Driving Factors of Mergers and Acquisitions: Review of Selected Studies

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ABSTRACT:

The banking sector of India is considered as a growing sector and the soundness of the banking sector has been vital for the development of the country's economy. Merger and Acquisition is a strategy adopted by the organizations globally to meet the needs of dynamic business environment Historically, mergers and acquisitions activity started way back in 1920 when the Imperial Bank of India was born when three presidency banks (Bank of Bengal, Bank of Bombay and Bank of Madras) were reorganized to form a single banking entity, which was subsequently known as State Bank of India. Globally mergers and acquisitions have become a major way of corporate restructuring and the financial services industry has also experienced merger waves leading to the emergence of very large banks and financial institutions. It drives the organization to create synergy and value creation by way of diversification and improved management. In the present paper the researcher has evaluated the various motives behind merger and acquisition in the banking sector.

Key words: Banking, Merger and Acquisitions, Motives.

INTRODUCTION:

"The banking sector will see some kind of shakeout in the next few years with a spate of mergers and acquisitions resulting in widening the scope and quality for small banks,"

Rajesh Mokashi, Executive director of credit rating agency CARE.

In recent years, mergers and acquisitions have become very common not only between business entities but also between financial institutions. Such factors as, liberalization, globalization, internationalization of competition and technological advancement have just intensified this tendency. The growth rate in this sector is outstanding and therefore, it has become the most preferred banking destinations for international investors. In the last two decades, there have been paradigm shift in Indian banking industries. The Indian banking sector is growing at an astonishing pace. A relatively new dimension in the Indian banking industry is accelerated through mergers and acquisitions. It will enable banks to achieve world class status and throw greater value to the stakeholders.

A deeper understanding of motives for mergers and acquisitions allows us to recognize what forces (economic, financial, technological, etc.) drive companies and other establishments towards the creation of such alliances. The global financial crisis of 2007-2008 negatively affected the economies of many countries and expedited consolidation of financial institutions. Studying motives for mergers and acquisitions in the banking sector will allow us to understand whether they were just driven by intentions of banks to improve their financial positions or whether mergers and acquisitions deals were forced under the pressures of macro factors such as legal economics and political systems, government and technology. Mergers and acquisitions are an integral part of the development and growth of any industry.

"Two companies together are more valuable than two separate companies" – at least, that's the reasoning behind mergers and acquisitions (McClure, 2009). In addition, the resulting organizations become more powerful and efficient relative to competitors (Pfeffer & Salancik, 1978).

Mergers and Acquisitions in Indian banking sector have been initiated in response to the various economic reforms introduced by the government of India since 1991, in its move towards liberalization, privatization and globalization. On the recommendation of Narshimam Committee- I (1991), Narshimam committee- II (1997) and Verma Committee (1999) policy makers cautiously introduced various reforms in the Indian Banking Sector. The main objective of these reforms was to improve the efficiency of the Indian banking sector and to promote a diversified and competitive financial system in Indian economy.

With this perspective the present study aims to examine the motives behind various mergers and acquisitions.

REVIEW LITRATURE:

The key driving forces for merger activity is severe competition among firms of the same industry which puts focus on economies of scale, profitability, and cost efficiency. In our country and in countries like Germany weak banks are forcefully merged to avoid the problem of financial distress arising out of bad loans and other bad financial crisis. The banking scenario in India has already gained all the momentum, with the domestic and international banking. The Indian banks are hopeful of becoming a global brand as they are the major source of financial sector revenue and profit .The focus of all banks in India has shifted their approach to 'cost', determined by revenue minus profit. This means that all the resources should be used efficiently to better the productivity and ensure a win-win situation. The financial services penetration in India continues to be healthy, thus the banking industry is also not far behind. As a result of this, the profit for the Indian banking industry will surely surge ahead.

Mirvis and Marks (1992) divide mergers into six categories: horizontal, vertical, market extension, product extension, conglomeration and strategic mergers. DePamphilis (2010) classifies mergers based on legal perspective and economic perspectives. Legal structures of mergers can be taken into five forms: short form merger, statutory merger, subsidiary merger, statutory consolidation and merger of equals. From the economic point of view mergers can be vertical, horizontal or conglomerate depending on whether firms operate in the same industry or different and on their positions in the value chain.

Why do businesses engage in mergers and acquisitions? **Coyle (2000)** asserts that companies merge in order to seek financial and strategic opportunities. Other authors pointed out the reasons such as diversification and corporate growth (Stahl & Mendenhall, 2005; Coyle, 2000; Walter & Barney, 1990; Paulter, 2001), revenue growth (Huang & Kleiner, 2004); changing economic conditions (Croson et al., 2004; Bruner, 2004; Coyle, 2000), enhancing learning or obtaining new knowledge (Ghoshal, 1987; Blonigen & Taylor, (2000), gaining access to improved resources (Barney, 1991), achieving cost efficiencies through economies of scale (Walter and Barney, 1990; Coyle, 2000; Paulter, 2001) or increasing their market share(Trautwein, 1990).

Bower (2002) explains that companies are merged or acquired for the following reasons: to expand into new markets (Walter & Barney, 1990), to add new products and/or services, to acquire R&D capability, and exploit emerging convergence of industries.

