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## **Impact of Merger of Bharat Overseas Bank on the Financial Performance of Indian Overseas Bank- A Case Analysis**

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### **Abstract**

Mergers have been long known to direct the merging entities towards positive synergies, enhanced resources and hence, overall increase in the profit statements. Mergers can be defined as a type of restructuring in that they result in some entity reorganization with the aim to provide growth or positive value. Mergers among different banks are classified as horizontal mergers.

Bharat Overseas Bank merged with Indian Overseas Bank on 31<sup>st</sup> March, 2007. Since the focus of the paper is to study the impact of merger on the performance analysis of Indian Overseas Bank, it has taken into consideration 4 years before merger data and 4 years after merger data and this data is analyzed using paired t-test. Financial Performance of the bank is analyzed using selected financial ratios. In the pre merger scenario the following financial ratios Operating Profit per share, Net Operating Profit per Share exhibited mixed trend, Return on Net Worth showed decreasing trend but whereas the Net Profit Margin, Earnings Per Share and Book Value per share showed an increasing trend. In the post-merger scenario it was found that Operating profit per share, Net profit Margin Return on Net Worth and Earnings Per Share showed mixed trend where as Net Operating Profit per share showed decreasing trend and Book Value per share showed increasing trend during the same period.

The study concluded Operating profit per share, Net operating profit per share, Net profit Margin, Return on Net Worth, Earnings Per Share and Book Value of the share it can be concluded that there is significant difference in these ratios before after merger.

**Keywords:** Merger, Impact, financial Performance

## **Impact of Merger of Bharat Overseas Bank on the Financial Performance of Indian Overseas Bank- A Case Analysis**

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### **Introduction**

Mergers and acquisitions are used for improving competitiveness of companies and gaining competitive advantage over other firms through gaining greater market share, broadening the portfolio to reduce business risk and entering new markets. There are variations in terms of impact on performance following mergers, depending on the firm acquired – domestic or cross-border. In particular, mergers have had a positive effect on key financial and operational performance of firms acquiring domestic firms while a slightly negative impact on the firms acquiring cross-border firms.

Banking sector occupies a very important place in every economy and is one of the fastest growing sectors in India. The competition is intense and irrespective of the challenge from the challenge from the multinational players, domestic banks - both public and private are also seen rigorous in their pursuit of gaining competitive edge by acquiring or merging with potential opportunities as present today. As a result, Mergers and acquisitions are the order of the

day. Indian commercial banks are witnessing sweeping changes in the regulatory environment, huge growth in off-balance sheet risk management financial instruments, the introduction of e-commerce and online banking, and significant financial industry consolidation. All of these forces have made the Indian banking industry highly competitive.

Mergers and acquisitions in the banking sector is a common phenomenon across the world. The primary objective behind this move is to attain growth at the strategic level in terms of size and customer base. This, in turn, increases the credit-creation capacity of the merged bank tremendously. Small banks fearing aggressive acquisition by a large bank sometimes enter into a merger to increase their market share and protect themselves from the possible acquisition. Banks also prefer mergers and acquisitions to reap the benefits of economies of scale through reduction of costs and maximization of both economic and non-economic benefits. The process of merger and acquisition is not a new happening in case of Indian banking.

The banking sector is one of the most important instrument of the national development, occupies a unique place in a nation's economy. Economic development of the country is evident through the soundness of the banking system. Deregulation in the financial market, market liberalization, economic reforms have witnessed astounding changes in banking industry leading to incredible competitiveness and technological sophistication leading to a new era of in banking. Since then, every bank is relentless in their endeavor to become financially strong and operationally efficient and effective. Indian banks are the dominant financial intermediaries in India and have made good progress during the global financial crisis, it is evident from its annual credit growth, profitability and trends in NPAs.

Companies' growth is possible in two ways, organic or inorganic. Organic growth is also referred as internal growth, occurs when the company grows from its own business activity using funds from one year to expand the company the following year. Such growth is a gradual process spread over a few years but firms want to grow faster. Inorganic growth is referred as

external growth and considered as a faster way to grow which is most preferred. Inorganic growth occurs when the company grows by merger or acquisition of another business. The main motive behind the Merger is to create synergy, that is one plus one is more than two and this rationale beguile the companies for merger at tough times. Merger and Acquisitions help the companies in getting the benefits of greater market share and cost efficiency. For expanding the operations and cutting costs, Banks are using Merger and Acquisitions as a strategy for achieving larger size, increased market share, faster growth, and synergy for becoming more competitive through economies of scale.

### **Review of Literature**

Past academic studies examined impact of merger in banking sector by adopting one of the two following competing approaches. The first approach relates to long-term evaluation i.e. performance resulting from mergers by analyzing the accounting information such as return on capital, profitability ratios and efficiency ratios. An alternative approach is to analyze the merger gains in stock price performance of the bidder and the target firms around the announcement event. In

such case a merger is assumed to create value if the combined value of the bidder and target banks increases on the announcement of the merger and the consequent stock prices reflect potential net present value of acquiring banks. The current paper follows the former method and tries to find some empirical evidence for the same.

Dutta and Dawn (2012), in a paper “Merger and acquisitions in Indian banks after liberalisation: An analysis” investigates the performance of merged banks in terms of its growth of total assets, profits, revenue, deposits, and number of employees. The performance of merged banks is compared taking four years of prior-merger and four years of post-merger. The study findings indicate that the post-merger periods were successful and saw a significant increase in total assets, profits, revenue, deposits, and in the number of employees of the acquiring firms of the banking industry in India.

