the periods (pre and post merger periods). The results signal towards the dynamism and resilience of the Indian economy. The researchers concluded that Indian banks, albeit small in comparison to their global counterparts, are taking great strides not only within the continental shelf of India, but even beyond its borders too.
Keywords: Mergers &Acquisitions, EVA, WACC
JEL Classification : G34

INTRODUCTION - FRAMEWORK OF RELEVANCE

The motive behind a merger or acquisition for any enterprise of any industry is to expand either geographically or to expand its own product/service offerings - but expansion it is! Every time a firm looks for expansion, it has to ensure it is adding value too. This makes merger / acquisition all the more difficult. In the present research enterprise, the researchers examine the inevitability of Indian banks from the value-addition point of view. Banks, through intermediation, create value when the returns from lending are more than the cost of its deposits. In order to do this, first, there must be an unrelenting focus to ensure that funds mobilized by the banks (whether through depositors, equity or debt issues) generate returns in excess of the cost of capital (*or can reasonably be expected to do so*) with an eye towards returning non -productive capital back to shareholders. Second, bankers should constantly seek to invest in technology increasing their reach; opening to strategic alliances, mergers & acquisitions and restructuring, including sometimes divestiture. The bankers in the new millennium, therefore, must attempt to make investment in “strategies” and not merely “remain confined to borrowing and lending”. Corporate value addition seems to be an appropriate tool to assess such investment strategies.

OBJECTIVES OF THE STUDY

The purpose of this paper is to examine Indian banks to discover whether the mergers or acquisitions that they executed made business sense from the standpoint of value addition. The present paper studies Indian bank's profiles to discover a correlation between the investment in stakeholder relationships and corporate performance. The motive of this study was to find out :

❖ Of all the mergers that have been hitherto taken place in the banking sector in India, how many have returned some positive value to the ultimate shareholder (whether they were a set of public investors or simply, the Government of India)?

❖ Was the case of a merger been mooted because of the public sector characteristics of the banking companies so that

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the burden would be borne by an elusive entity called the Government of India?

❖Were the arguments to merge some ailing banks with financial sound ones devoid of merit?

The present study begins to explore the entire spectrum of such mergers or takeovers from this perspective. As a matter of fact, up until this moment, the research community has made scarce effort in gauging the Indian banking sector for value additions, especially in the backdrop of a merger evaluation. Largely, the researchers feared that it may be due to the public-sector-characteristic-nature of most of the large banks in India; most of them have been derided and a have painted a somber picture of inefficiency, over and over again. Therefore, the merit of studying inefficiency was never viewed through the prism of curiosity. It was the general inquisitiveness in corporate value addition that prompted the researchers of the present paper to engage their disquisitive thinking into looking at this sector - the Indian banking sector.

❖ **Espousing Value - Addition With Decisions :** In order to help managements understand their own economics and arrive at value-creating investment decisions that adequately satisfy the two sensitive factors mentioned earlier, bankers must understand the concept and relevance of corporate values more commonly referred to as "Economic Value Added (EVA)". Multinational banks (such as Citibank, Deutsche Bank, Barclays, ABN AMRO) use value-based frameworks such as EVA to run their banking operations. Although EVA as a yardstick in India may be at a nascent stage, banks like HDFC Bank, ICICI Bank etc. have begun adopting such measures to cater to the increasingly discerning investor base.

❖ **Limitations With Traditional Methods :** Most of the accounting based measures such as Price : Earnings, Book Value, Returns on Equity, Return on Net worth, etc. failed to provide a clear understanding of the major variables that drive value, except, to some extent, Returns on Invested Capital. These methods are easily influenced by the smart and perhaps mischievous management through window dressings. They also do not incorporate risk and do not help investors understand the intricate process of value creation. In addition, these traditional measures use, for most part, historical data to measure current performance. Ideally, one would like to measure how current decisions will affect the firm's future performance.
This study sheds ample light in this area and would be quite useful for students of corporate finance, professionals in the banking industry, analysts of banking stocks, and for academicians to facilitate their teaching of M&A and EVA concepts. This research is pertinent for classroom discussion too.

LITERATURE REVIEW

Srinivas (2010) assessed the physical performance of the selected merged banks. The study indicated that the productivity and efficiency of the banks increased after the merger.
Popa, Laurentiu & Caragea (2009) concluded that EVA was an important tool in measuring a bank's performance by bank-shareholders' interest. Value creation is an economic concept, and not an accounting concept ,therefore, stock returns count.
Phani & Bhattacharyya (2000) elucidated that EVA was a corporate philosophy for motivating and educating employees to differentiate between value creating and value destructing activities. They claimed that EVA computation involves subjectivity and does not provide a positive signal to the markets as compared to other indicators.
Pradeep & Gian (2010) examined the impact of merger on the cost efficiency of Indian commercial banks, and found that, to some extent, merger programmes had been successful in the Indian banking sector.
Shimin & Dodd (1997) examined the EVA performance of 566 U.S. companies and compared the information usefulness of EVA with accounting earnings and residual income. Three conclusions resulted from the study :

(i) Although improving EVA performance is associated with a higher stock return, the association is not as perfect as claimed to be by EVA advocates.