Another issue identified in the analysis of merger gains in terms of stock price performance of the bidder and target banks on announcement of merger. A merger is expected to create value if the combined value of the bidder and target banks increases on the announcement of the merger. Pilloff and Santomero (1997) conducted a study of the empirical evidence and concluded that most studies fail to find a positive relationship between merger activity and gains in either performance or stockholder wealth. But studies by Trifts and Scanlon (1987), BaradwajHannan and Wolkan (1989), Hawawini and Swary (1990), Neely (1987), and Fraser and Furtado (1990), Cornett and Tehranian (1992), reports a positive reaction in the stock prices of target banks and a negative reaction in the stock prices of bidding banks after the announcement of merger.

Wheelock and Wilson (2004) find that expected merger activity in US banking is positively related to management rating, competitive position, bank size and geographical location of banks and negatively related to market concentration. Significant gains from mergers are expected to come from cost savings owing to scope and economies of scale. In a survey of US studies, Berger and Humphrey (1994) concluded that the consensus view of the recent scale economy literature is that the average cost curve has a relatively flat U-shape with only small banks having the potential for scale efficiency gains and usually the measured economies are relatively small. Studies on scope economies found no evidence of these economies. Based on the literature, Berger and Humphrey (1994) conclude that "synergies in joint products in banking are rather small."

Sherman and Hart (2006) argue that motivating factors are different for different mergers and acquisitions. Mergers are considered to be the easiest way for expansion and growth such as entering new markets or developing new products (Gaughan, 1999; Sherman & Hart, 2006; McClure, 2009). Other reasons for merging include greater efficiency through achieving economies of scale (Gaughan, 1999; McClure, 2009; Fontaine, 2007), improving technical competency and increasing efficiency of management (Gaughan, 1999), obtaining tax benefits (Paulter, 2001), synergies (Gaughan, 1999; Cigola & Modesti, 2008), and responding to changing economic conditions (Coyle, 2000). The main motivating factors for acquisitions is to gain economies of scale (William, 2009; Sherman & Hart, 2006; Miller, 2008), gaining market power (Miller, 2008; Paulter, 2001), integrating knowledge and combining superior technology (William, 2009), access to greater resources, expansion into new markets and products (Coyle 2000; Miller, 2008), and the desire to reduce the number of competitors (Sherman & Hart, 2006; Fontaine, 2007).

Similar studies conducted outside the U.S. show broadly the same results. In Europe consolidation is mainly a national phenomenon; a possible explanation for the lack of cross-border deals in Europe is given by Boot (1999), who argues that there is a political dimension to the consolidation process that protects national "flagships". Berger et al (1999) argue that cross-border deals introduce a new layer of complexity to M&As; but even for the deals concluded within national borders, improvements in performance are hardly detected; in general, they are to be expected only in mergers between banks of the same size (Vennet (1996))

Employing a sample of Texas banks in existence in 1970, Hannan and Rhoades (1987) report that banks that have larger market shares, maintain lower capital to asset ratios, and operate in urban areas were more likely to be acquired, all else equal. They do not find evidence that firms which have lower profitability or growth were more likely to be acquired. Thus, to the extent that profitability and growth indicate managerial performance, they fail to find support for the hypothesis that poorly managed banks are more likely to be acquired than well managed ones.

Amel and Rhoades (1989), however, using a large nationwide sample of mergers occurring during the years 1978 to 1983, do find that the lower a bank's earnings, the more likely it was to be acquired.

Using a sample of 84 banks that were acquired during the years 1982-1992 and a matched sample of 84 banks that were not acquired, Hadlock, Houston and Ryngaert (1999) find no relationship between earnings and the probability of acquisition. The major focus of their study is the ownership structure of potential acquisition targets. They report that the probability of being acquired is lower when the bank's managers had a larger ownership stake, and the authors suggest that this reflects a tendency on the part of entrenched managers to block acquisitions that could be relatively profitable to other owners.

- to achieve greater efficiency through economies of scale	Walter and Barney (1990); Gaughan (1999); Coyle (2000); Paulter (2001); Sherman and Hart (2006); Fontaine (2007); Miller (2008); William (2009); McClure (2009)
- to expand into new markets, to develop new products and/or services	Walter and Barney (1990); Gaughan (1999); Bower (2002); Sherman and Hart (2006); McClure (2009)
- to exploit strategic opportunities through synergies and convergence of industries	Gaugham (1999); Coyle (2000); Bower (2002); Miller (2008); Cigola and Modesti (2008)
- to obtain tax benefits	Paulter (2001)
-to guarantee revenue growth	- Coyle (2000); Huang and Kleiner (2004) Gaughan (1999)
- to ensure corporate growth and diversification	Walter and Barney (1990); Coyle (2000); Paulter (2001); Stahl and Mendenhall (2005)

- to increase market power	Trautwein (1990); Paulter (2001); Miller (2008)
- to respond to changing economic conditions	Coyle (2000); Croson et al (2004); Bruner
- to acquire R&D capability	Bower (2002)
- to reduce the number of competitors	Sherman and Hart (2006); Fontaine (2007)
- to enhance learning, obtain new knowledge, combine superior technology	Ghoshal (1987); Blonigen and Taylor (2000); William (2009)
- to gain access to better and greater resources	Barney (1991); Coyle (2000); Miller (2008)

CONCLUSION

Nowadays, only a few numbers of mergers can be seen; however, acquisition is getting popularity due to extreme competition. The merger is a mutual collaboration between the two enterprises in becoming one while the acquisition is the takeover of the weaker enterprise by the stronger one. But both of them gain the advantage of Taxation, Synergy, Financial Benefit, Increase in Competitiveness and much more which can be beneficial, however sometimes adverse effect can also be seen like an increase in employee turnover, clashing in the culture of organizations and others but these are very few.

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