

# Impact of Leverage Position in Post-Acquisition – A Case Study of State Bank of India and State Bank of Mysore

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## 1. INTRODUCTION

Mergers and acquisitions are increasingly becoming strategic choice for organizational growth and achievement of business goals including profit, empire building, market dominance and long-term survival. The ultimate goal of this strategic choice of inorganic growth is, however, maximization of shareholder value. The phenomenon of rising M&A activity is observed world over across various continents, although, it has commenced much earlier in developed countries (as early as 1895 in US and 1920s in Europe), and is relatively recent in developing countries. In India, the real impetus for growth in M&A activity had been the ushering of economic reforms introduced in the year 1991, following the financial crisis and subsequent implementation of structural adjustment programme under the aegis of International Monetary Fund (IMF). In recent times, though the pace of M&As has increased significantly in India too and varied forms of this inorganic growth strategy are visible across various economic sectors.

The term mergers and acquisitions encompass varied activities of stake acquisition and control of assets of different firms. Besides, there are several motives for different types of mergers and acquisitions seen in corporate world.

## 2. BACKGROUND OF STUDY

- The State Bank of India (SBI), India's largest Bank has started working as a unified entity from 1 April, 2017.
- It merged with 5 associate Banks besides BharatiyaMahila Bank (BMB).
- The associate Banks are State Bank of Bikaner and Jaipur (SBBJ), State Bank of Mysore

(SBM), State Bank of Travancore (SBT), State Bank of Hyderabad (SBH) and State Bank of Patiala (SBP).

- According to a gazette notification dated 22 February, the government said that all shares of these associate banks would cease to exist as individual entities and would merger with SBI.
- The proposed merger of the State Bank of Mysore (SBM) with State Bank of India (SBI) should be smooth on the back of various synergies between the two public sector lenders in the form of similar business philosophy, technology platform among others, a top SBI official said.
- "Our technology platform, business philosophy and work cultures have a lot of similarities. So, the proposed merger of SBM with SBI should be smooth in creating value for all stakeholders," R Sridharan, managing director and group executive (associates and subsidiaries), said on the sidelines of a function here.
- He, however, said the government would take a final call on the merger with the parent.

## 3. LITERATURE REVIEW

Akhtar, et al (2012)The result shows that there is a general perception that a relationship exists between the financial leverage and the performance of the companies' i.e most of the financial performance indicators have positive relationship among leverage and the financial performance when compare with debt to equity ratio while the gearing ratio indicates negative relationships with the leverage indicators. Rajin (2012) says that investigates the influence of financial leverage on shareholders return and market capitalization, evidence of telecommunication sector companies in India. The state of influence of the

financial leverage on shareholder's return and market capitalization individually indicates positive relationship between financial leverage and shareholder return but negative relationship between financial leverage and market capitalization. Akbarian (2013) says that the result shows that there is a negative relation between financial leverage and cash flow per share and between variables market risk and economic risk with free cash flow per share positive significant. Alcock, et al (2013) says that examines the role of financial leverage in the performance of private equity real Estate funds. The results indicate that funds overall are unable to deliver significant positive out performance on the basis of managerial skill that is unrelated to the exposure to the variation in the underlying market return. Enuju and Soocheong (2005) says that examine the effect of financial leverage on profitability and risk of Restaurant firms. financial leverage and agency cost, an empirical evidence of Pakistan. The study found out that general and admin expense into to sales ratio is negatively related to all four-leverage ratio. ramachandira reddy & yuvaraja reddy 2007 examined the effect as selected variables on MVA. This study was conducted with 10 cement companies in Indian and the objective of his study was to examine the effect of select variables on MVA. For this purpose, multiple regression technique has been used to test the effect of select variable on MVA. Ball and Brown (1968) observed that literature supports the proposition that capital markets are both efficient and unbiased, which means that if information is useful in forming security prices, then the market will adjust these prices to that information quickly, without leaving any opportunity for further abnormal returns. Barlev and Livnat (1986) argued that share prices might be indirectly influenced by financing events because such events can affect investment activity and can additionally affect a firm's future cash flow. They concluded that rates of return on a firm's securities relate positively to the use of funds and negatively to the source of funds. In addition, the application of funds is generally positively related to the various sources of funds. McConnell and Muscarella (1985) examined the relationship between the announcement of unexpected increases/decreases in capital expenditure and increases/decreases in common stock prices. Their work provides evidence of the effect of corporate investment decisions on the