(ii) EVA is more powerful than traditional measures of accounting profit in explaining stock return; however, accounting earnings are still of significant incremental information value in addition to EVA.

(iii) Not only is EVA similar to residual income in concept, the two metrics are empirically comparable.

Sinha, Kaushik and Chaudhary (2010) performed a survey on selected financial institutes of India for the period from

2000-2009 and used the methodology of ratio analysis and Wilcoxon signed rank test. According to their study, more than half of the mergers showed a better result in the post - merger stages than in the pre-merger stages. Their research showed a significantly good result in earnings available to shareholders and debt to equity ratio, in the return on net worth, liquidity position and profit before tax to total income in the post merger stage.
Raiyani and Joshi (2011) studied the profile of Indian banks to demonstrate a direct correlation between the investment in stakeholder relationships and corporate performance. With the help of EVA (Economic Value Added), they found out which Indian banks had been able to create (or destroy) shareholders' wealth since 2005-2006 to 2007-2008.

DATA & METHODOLOGY

❖ **Methods of Data Collection :** The researchers examined the financials of Indian Banks between 2000-01 and 2010-11. This research paper is based on a longitudinal study on the banking sector. The researchers took the period from 2004-07 as an eventful-year, and most of the banks they identified for the study merged with some other bank during this period. The periods between April 1, 2000 and March 31, 2004 were taken as the 'Pre-merger' period and the period between April 1, 2007 and March 31, 2011 was taken as the 'Post-merger' period. The data required for this study was collected from various sources, mainly from Annual Reports of respective banks, the internet, magazines and journals; and the nature of the data was secondary data. The researchers did not use any other tools other than EVA techniques to complete their study. The crux of the research study is to examine the value addition in both the periods of time: pre-merger and post-merger period for the selected banks.

❖ **Sample Size :** The researchers identified seven commercial Indian banks which had undertaken M&A deal(s) during this period (Ref. Appendix II). However, it is to be noted that IDBI Ltd. merged with IDBI Bank Ltd. on April 2, 2005 and again, on October 3, 2006, it acquired the distressed United Western Bank Ltd. On October 1, 2005, Bank of Punjab Ltd. merged with Centurion Bank and later Centurion Bank took over Lord Krishna Bank. Eventually, Centurion Bank of Punjab was acquired by HDFC Bank in 2008.
The selected banks considered for the study are Bank of Baroda (BOB), Indian Overseas Bank (IOB), Oriental Bank of Commerce (OBC), Federal Bank Ltd. (FBL), and IDBI Bank Ltd. (IBL).

❖ **Tools and Techniques :** EVA is considered to be an effective accounting tool for gauging value addition, and therefore, the researchers chose this accounting tool for measuring value addition by banking companies, during both the pre-merger and post-merger periods. With regards to the estimation of EVA for banks, one important difference between financial institution and other firms is the role of debt. Unlike non-banking firms, debt (including deposits) does of course help finance a bank's assets, but financial institutions are different at least in two important ways. Deposits are value generating in themselves, or can be, since they usually represent funding at below market costs (i.e. - it would be incorrect to calculate the value of the whole enterprise and arrive at the value of the equity simply by excluding the liabilities). A bank's debt funding is effectively the raw material which is intermediated ("manufactured") into high-yielding assets. Interest expense, according to this view, is the equivalent of the cost of goods sold. This has two consequences :

❖ Interest expense is included in NOPAT (see below) and, because of this,

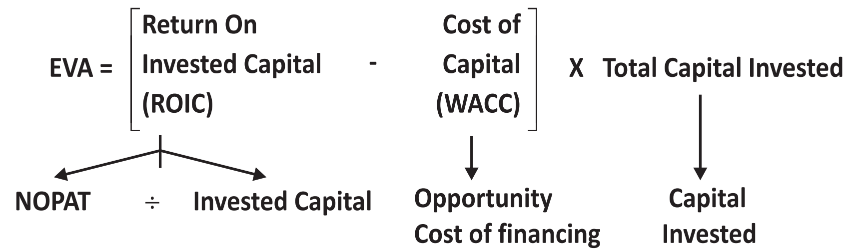
❖ When calculating the cost of capital, we define capital as equity and equity equivalents (the cost of other funding example, debt and deposits having been expensed in the income statement, thus allowing for the value creation of below market cost).

❖ **Corporate - Values In Context :** A bank's invested capital multiplied by WACC gives the minimum level of operating profits the bank should generate to satisfy shareholders. EVA measures how much Net Operating Profit (adjusted for tax and also called NOPAT) exceeds the capital charge (See Figure 1).
EVA - (As A Measure of Value Creation Through Management of Profits - See Figure 1)
Alternatively,
EVA - (As A Measure Of Value Creation Through Management of Capital)

EVA = NOPAT - (WACC × Total Invested Capital)

When EVA is greater than zero, value is created during the period for the bank, and if EVA is less than zero, value is

Figure 1 : EVA - (As A Measure Of Value Creation Through Management Of Profits)



destroyed during the period. In order to create values, ROIC for a bank must be greater than the Weighted Average Cost of Capital (WACC).

