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"Study on Impact of Merger and Acquisition of HDFC Bank and HDFC Ltd."

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ABSTRACT

The current paper's goal is to investigate the numerous reasons why the Indian banking industry might merge. This covers a variety of bank merger-related elements. Financial indicators such the gross profit margin, net profit margin, operational profit margin, return on capital employed, return on equity, and debt equity ratio are used to analyse the pre- and post-merger financial performance of merged institutions. After a review of the literature, it was discovered that the majority of the work was done to minimize the effects of mergers and acquisitions on various companies. With economic liberalization, data on mergers and accusations have been gathered for a number of different financial metrics.

Keywords: Banking, Financial Parameters, Mergers & Acquisition.

I. GENERAL INFORMATION

The largest private bank in India will be created by the mega merger of parent company HDFC Ltd and its own subsidiary HDFC Bank, a domestic systemically important bank (D-SIB), in March 2021. This bank will have assets worth Rs. 27,24 trillion, second only to SBI's Rs. 45,43 trillion. After the merger, the size of HDFC Bank will be nearly twice that of ICICI Bank, which will have assets worth Rs. 12.33 trillion in March 2021. In March 2021, the assets of HDFC Bank alone totaled Rs. 17.47 trillion. The competition that the banking system merger will bring about will be able to energize the buoyancy advantageous to the stakeholders.

The merger will happen in two stages. The two wholly owned subsidiaries of HDFC, HDFC Investments Ltd. and HDFC Holdings Ltd., will combine to form one company. The reorganized HFDC will merge with HDFC Bank as the next step. It will probably take close to 15 to 18 months to complete the entire process, including getting regulatory approvals and combining the entities. They will carry on in their current format until then.

In exchange for 25 shares of HDFC Limited with an issue price of Rs. 2, the shareholders of HDFC Limited as of the record date will receive 42 shares of HDFC Bank with an issue price of Rs. 1. Following the merger of the two companies, the public will own all of the shares of HDFC Bank, while former HDFC shareholders will own 41 percent of the stock. It will have a market value of 14 trillion rupees.

The size advantage following the merger

While inorganic growth could fast increase size through mergers, organic growth is a slow race to reach higher scale and size. In order to remake itself as a trend-setter, HDFC Bank correctly mined its own entity, HDFC, which delivers similarity in culture and imbedded value systems. As a result, it will have a higher willingness to take risks and the capacity to actively lend to the corporate sector. With nearly 7000 offices, the united organization will have the depth and reach to address every sector of the community. With the addition of 9 million new borrowers who can use the diverse product offering of HDFC bank, the credit portfolio's size will increase to Rs. 17.86 trillion. Similar to this, HDFC Bank's 68 million customers will benefit from its 45 years of extensive industry experience in housing finance. As a result, HDFC Bank will be able to offer flexible mortgage solutions in a way that is both economical and effective. The combined company would gain from increased scale, a wide range of products, a resilient balance sheet, and the ability to drive synergies across revenue opportunities, operating efficiencies, and underwriting efficiencies, among other benefits. This merger would benefit various stakeholders, including the respective shareholders, customers, and employees.

As much low- and medium-ticket loan processing is now algorithm-based technology, and some is even app-based, there is no need for human participation. With its recent establishment, HDFC Bank will be able to concentrate on developing new products to finance larger corporate business segments. The combination will give the long tenor loan book a well-diversified low cost capital basis from which to expand. A higher capital adequacy ratio (CAR) of 19.8 percent will give the combined business more strength. 15 percent of the market share will replace the current 11 percent.

Motives for the merger:

Together with internal factors, a truncated regulatory arbitrage between banks and non-banks may be the cause of the obvious merger. Commercially speaking, becoming a universal bank makes sense for a sizable, well-established, and reputable NBFC. In such a strategic scenario, integrating HDFC and HDFC Bank may be the best course of action. The RBI has recently changed the NBFCs' regulatory framework to bring them closer to banks.

II. INTRODUCTION OF THE STUDY

Banks in India may be broadly categorized based on ownership into three tiers as follows: Scheduled commercial Banks (SCBs), Regional Rural Banks (not covered by SCBs) and Cooperative and special purpose Rural Banks. Private sector banks dominate the Indian Banking System accounting for over 70% of the assets of the SCBs in India (Report on Trends and Progress of Banking in India, 2019).

The financial system in India in the first decade following independence in 1947 was a liberal one. However, the first of two waves of nationalization occurred in 1969, and heralded a new system of tight regulatory control. The primary features of this system were high reserve ratios and an administered interest rate regime in which regulations dictated deposit and lending rates. Furthermore, certain economic sectors were designated Priority Sectors and banks were required to lend up to 40% of their total credit to these sectors.