market value of a firm. They found that the reactions of security prices to announced capital 3 expenditure are generally consistent with the market value maximisation hypothesis and the traditional model of corporate valuation. Chisti et al. (2013) studied companies listed in various stock exchanges in India and found that debt to equity ratio is negatively correlated to profitability ratios, which implies that if the debt increases aggressively, it will have an adverse impact on profitability. Moreover, companies in such circumstances expose themselves to more risk and the possibility of losing control. Barclay and Litzenberger (1988) found that the relationship between marginal profitability of growth opportunities and Q-ratio is positive, and is used as a measure of investment, investment opportunity and market valuation. Ou and Penman (1989) identified factors that could explain the variation among firm's PE ratios. They used Logit models and a set of independent variables as forms of ratios: liquidity, turnover, profitability and leverage. They concluded that several ratios provide useful information for predicting the direction of the change in earnings for the next period. Shen (2000), some researchers believe that a high PE ratio is usually followed by slow growth in stock price while others believe the opposite. They argue that history is no longer a true guide because fundamental changes in the economy have made stocks more attractive to investors, justifying a higher PE ratio. Shen finds strong historical evidence that high PE ratios often precede disappointing stock market performance in both the short and long term. Specifically, he claims that it leads to slow long-run growth in stock prices. Asiri and A Hameed (2014) used all five financial ratios to assess the firm values for all listed companies in the Bahrain Bourse, and found that ROA is the most prevalent determinant in explaining the market value, followed by financial leverage beta and the size of the firm. Musso and Schiavo (2008) have focused on testing the impact of individual financial factors such as cash flow and investment decisions on firm growth. By selecting a few ratios from a financial data set, researchers have been trying to identify the underlying theoretical assumptions of the statistical model that would best describe the salient characteristics of a firm's activities where each financial ratio conveys unique information about those activities. Kiani et al. (2012) argued that without

full knowledge of the empirical relationships that exist among individual financial ratios, attempts to draw a meaningful financial selection of variables are not necessarily effective. As a result, the ratios chosen are often neither exhaustive nor exclusive in their ability to describe firm behaviour that would best represent the firm, or to cull the most relevant information from the original data set. Pringle (1973) argued that PE ratio can lead to confusion regarding the effects of investment decisions with those of financing decisions, 4 and often leads to a wrong decision. As a result, the magnitude of the PE ratio becomes irrelevant. He further argued that to the extent that a high PE ratio indicates that management is doing a good job of maximizing market value, it is desirable, but a high PE ratio should not be considered as unequivocally desirable because it also permits raising equity capital "cheaply" and making investments on more favourable terms. Wahlen and Wieland (2011) and Lev et al. (2010) argued that if capital providers want to choose which company to invest their resources in, they need to compare the contemporary financial position and performance of their chosen company to other relevant entities and use this information to forecast their company's future developments. Litzenberger(1989) suggest that an average Q-ratio of more than one is a necessary condition for a firm that invests in positive NPV projects, while an average Q-ratio of less than one is sufficient for firms that lack such projects. Land and Ruland and Zhou (2005) found that the association of leverage and valuation is strong in diversified firms that are smaller in size. To measure the factors that are associated with the excess value of a firm, they used debt ratio, Capex, operating income, dividend yield, cash flow, size and several other ratios.