❖ **Corporate - Values In Banking :** While value-add examines the three fundamental principles of value creation related to Cash Flow, Risk and Sustainability of return, it has four distinct applications. They are:

❖ To measure a bank's historical success in creating values.
❖ To determine how a bank's stock will perform in the future.
❖ To examine the excess returns in future and its impact on the value of the bank.
❖ To calculate an intrinsic value of a stock by discounting future value of EVAs.

❖ **Calculation of Various Ratios :** The return on invested capital can be measured incrementally from one year to the next year, with the aim to spot emerging trends in bank-performance. This measure shows how much additional profit a company is able to generate for every additional rupee put into the business. This measure equals :

NOPAT (t) - NOPAT (t-1) / (Invested Capital (t) - Invested Capital (t-1))

and is analogous to the first derivative in calculus. This method is likely to smooth out any time events present in the data. Banks' use of debt-financing is different from firms of other business sectors. The debt funding of banks is effectively the raw material intermediated into higher-yielding assets. Here, the interest expense is equivalent to cost of goods sold. Consequently, therefore, in the present analysis, NOPAT was arrived at after adding interest on RBI loans and other loans to Profit before Depreciation and Taxes less Cash. In order to calculate cash taxes, tax shield on the interest paid on RBI loans and others were added back to Tax Provision, and Tax paid on other incomes was deducted from the tax provision of the year. The researchers assumed a tax rate of 30 percent per year for maintaining consistency in their analysis.

To the shareholders' funds are added reserves, excluded from equity, such as loan losses or contingency reserve, which in economic terms, function as capital. To this, total long term borrowings of the bank are added to get Invested Capital (IC). The analysis evaluates banks' performance in generating Return on Invested Capital (ROIC). It can be seen from the Table (See Appendix I: Table I: ROIC Table of Selected Indian Banks) that in the pre-merger period, IOB enjoyed the highest Return on Invested Capital followed by Federal Bank, except for the year 2003-04, when Federal Bank clocked the highest return at 25.6% followed by IOB at 23.72%. However, in the post-merger scenario, BOB showed the highest ROIC for all the year, except for 2007-08, where IOB stood first at 14.55%. On an average, in this period, IOB, OBC and Federal Bank showed approximately 11% ROIC. Lowest ROIC among all the five banks for both the periods was shown by IDBI at an average of 4.01% and 6.73% respectively. The incremental ROIC in the pre-merger years was dominated by IOB, BOB and OBC in the years 2001-02, 2002-03 and 2003-04 respectively. But in the post-merger period, this measure showed rather mixed performance (See Appendix I : Table II).

❖ **Establishing WACC :** The Weighted Average Cost of Capital (WACC) is the minimum rate of return on capital required to compensate both creditors and shareholders for bearing risk in investing their money into that specific bank and is the measure of total cost of capital. The estimation of cost of capital involved estimation of Cost of Equity (K_e) as per Capital Asset Pricing Model (CAPM), Cost of Debt (K_d), Risk free rate (R_f), Market Return (R_m), Betas (β) and the target capital structure.

The cost of equity was calculated by using CAPM and taking inputs such as R_f, R_m and β. The risk-free rate is assumed to be the same as interest rates on 10 Year Government Securities for the respective years (Appendix III). The average daily Sensex return for the period from 1999 - 2004 multiplied by 365 (days in a year) was taken as market return for the pre - merger period, and the same was calculated for the post-merger period by collecting the data for the period from 2008 - 2011. Betas for all the years for all the banks were calculated by regressing weekly stock returns of respective banks against weekly Sensex returns. Cost of Debt is the combination of Cost Of Deposit and Cost Of Borrowings. Interest paid on deposit reflected the Cost of Deposit, and Cost of Borrowings was considered as the interest paid on RBI loans and other loans.

The Table (See Appendix I: Table III: Cost of Capital of Selected Indian Banks) lists the cost of capital in the pre-merger period of BOB, IOB and Federal Bank, which went up in 2002 and then gradually decreased to 5.0 % , 5.01% and 5.13% respectively. In case of OBC, WACC gradually decreased to 5.26%. Although the same phenomena happened with IDBI, but in 2003-04, it shot up to an all -time high to 10.90%. In the post-merger years, all the banks enjoyed comparatively lower WACC may be due to general ease in the interest rates. Among all the five banks (Bank of Baroda (BOB), Indian Overseas Bank (IOB), Oriental Bank of Commerce (OBC), Federal Bank Ltd. (FBL), and IDBI Bank Ltd. (IBL)) Cost of Capital of BOB reached to an all-time low of 4.36% in 2010-11. In the study, the researchers discovered that IDBI Ltd. was a noted exception until it merged with IDBI Bank Ltd.