These policies were introduced in an effort to facilitate the spread of banking services to rural areas, mobilize savings, and channel credit towards the development of weaker but vital sectors of the economy such as the agricultural sector and the small-scale industry (Bhattacharya, Lovell, and Sashay, 2018). As a result of the aforementioned policies, the PSBs began to dominate the Indian Banking System.

Indeed, prior to economic liberalization in 2019, the PSBs accounted for 90.8% of aggregate deposits of SCBs. The financial system came to be characterized by low profitability, high levels of Non-Performing Assets (NPAs), and A low capital base and high levels of operational inefficiency (Arun& Turner, 2017). While the banking system was successful in mobilizing savings, it failed in efficient resource allocation. The reasons for this failure are not far to seek. In a market-oriented framework, banks would only undertake those loans which met stringent credit risk standards. Thus, scant regard to fundamental financial performance coupled with a rigid desire to meet quantitative objectives led to the permeation of operational inefficiency in the banking system triggering the need for economic reforms in 2019 to improve its strength, profitability, and efficiency (Mistry, 2018).

The recommendations of the Committee on Financial System and the Committee on Banking Sector Reforms (Narasimha Committees on Banking Sector Reforms I and II) formed the foundations of the economic reforms undertaken. The economic reforms brought about a comprehensive change in the competitive landscape of the Indian Banking System forcing many of the incumbent banks to adopt Mergers and Acquisitions with the objective of restructuring themselves in order to enhance their efficiency, profitability and competitive strength. In addition, the Government introduced policy initiatives aimed at deregulation and encouragement of mergers with a view to increasing the size, profitability, and financial strength of Indian Banks thereby enhancing their capability to compete globally.

III. LITERATURE REVIEW

Global Literature:

There have been numerous studies on mergers and acquisitions abroad, in the last four decades, and several theories have been proposed and tested for empirical validation. Researchers have studied the economic impact of mergers and acquisitions on industry consolidation, returns to shareholders following mergers and acquisitions and the post-merger performance of companies.

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Maravedi and Reddy, (2018) states whether or not a merged company achieves the expected performance is the critical question that has been examined by most researchers. Several measures have been postulated for analyzing the success of mergers. A number of studies were done in developed capital markets of Europe, Australia, and the USA, on evaluation of corporate financial performance following mergers Caruso and Pamlico, (2018), performs an event study on mergers and acquisitions between publicly listed Italian banks.

The study shows that previous literature may have only partially captured the market reaction by choosing the announcement date as the event date. In less efficient markets that date is not sufficiently accurate to capture all the market reaction because of the leakage of information. Using the rumours date instead, they find that in our sample the overall market value creation can even become from negative to positive. Moreover, they also find evidence that in Italy private benefits are more likely to drive the bidders' decisions rather than value creation goals.

Research on post-merger performance in India:

The research on post-merger performance following mergers and acquisitions in India thus far has been limited. Agrawal and Jaffe, (2000), state that long run performance is negative following mergers, though performance is non-negative and perhaps even positive following tender offers.

There may be several explanations for such under performance following a merger like:

1) Speed and price adjustment
2) Short-run focus on EPS
3) Method of payment
4) Estimating performance two explanations of underperformance (speed of price adjustment and short-term EPS focus) are not supported by the data, while two other explanations (Method of payment and estimating performance) received greater support.

Kopf and Viswanathan, (2019), state that private information on acquiring and target firms leads to increased stock merger activity that is correlated with market valuation. Managers of bidding firms have private information about the stand-alone value of their firms and the potential value of merging with a target firm. Both bidders and targets have market values that may not reflect the true value of their companies which leads to mergers and acquisitions. The target has limited information about the components of the misevaluation, and therefore has difficulty in assessing the synergies.

The rational target knows whether their own firm is overvalued or undervalued, so they are not easily fooled, but they cannot determine whether this misevaluation is a market effect, a sector effect, or a firm effect. Vichy and Yang, (2017), compared the acquisition performance of S&P 500 and non-S&P 500 firms after controlling for differences in the firm characteristics. During 1980-2004, S&P 500 firms made a greater number and dollar value of acquisitions.

IV. BACKGROUND OF THE STUDY

Mergers and Acquisitions (M & A) are defined as consolidation of companies. Difference between the two terms, Mergers is the combination of two companies to form one, wherein Acquisitions is one company taken over by the other. M & A is one of the important aspects of corporate finance world. The idea behind M & A is generally given is that the two separate companies together create more value compared to being on an individual stand. With the main objective of wealth maximization, companies keep on evaluating different opportunities through the route of merger or acquisition. In this, always synergy value is created by the joining or merger of two companies.