#### 4. OBJECTIVE OF THE STUDY

To analyse the impact of leverage on profitability in pre-&post-merger

#### 5. RESEARCH METHODOLOGY

Research Method: Descriptive research were adopted as research design

Descriptive research: It is used to answer the research questions that describe who, what, where, when and how. It is undertaken to describe the synergies of

merger and acquisition through financial data of the company and the merging process followed by the company.

#### SOURCE OF DATA

Data is very important source for the study. It is the process of gathering and measuring the information with respect to the topic.

Secondary Data: Secondary data were collected through printed sources like magazines, past records of the company, journals, periodicals and articles.

#### SAMPLE DESIGN:

Acquiring	Acquired	Type of activity	Deal value	Year of occurrence	Strategic motives
SBI	SBM	Merger	37 trillion	2017	1. productivity improvement 2. market/customer focus 3. credit portfolio management

#### TOOLS FOR THE STUDY

Statistical Tool: The various statistical tools like mean, SD, kurtosis, skewness

Standard deviation: it is a measure that is use to quantify the amount of variation or dispersion of a set off data value.

Kurtosis: it is a measure of "tailedness "of the probability distribution of a real-valued random variable.

Skewness: it is a measure of the asymmetry of the probability distribution of a real valued random variable about its mean.

Mean: simple or arithmetic average of a range of values or quantities computed by dividing the total of all values also called arithmetic mean.

Financial tools: Ratio

Hypothesis (HO): There is no significance of impact of leverage on profitability in pre-& post-merger.

#### 6. DATA ANALYSIS AND INTERPRETATION

The following study ascertain the to analyse impact of merger and acquisition compare to leverage of the SBI after merging the SBM considering in the year of 2017. The study using both statistical and financial tools.

Financial ratio

Ratio	OP	NPM	RONW	RLTF	DE	OOF
2013	12.57	11.78	14.26	96.35	13.87	7.59
2014	9.94	7.98	22.77	100.85	13.34	7.81
2015	10.72	8.59	25.09	105.75	13.87	7.53
2016	9.22	6.07	6.89	83.57	13.55	7.69
2017	8.76	5.97	6.69	82.01	15.08	7.11

Source: authors calculation: annual report database

From the above table shows that the financial ratio 2013 to 2017 the liquidity values decline by comparing current ratio and quick ratio by comparing ROCE and ROE return is decline from 2013 to 2017. Comparing NPM and PBIT margin profitability ratios increased from 2013 to 2017.

Descriptive analysis

DESCRIPTIVE	OP	NPM	RONW	RLTF	DE	OOF
Mean	10.24	8.07	15.14	93.70	13.94	7.54
Standard Deviation	1.49	2.36	8.62	10.51	0.67	0.26
Kurtosis	0.76	0.88	-2.81	-2.59	3.04	2.36
Skewness	1.03	1.04	0.17	-0.18	1.61	-1.36
Minimum	8.76	5.97	6.69	82.01	13.34	7.11
Maximum	12.57	11.78	25.09	105.75	15.08	7.81

Source: authors calculation: SPSS database

- In the above table OP resulted with the descriptive mean value of 10.24, SD value 1.49, kurtosis 0.76, skewness 1.03, minimum 8.76, maximum 12.57.
- In the above NPM resulted with the descriptive mean value of 8.078, SD value 2.36, kurtosis 0.88, skewness 1.04, minimum 5.97, maximum 11.78.
- In the above RONW resulted with the descriptive mean value of 15.14, SD value 8.62, kurtosis - 2.81, skewness 0.17, minimum 6.69, maximum 25.09.
- In the above RLTF resulted with the descriptive mean value of 93.70, SD value 10.51, kurtosis - 2.59, skewness- 0.18, minimum 82.01, maximum 105.75.
- In the above DE resulted with the descriptive mean value of 13.94, SD value 0.67, kurtosis 3.04, skewness 1.61, minimum 13.34, maximum 15.08.
- In the above OOF resulted with the descriptive mean value of 7.54, SD value 0.26, kurtosis 2.36, skewness -1.36, minimum 7.11, maximum 7.81.