❖ **Scope of The Research :** Merger analyses of banking companies using EVA techniques is, in itself, a daunting task. Indian economy has over 50 banks : Public Sector (where the government owns more than 51% of shareholding); Private Sector (divided into old and new generation); and Foreign Banks. Some of them, if not all, have engaged in some merger activities or the other with the exception of foreign banks (regulatory compliances preclude foreign banks from taking over Indian banks). Keeping in view the vastness of the study, the researchers embarked upon their research journey by focusing only on a few banks and selecting five from the list of banking companies that either merged or acquired another one for the period of the study (the list is given in the Appendix II). The researchers selected a fine mix of both private sector and public sector banks based on the type of mergers and acquisitions involved. At the end of it all, the researchers concluded that there is a tremendous scope for further research in the same area, using a much larger sample size and expanding the time-lines.

❖ **Limitations of The Research :** The researchers focused on five banks and limited their study to these banks in their final analysis of pre-merger and post-merger analysis of those banks. It is apparent that their research efforts may not depict a wholesome picture of the full events that would have unfolded in the banking sector, typically with mergers and acquisitions. The researchers discerningly chose a few banks to conduct their study based on a few parameters that are well delineated in other and relevant parts of the research paper. However, there are abundant opportunities to conduct research in the banking sector with reference to mergers and acquisitions and that using EVA techniques. In making an attempt to conduct an analysis of pre-merger and post-merger study using EVA techniques, the study lacks other relevant parameters that may shed a different light upon similar sector-specific studies.

DISCUSSION & ANALYSIS

Revelation From The Study Of Select Indian Banks - Pre & Post Merger Analysis

(a) The Merger of South Gujarat Local Area Bank with Bank of Baroda (BOB) : On June 25, 2004, South Gujarat Local Area Bank Limited (SGLABL) was amalgamated with Bank of Baroda (BOB) following clear identification of 'management failure' of the local - area bank. The SGLABL was incepted on October 10, 2000 with seven branches with an area of operation comprising of three contiguous districts viz. Navsari, Surat and Bharuch, with its head office at Navsari (Gujarat). The Local Area banks were established with the objective of mobilization of rural savings by local institutions and finance projects in general, and for rural development and agricultural development, to bridge the gap in credit availability and to strengthen the institutional credit framework in the rural and semi-urban areas. But within three years of operation, the bank ran into trouble and incurred a loss of ₹ 3.69 crore as on September 30, 2003. Consequently, RBI proposed the amalgamation of SGLABL with BOB and prepared the merger scheme. According to the scheme, BOB would takeover SGLAB and settle all its claims. If any surplus remained after paying off the depositors and creditors, the shareholders of the bank would be entitled for payment only on pro - rata values of shares. The scheme waived-off allotment of shares of BOB to the shareholders of SGLABL.

(b) The Merger of Global Trust Bank With Oriental Bank of Commerce (OBC) : In the era of "New Generation Banks", the Global Trust Bank (GTB) was established by Ramesh Gilli. It was the first bank to have equity participation from multilateral institutions - IFC (The International Finance Corporation) & ADB (Asian Development Bank). GTB was also the first among Indian banks to raise Tier-II capital from multilateral institutions, and the investment was in the form of seven-years loan. The bank introduced a unique innovative equity ownership scheme for each employee for the first time in the country. It was also the first Internet banking service provider in the country. In 2003, GTB got the best in 'Microbanking' award by Microbanking Inc. However, troubles started spewing in its backyard and were brought to the fore when allegations of rigging of the GTB share price started surfacing. As a result, GTB's proposed merger with UTI Bank was called off. The situation became more critical when SEBI prohibited GTB from raising money from the capital market. The stock market fall left GTB with ₹ 11 billion of non-performing assets, and a negative net worth of $ 237 million. On July 24, 2004, a three-month moratorium on GTB was imposed by the government. During this period, GTB was expected to explore various options like voluntary merger with any domestic bank to arrange the required capital. Consequently, GTB was amalgamated with Oriental Bank of Commerce on August 14, 2004 in accordance with the amalgamation scheme drafted by the RBI. Broad strokes of this scheme were: the shareholder of GTB would receive pro-rata payments after meeting all the liabilities out of the realization of assets of GTB. Synergistically, since GTB was a south based bank, it gave OBC the much-needed edge in the southern part of the country. Finacle - the core banking solution, aided in their integration.

(c) The Merger of Ganesh Bank of Kurudwad With Federal Bank Limited (FBL) : On January 7, 2006, Ganesh Bank of Kurundwad was taken under moratorium after being given time to arrange for infusion of capital as also to explore other options for its future set-up. Its failure compelled RBI to look for merger-options. Ganesh Bank had 32 branches concentrated in Sangli, Maharashtra. Federal Bank's proposal to merge with Ganesh Bank was accepted by RBI. Keeping in view Federal Bank's financial parameters, retail network and synergies as well as strategic advantages and interest of depositors of Ganesh Bank, RBI prepared a draft-scheme of amalgamation. The merger took place on September 2, 2006. Accordingly, customers or depositors of Ganesh Bank were allowed to operate their accounts as customers of Federal Bank; all employees of Ganesh Bank continued in service in Federal Bank as its employees on the same terms and conditions (as they did with Ganesh Bank before the moratorium period).