The synergy value can be analyzed either through the Revenues (higher revenues), Expenses (lowering of expenses) or the cost of capital (lowering of overall cost of capital). It's obvious that, both sides of an M & A deal will have different ideas about the worth of a target company: Its seller wants to value the company at as high of a price as possible, while the buyer would try to get the lowest price that he can. There are, however, many legitimate ways to value companies. The most common valuation method is to look at comparable companies in an industry, but deal makers implements a variety of other methods and tools when assessing a target company. Some of them are as follows:

Comparative Ratios. The following are two examples of the many comparative metrics on which acquiring companies may base their offers:

Price-Earnings Ratio (P/E Ratio)—with this ratio, an acquiring company makes an offer that is a multiple of the earnings of the target company. Looking at the P/E for all the stocks within the same industry group will give the acquiring company good guidance for what the target's P/E

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multiple should be. Enterprise-Value-to-Sales Ratio (EV/Sales)—with this ratio, the acquiring company makes an offer as a multiple of the revenues, again, while being aware of the price-to-sales ratio of other companies in the industry. Replacement Cost—in a very few cases, acquisitions are based on the cost of replacing the target company.

For simplicity's sake, suppose the value of a company is simply the sum of all its equipment and staffing costs. The acquiring company can literally order the target to sell at that price, or it will create a competitor for the same cost. Naturally, it takes a long time to assemble good management, acquire property and get the right equipment.

V. PROBLEM STATEMENT

HDFC Ltd. shareholders would get 42 shares of HDFC Bank, each with a face value of one rupee, for every 25 shares of HDFC Ltd. worth Rs 2 after the merger, an exchange ratio of 1:1.68. They'll then possess 41% of the combined financial institution. The most difficult part will be navigating the approval process. "Numerous industries, including banking, asset management, and insurance, are joining forces. So, the most difficult part of this purchase will be obtaining necessary clearances from authorities "The remark was made by Dugal. Second, most of HDFC Ltd.'s staff has experience in the mortgage industry.

OBJECTIVES OF THE STUDY

- To strengthen their combined strengths and to counteract either company's deficiencies,
- To eliminate a danger or rival within their sector, or to experience rapid exponential growth
- To evaluate the financial performance pf HDFC bank and HDFC LTD. for the year 2017-2021.
- To compare financial performance of HDCF bank.

HYPOTHESIS

H0: There is a significant different between impact of merger and acquisition of HDFC bank and HDFC Ltd.
H1: There is no significant different between impact of merger and acquisition of HDFC bank and HDFC Ltd.

$\chi^2 =$ (38-36)2+ (62-64)2=0.174
36 64

P-value = 1 - p(χ^2 (1) $\leq$ 0.174).

VI. RESEARCH METHODOLOGY

METHODS FOR DATA COLLECTION & VARIABLES OF THE STUDY

Methods for data collection

Secondary Information

Secondary Information

Secondary data was gathered from Books Journals Magazines Web's logistics es

Sampling

The sampling approach used for data collection is convenient sampling. The convenience sampling technique is a non-probability approach.

Sample size

The number of individuals to be polled is indicated by logistics. Although big samples provide more trustworthy findings than small samples, owing to time and financial constraints,

Analytical strategy

- Graphs and charts are used to depict diagrams.
- Following the use of the relevant statistical methods, logistical conclusions will be formed.
- Findings and recommendations will be provided to make the research more helpful.

LIMITATIONS OF THE STUDY

- A clash of cultures in a merger and acquisition, the cultures of the two companies mix as well. ...
- Scale Diseconomies Gaining from synergies and economies of scale is the major goal of a merger.
- Employee Anxiety,
- Financial Burden,
- Price Increases,
- Job Losses,
- Sunk Costs, etc.

VII. CONCLUSION/SUGGESTIONS

Several companies think that a merger or acquisition by Hdfc bank or hdfc Ltd. would be the best way to increase ownership and, by extension, profits. The advantages of splitting a subsidiary or business unit out into its own publicly traded firm, however, are more appealing to some. Mergers, in theory, may improve operations while cutting costs due to economies of scale and synergies. A merger's greater market dominance might provide investors peace of mind.

Instead, demerged companies often see improved operational success as a consequence of realigned management incentives. Financial investments may support either internal growth or external growth via acquisition. When companies are demerged, investors benefit from a more streamlined flow of information. There are a wide variety of challenges that investors must take into consideration in light of the merger and acquisition of Hdfc bank and hdfc Ltd. The optimal equity structure thinks about the pros and cons of the deals being made.

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