Efficiency Study on Proposed Merger Plan of State Bank of India (SBI) and its Subsidiaries: A DEA Perspective

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ABSTRACT

The Banking industry is undergoing unprecedented changes driven by consolidation through mergers and acquisitions all over the world. India is no exception. Merger of State Bank of India (SBI) and its subsidiary banks have been for several years, and SBI has already merged State Bank of Saurashtra (2008) and State Bank of Indore (2010) with itself. SBI management proposes to merge its five remaining subsidiaries within the next two fiscal years. The present paper measures and examines technical efficiency of SBI and its subsidiaries before and after their hypothetical merger. The study has utilized the two basic DEA models – CCR (Charnes, Cooper and Rhodes) and BCC (Bankers, Charnes and Cooper) to measure technical efficiencies of selected major Indian commercial banks before and after merger of SBI and its associates for the financial year 2009-10. The results reveal that the merger proposal of SBI associates may bring in fully technical efficiency but not fully scale efficiency of the merged entity. In order to be fully technical and scale efficient, merged SBI has to reduce its present number of employees substantially and should follow the prudent operating practices of three peer banks namely Corporation Bank, Axis Bank and Federal Bank.

Keywords: Bank Mergers, Banking Industry, Data Envelopment Analysis (DEA), Peer Banks, Relative Technical Efficiency

1. INTRODUCTION

Banking industry is undergoing unprecedented changes driven by consolidation by means of mergers and acquisitions all over the world. One of the principle objectives behind the merger and acquisitions in banking sector is to reap the benefits of economies of scale. Moreover, mergers and acquisitions in the banking industry have resulted in large universal banks in terms of total assets, products, and geographical diversification. Large banks are in a better position to introduce technology and reduce cost than small banks. Large banks have normally large capital and easily utilize economies of scope. For all these reasons, size of banks is considered to be normally associated with higher efficiency. Bank size thus is now an important factor in
today’s banking efficiency analysis study. However, literature on banking efficiency does not suggest a consistent relationship between size and efficiency, which is the area of interest for researchers like us.

Merger of State Bank of India (SBI) with its subsidiary banks has been considered for several years. SBI management has got a blanket approval from the government to merge all the banks. SBI management has taken this consolidation exercise step by step. The first step towards unification occurred on 13 August 2008 when State Bank of Saurastra merged with SBI, then on 19 June 2009, the SBI board approved the merger of its subsidiary, State Bank of Indore, with itself. SBI proposes to merge its five remaining subsidiaries - State Bank of Hyderabad, State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Travancore and State Bank of Mysore with itself by mid 2012 (“SBI to take a view on merger,” 2011). This consolidation is aimed at making the State Bank group a stronger and more resilient organisation. Merger/acquisition of its subsidiary banks by SBI should not be seen as a merger in the conventional sense but is more in the nature of restructuring within the Group as SBI already held 75% or more equity stake in all its subsidiary banks. Parliamentary Standing Committee on Finance reported while SBI has also stepped up its efforts to grow organically, the inorganic growth through mergers would also help the bank in scaling up within an acceptable time frame, to enable it to compete on an equal footing with foreign banks, not only in India but in the international economic arena as well (Feb 23, 2011; Business Line). On the other side, State Banks’ Staff Union and SBI Officers’ Association opposed this proposed merger of associate banks with State Bank of India and termed this as a retrograde step.

In this background, an obvious question arises in our mind – ‘will the merger proposal of SBI and its subsidiaries produce an efficient bank in Indian banking industry?’ Therefore, the present study evaluates efficiencies of Indian banks particularly seven banks of SBI associate before and after hypothetical merger of such seven banks using data envelopment analysis (DEA). For this, the study has utilized the two basic DEA models – CCR and BCC to measure technical efficiencies of 31 major Indian commercial banks (before merger) and 25 banks (after merger) taking hypothetically merged SBI in place of seven SBI group banks based on the financial data of the financial year 2009-10.

The main objectives of this paper are-

- To measure the extent of relative technical efficiency of hypothetically merged SBI.
- To analyse its efficiency from various perspectives of DEA methodology.

2. MERGER—INDIAN BANKING INDUSTRY

The Indian banking industry has been in the process of transformation and consolidation ever since 1961. The Banking Regulation Act, 1949 empowers the regulator with the approval of the government to amalgamate weak banks with stronger ones. But, the thrust on consolidation has emerged with the Narasimham committee (1991) emphasising on convergence and consolidation to make the size of Indian commercial banks comparable with those of globally active banks. Further, the second Narasimham Committee (1998) had also suggested mergers among strong banks, both in the public and private sectors and even with financial institutions and Non-Banking Finance Companies (NBFCs). The Second Narasimham Committee - 1998 recommended a multi-tier banking system with existing banks to merge into 3-4 international banks at the topmost level, 8-10 national banks engaged in universal banking at the next level and local and rural banks confined to specific regions (Bansal et al., 2011).

Deregulation in the financial market, market liberalization, economic reforms, pressure from global competition, development of technology, Basel-II implementation and a number of other factors have played an important function behind the growth of mergers and acquisitions in the Indian banking sector.
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