(d) The Merger of Bharath Overseas Bank With Indian Overseas Bank (IOB) : Bharat Overseas Bank (BhOB) was a Chennai based private bank and was established by IOB along with six other banks in 1973 in order to take over IOB's Bangkok branch. It was one of the few private banks that the RBI permitted to have a branch outside of India. BhOB's profitability since March 2004 suffered poorly and the return on assets had been significantly below 1 percent when most public sector banks managed better. As a result, IOB acquired BhOB (with the aim to expand abroad) on March 31, 2007 after getting the Parliament's approval. The integration process was completed smoothly as BhOB was smaller than IOB, and both were south based banks.

(e) The Merger of IDBI Bank Ltd. With IDBI Ltd. : The Industrial Development Bank of India (IDBI) is categorized as an "other public sector bank". It was established on July 1, 1964 by an Act of Parliament as a wholly owned subsidiary of the Reserve Bank of India. It is currently the 10th largest development bank in the world in terms of reach - with 1514 ATMs, 923 branches, including one overseas branch at DIFC, Dubai and 621 centers, including two overseas centers at Singapore & Beijing. On February 16, 1976, the ownership of IDBI was transferred to the Government of India, and it was made the principal financial institution for coordinating the activities of institutions engaged in financing, promoting and developing industry in the country. Following IDBI's public issue in 1995, the government's stake came down (current shareholding : 65.14%). IDBI provides financial assistance, both in rupee and foreign currencies, for green-field projects as also for expansion, modernization and diversification purposes. One of the institutions built by IDBI was the IDBI Bank, a government-owned bank. IDBI Bank, a new-generation bank merged with the parent IDBI on April 2, 2005.

❖ **Analysis of Economic Value Addition By Select Indian Banks :** Earlier in this research paper, it was described how banks should use their capital base and other borrowings and fine-tune it to best lending practices so that the profits that are generated out of such practices exceed the costs of engaging this business and indeed creating some value. In the analysis of EVA by the selected Indian Banks upon which the researchers committed this study, they discovered the following :

❖ In the case of Bank of Baroda (BOB), for the size of this public sector bank, it was indeed creating positive value since the beginning of the period of the study, i.e. 2001. The EVA that it added in the year 2001 was ₹ 248.35 Cr. (See Appendix I: Table IV: EVA Table of Selected Indian Banks). By the year in 2004, the value addition amounted to ₹ 896.12 Cr. that amounted to four times since the beginning of the period of the study in 2001. In 2008, the value added was ₹ 1069.92 Cr., much more than 2004 and in spite of merging with a bank that had a negative net-worth, Bank of Baroda seems to have taken the merger in its stride, as the end of the study period, the value addition posted was a whopping ₹ 3645.12 Cr, 15 times more than what was in the beginning i.e. 2001!

❖ Bharath Overseas Bank had structural problems in its balance sheet. Indian Overseas Bank's value addition was a mere ₹135.75 Cr. in the beginning of the evaluation period: 2001. By the end of the pre-merger period, it had a value addition of ₹ 491.11 Cr. It became evident in the analysis that Bharath Overseas Bank's merger with Indian Overseas Bank had not roughened the feathers of Indian Overseas Bank. Like, BOB, IOB too appears to have taken the merger effects in its stride. It appears that the bank's provisioning costs upon loans shot up to ₹ 925.47 Cr. in 2010 from ₹ 412.90 Cr. in 2009. Additionally, its operational costs too went up - probably due to re-structuring of banking operations' redundancies post merger of Bharath Overseas Bank - from ₹ 1941.69 Cr. in 2009 to ₹ 2466.50 Cr. in 2010. Even though its value-add got lower, however, the bank appears to have doubled its value addition from ₹ 388 Cr. in 2010 to ₹ 791.97 Cr. by 2011!

❖ Of all the mergers analyzed in the present study, the case of the merger of Global Trust Bank with Oriental Bank of Commerce (OBC) stood apart as an exception for a number of reasons. The RBI-mandated merger of Global Trust Bank (which was muddled in controversies of unimaginable proportions) with Oriental Bank of Commerce was proposed. This was one merger that was even politically decried by the CPI (M) party - calling it the excesses of 'capitalism' and avarice of private enterprises. Even though this merger was politically motivated and without alternatives, it did not reduce the economic value addition in the case of Oriental Bank of Commerce. OBC, which had an EVA of ₹ 345 Cr. in the year 2004, did take a beating in the year 2008, when its economic value addition took a beating to ₹109.71 Cr. But since that year, the OBC added value to the tune of ₹ 926.42 Cr by the end of 2011 - almost nine times the value it had created in 2008!