T- TEST ANALYSIS

One-Sample Test					95% Confidence Interval of the Difference	
	T	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
PE	13.419	4	0.000	25.81	20.470	31.150
PS	20.227	4	0.000	0.548	0.473	0.623
PCE	8.936	4	0.001	0.856	0.590	1.122
POP	26.076	4	0.000	7.888	7.048	8.728
PBV	12.839	4	0.000	9.146	7.168	11.124

Sources: authors calculations: spss database

From the above table represent the calculation of one sample t- test considering the study period of 5 years. using different ratios of the firms. The study found, all the financial performance ratios variables t-test resulted positive with the degree of freedom at 4. The study find that all the ratios are less than the significance level 0.05 therefore it proven There is no significance of impact of leverage on profitability in pre- & post-merger. Further, it observed that, all the ratios resulted p-value less than 0.05 significance level therefore  $H_0$  is rejected. hence forth, its proven that there is a significant impact of M&A on leverage performance pre and post-merger.

7. FINDINGS AND SUGGESTION

- Compared to 2013 to 2017, the ratios of the firm are positively decreased year by year.
- The ratios of the company are highly changes after the acquisition. And there is a highly decreased in it.
- The maximum value of the firm is also very decreased in 2014 to 2017
- There is a higher working capital in their business activities
- There is a negative impact in the working capital of the firm
- There is a huge difference in mean of the banks,
- The degree of the freedom is constant in all the cases
- In 2017, ratios positive as well as the negative values, but when compared to 2013, it is highly decreased and the bank may able to pay the interest and all to their investors
- The company is need to maintain their current assets and current liabilities to manage their day to day business activities properly.

- The company is need to select the best method of capital structure to pay the interest and dividends to their investors

State Bank of India should work more on making its services more reliable. It is very important for any service organization, particularly for a bank, to be seen as a reliable service provider.

- SBI should take steps to ensure that the employees deliver the services at promised time, as time is very important factor in the purchase of services.
- SBI should work on its complaint handling process so that complaints were handled efficiently and effectively. Service failures are inevitable and this needs to be understood and managed by the bank to ensure greater customer satisfaction. Service failures should be backed by strong recovery techniques to offset the negative impact of the failures.
- The bank needs to assess the effectiveness of its training programs as the result shows that the managerial and non- managerial staff rank the training programs differently. While the managerial staff perceives the trainings to be highly effective, the non-managerial staff seemed to be less convenience about this fact. Therefore, a comprehensive training programme needs to be designed taking the inputs from both the managerial and non-managerial staff.

## 8. CONCLUSION

state Bank of India is also concentrating at the top end of the market, on wholesale banking capabilities to provide India is growing mid / large Corporate with a complete array of products and services. It is consolidating its global treasury operations and entering into structured products and derivative instruments. State Bank of India is the only Bank of India that has been included in the list of fortune 500. It is the largest provider of infrastructure debt and the largest arranger of external commercial borrowings in the country.

Competition has already set in and public sector and private sector players should take steps to recapture the market by changing their strategy in the above lines. The future growth of the insurance sector will depend on how effectively the insurers are able to

come up with product designs suitable to our context and how effectively they are able to change the perceptions of the Indian consumers and make them aware of the insurable risks. The future growth of insurance also depends on how service-oriented insurers are going to be. On the demand side, the rise in incomes will trigger the growth of physical and financial assets. With the growth of infrastructure projects, the demand for insurance to cover the project and the risks during operations will increase. The other growth trigger is the increase in international trade. However, servicing of the large domestic market in India is a real challenge. Some of these challenges pertain to the demand conditions, competition in the sector, product innovations, delivery and distribution systems, use of technology, and regulation.

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