❖ The case of Ganesh Bank of Kurudwad was a small schedule bank that lent quite in excess of its ability - the credit to deposit ratio was way above the limits drawn by RBI. Eventually, indeed, under the influence of political pressure, RBI mooted its merger with Federal Bank Limited (FBL). In the analysis of economic value addition, the researchers discovered that this is one bank that has evolved over the years and has emerged as a matured banking company. A look at its value addition reveals how methodical and systematically it governed its business and conservatively increased its value over the period of the study that spanned 11 years! In the year 2001, its EVA stood at a mere ₹ 74 Cr., but after the eventful period, it emerged as a clear winner. Although it took a hit in terms of value addition in the year 2004 (before the merger), but by 2008, and in spite of taking over a weaker bank, it posted a value addition of ₹175 Cr. and maintained the growth of economic value addition continuously. It was only in the year 2010 that it took a hit in its value addition due to provision costs - it posted economic value addition of 168 Cr. in 2010 as compared to 273 Cr posted in the previous year 2009. However, by the end of the period of the study (2011), it almost doubled its economic value added to ₹ 309.53 Cr! This was an exceptional performance - for a very conservative bank in the private domain - to have emerged as a clear winner in spite of all odds against it.

❖ After the merger of IDBI Bank Ltd. with its parent organization IDBI Ltd. to retain the PSB character, a new and modern public sector bank emerged. IDBI Ltd. had been engaged in industrial development projects for quite a while, and it was clearly making losses in its investments. The only way to recapitalize was to merge it with its subsidiary, IDBI Bank Ltd. One look at the economic value addition will give enough insight into the reasons for a merger.
The pre-merger economic value addition was clearly in the negative: from ₹ -3408 Cr. in 2001 to ₹ -3359.43 Cr. by the year 2004. It was only in the year 2003 that its EVA bettered briefly to ₹ -2955.58 Cr. However, its post-merger EVA in contrast, was far better than during any preceding period. Sample this: by 2008, the economic value added bettered to ₹ -130.77 Cr in 2008; reduced to ₹ -150.56 Cr in 2009 due to heavy provisioning of its bad loans. In 2010, this situation improved to -83.14 Cr. and finally by 2011, the EVA - for the first time in a decade - entered into the positive category of ₹ 585 Cr!

CONCLUSION

In the present study of Indian banks, the researchers discovered that value addition has more to do with operational efficiency of the banking company in particular: Oriental Bank of Commerce, Federal Bank Limited and IDBI Bank Ltd. among other banking companies and how effectively these banks emerged as winners in merging the entities and integrating their operations with the merged company.

All those mergers were mandated by RBI either due to economic compulsion for the lack of better alternatives or were politically motivated and mediated. A case in point is the merger of two such banking companies: The Ganesh Bank of Kurudwad with Federal Bank Limited and the merger of Global Trust Bank Ltd. with Oriental Bank of Commerce. In stark contrast to the aforementioned case was the case of Bharath Overseas Bank, which did find itself in turmoil, not due to the lack of prudent lending practices but rather, a case of lack of clear risk-management processes. The researchers discovered that IDBI Limited's continued negative value-addition, notwithstanding the merger with an agile bank - IDBI Bank Ltd. was brought about, albeit politically driven - to save IDBI Ltd.! What clearly emerged out of this merger was that IDBI Bank Ltd. ended up changing IDBI Ltd.'s fate - by turning its negative value addition into positive value creation - after a gap of a decade! These mergers were a clear case of a stronger bank acquiring a weaker counterpart which performed inefficiently and ineffectively, except perhaps, in the case of IDBI Bank - IDBI Ltd. merger which led to accumulating losses and with capital and net-worth completely wiped out of its balance sheet. Inefficiencies and lack of a better alternative notwithstanding, in the test of time, the merged entities did clearly emerge as a winner, proving those analysts who had written the obituary of all those banking companies - wrong!

The study that the researchers embarked upon also posed a question : Was the value addition of the bank due to economic growth or was it really due to efficiency overriding inefficiency? The study did reveal that banking companies are engaged in financial intermediation and ,therefore, their performance is directly linked to the economic performance of all the constituents in it. The researchers thought that economic growth may make its constituents to tend toward over-optimism and then price their actions - lending and borrowing - at rates disconnected to the real-economic world. Many a times, over confidence too leads to bad risk mitigation/management practices and thus leads the financial institutions to stare at mounting losses that culminated due to their ill-practices quite similar to the ones that were witnessed during the days that clearly led to the global financial / Lehman Brother's crisis of 2008. However, when firms engage in efficient practices and make conscious efforts to ensure that the cost of doing business does not exceed the benefits accruing from doing business, firms - whether they are in banking or engaged in any other economic activity - are bound to end up with positive economic value addition.

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APPENDIX - I

Table I: Return On Invested Capital (ROIC) - Table of The Selected Indian Banks											
Name of	Pre Merger Period					Event Period	Post Merger Period				
the Bank	2001	2002	2003	2004	Average		2008	2009	2010	2011	Average
BOB	11.80%	16.23%	20.11%	20.24%	17.09%		12.80%	14.15%	13.86%	13.75%	13.64%
IOB	18.24%	26.02%	30.42%	23.72%	24.60%		14.55%	12.83%	8.01%	8.41%	10.95%
OBC	15.0%	18.9%	19.2%	22.8%	18.98%		8.0%	12.2%	11.9%	11.6%	10.94%
FBL	16.8%	17.7%	20.4%	25.6%	20.12%		10.2%	11.9%	9.6%	10.9%	10.63%
IDBI Ltd.	4.1%	3.8%	3.5%	4.6%	4.01%		6.2%	6.5%	6.8%	7.4%	6.73%
Source: Compilation of Annual Reports and Indian Banks' Association Records											

Table II: Incremental Return On Invested Capital (ROIC)- Table of The Selected Indian Banks							
Name of	Pre Merger Period			Event Period	Post Merger Period		
the Bank	2002	2003	2004		2009	2010	2011
Bank of Baroda	63.8%	60.1%	21.0%		17.4%	13.0%	13.5%
Indian Overseas Bank	67.5%	43.4%	11.1%		8.4%	-36.4%	9.5%
Oriental Bank of Commerce	45.3%	20.1%	39.2%		26.9%	10.4%	10.8%
Federal Bank Limited	32.7%	-23.2%	-903.4%		24.3%	-6.9%	21.4%
IDBI Ltd.	8.8%	8.3%	-23.7%		22.6%	11.7%	12.3%
Source: Compilation of Annual Reports and Indian Banks' Association Records							

Table III: Table of Cost of Capital For The Selected Indian Banks										
Name of		Pre Merger Period				Event Period	Post Merger Period			
the Bank		2001	2002	2003	2004		2008	2009	2010	2011
Bank of Baroda	Cost of Deposits	7.47%	7.41%	6.52%	5.32%		5.28%	5.77%	4.94%	4.70%
	Cost of Borrowings	24.28%	29.50%	33.20%	28.09%		12.66%	9.35%	6.72%	6.85%
	Cost of Equity	13.92%	16.59%	17.52%	20.21%		31.43%	23.06%	22.71%	17.98%
	Weighted Cost Of Capital	**5.90%**	**6.08%**	**5.56%**	**5.00%**		**5.65%**	**5.42%**	**4.71%**	**4.36%**
Indian Overseas Bank	Cost of Deposits	7.51%	7.86%	6.98%	5.84%		6.35%	7.12%	6.49%	5.76%
	Cost of Borrowings	39.05%	56.72%	36.45%	18.43%		7.97%	9.69%	8.28%	8.05%
	Cost of Equity	13.92%	16.59%	17.52%	20.21%		31.43%	23.06%	22.71%	17.98%
	Weighted Cost Of Capital	**5.66%**	**6.07%**	**5.55%**	**5.01%**		**5.89%**	**6.32%**	**5.76%**	**5.04%**
Oriental Bank of Commerce	Cost of Deposits	8.57%	8.32%	7.63%	5.99%		6.98%	8.13%	7.00%	6.24%
	Cost of Borrowings	13.73%	9.03%	8.37%	8.01%		14.16%	13.64%	8.18%	8.28%
	Cost of Equity	13.55%	13.59%	13.21%	18.27%		28.28%	22.25%	25.87%	24.52%
	Weighted Cost Of Capital	**6.47%**	**6.27%**	**5.87%**	**5.26%**		**6.58%**	**7.04%**	**6.35%**	**5.95%**
Federal Bank	Cost of Deposits	8.75%	9.28%	7.86%	6.25%		6.24%	6.79%	6.67%	5.78%
	Cost of Borrowings	20.02%	17.02%	18.79%	44.69%		15.35%	12.60%	6.81%	8.35%
	Cost of Equity	16.82%	16.51%	12.33%	15.07%		19.78%	19.50%	22.71%	24.20%
	Weighted Cost Of Capital	**6.97%**	**7.20%**	**6.01%**	**5.13%**		**6.51%**	**6.73%**	**6.78%**	**6.33%**
IDBI Bank Ltd.	Cost of Deposits	179.21%	148.83%	101.04%	123.92%		5.78%	7.93%	7.25%	6.47%
	Cost of Borrowings	4.40%	4.30%	3.99%	5.32%		8.13%	8.35%	8.30%	8.63%
	Cost of Equity	13.85%	13.52%	16.74%	16.44%		30.49%	23.38%	37.02%	32.06%
	Weighted Cost Of Capital	**9.51%**	**9.07%**	**8.82%**	**10.90%**		**6.48%**	**6.79%**	**6.90%**	**6.53%**
Source: Compilation of Annual Reports, Indian Banks' Association Records, BSE India Ltd.; (Bombay Stock Exchange)										

Table IV: Table of Economic Value Addition (EVA) of The Selected Indian Banks											
Name of	Pre Merger Period					Event Period	Post Merger Period				
the Bank	2001	2002	2003	2004	Average		2008	2009	2010	2011	Average
BOB	248.35	467.08	733.96	896.12	586.38		1069.92	1854.58	2577.44	3645.12	2286.77
IOB	135.75	255.57	426.06	491.11	327.12		970.76	1013.08	388.97	791.97	791.20
BC	150.84	258.27	374.56	598.05	345.43		109.71	510.23	673.16	926.42	554.88
FBL	74.31	84.95	108.86	154.76	105.72		175.61	273.47	168.95	309.53	231.89
IDBI Ltd.	-3408.01	-3121.43	-2955.58	-3359.43	-3211.11		-130.77	-152.56	-83.14	585.00	54.63
Source: Compilation of Annual Reports and Indian Banks' Association Records											

APPENDIX II

List of Indian Commercial Banks Merged Since January 1990 to August 2007 Under The Provisions of the Banking Regulation Act, 1949			
Sr. No.	Name of the Transferor Bank	Name of the Transferee Bank	Date of Merger
1.	Bank of Tamilnad Ltd.	Indian Overseas Bank	20.02.1990
2.	Bank of Thanjavur Ltd.	Indian Bank	20.02.1990
3.	Parur Central Bank Ltd.	Bank of India	20.02.1990
4.	Purbanchal Bank Ltd.	Central Bank of India	29.08.1990
5.	Kashi Nath Seth Bank Ltd.	State Bank of India	01.01.1996
6.	Bari Doab Bank Ltd.	Oriental Bank of Commerce	08.04.1997
7.	Punjab Co-operative Bank Ltd.	Oriental Bank of Commerce	08.04.1997
8.	Bareilly Corporation Bank Ltd.	Bank of Baroda	03.06.1999
9.	Sikkim Bank Ltd.	Union Bank of India	22.12.1999
10.	Times Bank Ltd.	HDFC Bank Ltd.	26.02.2000
11.	Bank of Madura Ltd.	ICICI Bank Ltd.	10.03.2001
12.	Benaras State Bank Ltd.	Bank of Baroda	20.06.2002
13.	Nedungadi Bank Ltd.	Punjab National Bank	01.02.2003
14.	South Gujarat Local Area Bank Ltd.	Bank Of Baroda	25.06.2004
15.	Global Trust Bank Ltd.	Oriental Bank Of Commerce	14.08.2004
16.	Bank of Punjab Ltd.	Centurian Bank	01.10.2005
17.	IDBI Bank Ltd.	IDBI Ltd.	02.04.2005
18.	The Ganesh Bank of Kurundwad Ltd.	The Federal Bank Ltd.	02.09.2006
19.	United Western Bank Ltd.	IDBI Ltd.	03.10.2006
20.	Bharat Overseas Bank	Indian overseas Bank	31.03.2007
21.	The Sangli Bank Ltd.	ICICI Bank Ltd. (Voluntary)	19.04.2007
22.	Lord Krishna Bank Ltd.	Centurion Bank of Punjab Ltd.(Voluntary)	29.08.2007
Source: Reserve Bank of India Records			

APPENDIX III

Interest Rates On Central And State Government Securities (Per Cent Per annum)				
Year	Central Government Securities		State Government Securities	
	Range	Weighted Average	Range	Weighted Average
1980-81	5.98 - 7.50	7.03	6.75	6.75
1981-82	6.00-8.00	7.29	7.00	7.00
1982-83	6.25-9.00	8.36	7.50	7.50
1983-84	7.75-10.00	9.29	8.25-8.75	8.58
1984-85	7.75-10.50	9.98	9.00	9.00
1985-86	9.00-11.50	11.08	9.75	9.75
1986-87	10.00-11.50	11.38	11.00	11.00
1987-88	10.50-11.50	11.25	11.00	11.00
1988-89	10.00-11.50	11.40	11.50	11.50
1989-90	10.50-11.50	11.49	11.50	11.50
1990-91	10.50-11.50	11.41	11.50	11.50
1991-92	10.50-12.50	11.78	11.50-12.00	11.84
1992-93	12.00-12.75	12.46	13.00	13.00
1993-94	12.00-13.40	12.63	13.50	13.50
1994-95	11.00-12.71	11.90	12.50	12.50
1995-96	13.25-14.00	13.75	14.00	14.00
1996-97	13.40-13.85	13.69	13.75-13.85	13.82
1997-98	10.85-13.05	12.01	12.30-13.05	12.82
1998-99	11.10-12.60	11.86	12.15-12.50	12.35
1999-00	10.73-12.45	11.77	11.00-12.25	11.89
2000-01	9.47-11.70	10.95	10.50-12.00	10.99
2001-02	6.98-11.00	9.44	7.80-10.53	9.20
2002-03	6.57-8.62	7.34	6.67-8.00	7.49
2003-04	4.62-6.35	5.71	5.78-6.40	6.13
2004-05	4.49-8.24	6.11	5.60-7.36	6.45
2005-06	6.70-7.79	7.34	7.32-7.85	7.63
2006-07	7.69-8.75	7.89	7.65-8.66	8.10
2007-08	7.55-8.64	8.12	7.84-8.90	8.25
2008-09	5.44-10.03	7.69	5.80-9.90	7.87
2009-10	6.09-8.43	7.23	7.04-8.58	8.11
Source: Reserve Bank of India Records				