Azhagaiah & Kumar (2011), in their study tested hypothesis concerning whether there is significant improvement in the corporate performance of Indian manufacturing corporate firms following the merger event using paired t-test. The study findings indicate that Indian corporate firms

involved in M&A have achieved an increase in the liquidity position, operating performance, profitability, and reduce financial and operating risk. In another study they examined a sample consisting of 20 acquiring firms during the period 2007. They concluded that corporate firms in India appear to have performed better financially after the merger, as compared to their performance in the pre-merger period.

Azhagaiah and Sathish Kumar (2011), in their study related to short-run profitability of acquirer firms in India, selected 10 acquiring firms from chemical industry evaluated them based ratios such as Gross profit ratio, Operating profit ratio and Net profit ratio. Based on 3 years data before and after merger they concluded that there has been an increase in OPR, GPR, and NPR. The study finally indicates that there is a significant positive impact of M&A on the short-run post-merger profitability of acquirer firms of the chemical industry in India.

Antony Akhil (2011), in an analysis “Post-merger profitability of selected banks in India” examined the impact of the banks merged in India from 1999 to 2011. Between 1999 and 2011, around 18 M&A took place in the Indian banking sector. The

study samples were six acquirer banks selected, three of them were public sector banks and three were private sector banks. The study used paired t-test. The study findings indicate that there is a significant difference in the profitability ratios, like (growth of total assets ratio, growth of net profit ratio, return on assets ratio, return on equity ratio, and net interest margin ratio) of banks in the post-merger scenario.

Deo and Shah (2011), in a work entitled "Shareholder wealth effects to merger announcements in Indian industry" addressed the financial implications of the acquirer and target shareholders wealth in the Indian information technology industry (IT) that occurred from January 2000 to June 2010. The study which consisted of a sample of 28 merger announcements both by independent and controlling bidder firms, applied a constant market model to evaluate acquirer and target shareholders wealth. The study findings indicate that merger announcements in the IT sector have no significant impact on the bidder portfolio. M&A create significant positive abnormal returns for target shareholders only.

Pramod & Reddy (2007) evaluated that the impact of merger on the operating performance of acquiring firms in different

industries by using pre and post financial ratio to examine the effect of merger on firms. They selected all mergers involved in public limited and traded companies in India between 1991 and 2003, result suggested that there were little variation in terms of impact as operating performance after mergers. They concluded that particularly banking and finance industry had a slightly positive impact on profitability. Nevertheless, pharmaceutical, textiles and electrical equipments sector and showed the marginal negative impact on operative performance. However, some of the industries had a significant decline in terms of both profitability and return on investment and assets after merger.

Tambi (2005) evaluated the impact of mergers on the performance of a corporation of India. However, the theoretical assumption says that mergers improve the overall performance of the company due to increased market power and synergy impacts. He has evaluated selected banks using three parameters – PBITDA, PAT and ROCE - for any change in their before and after values by comparison of means using t-test. The results of his study indicate that mergers have failed to contribute positively.

Vardhana Pawaskar (2001) studied the impact of mergers on corporate performance. It compared the pre- and post-merger operating performance of the corporations involved in merger between 1992 and 1995 to identify their financial characteristics. The study identified the profile of the profits. The regression analysis

explained that there was no increase in the post-merger profits. The study of a sample of firms, restructured through mergers, showed that the merging firms were at the lower end in terms of growth, tax and liquidity of the industry. The merged firms performed better than industry in terms of profitability.

S.No	Name of the Acquirer Bank	Name of the Acquired Bank	Date of Merger/ Amalgamation
1	Bank of Bihar Ltd.	State Bank of India	November 8, 1969
2	National Bank of Lahore Ltd.	State Bank of India	February 20, 1970
3	Miraj State Bank Ltd.	Union Bank of India	July 29, 1985
4	Lakshmi Commercial Bank Ltd.	Canara Bank	August 24, 1985
5	Bank of Cochin Ltd.	State Bank of India	August 26, 1985
6	Hindustan Commercial Bank Ltd.	Punjab National Bank	December 19, 1986
7	Traders Bank Ltd.	Bank of Baroda	May 13, 1988
8	United Industrial Bank Ltd.	Allahabad Bank	October 31, 1989
9	Bank of Tamilnadu Ltd.	Indian Overseas Bank	February 20, 1990
10	Bank of Thanjavur Ltd.	Indian Bank	February 20, 1990
11	Parur Central Bank Ltd.	Bank of India	February 20, 1990
12	Purbanchal Bank Ltd.	Central Bank of India	August 29, 1990
13	New Bank of India	Punjab National Bank	September 4, 1993
14	Bank of karad Ltd	Bank of India	1993-1994
15	Kashi Nath Seth Bank Ltd.	State Bank of India	January 1, 1996
16	Bari Doab Bank Ltd	Oriental Bank of Commerce	April 8, 1997
17	Punjab Co-operative Bank Ltd.	Oriental Bank of Commerce	April 8, 1997
18	Bareilly Corporation Bank Ltd	Bank of Baroda	June 3, 1999
19	Sikkim Bank Ltd	Union Bank of India	December 22, 1999
20	Times Bank Ltd.	HDFC Bank Ltd	February 26, 2000
21	Bank of Madura Ltd.	ICICI Bank Ltd.	March 10, 2001
22	ICICI Ltd	ICICI Bank Ltd.	May 3, 2002
23	Benares State Bank Ltd	Bank of Baroda	June 20, 2002
24	Nedungadi Bank Ltd.	Punjab National Bank	February 1, 2003
25	South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 25, 2004

26	Global Trust Bank Ltd.	Oriental Bank of Commerce	August 14, 2004
27	IDBI Bank Ltd.	IDBI Ltd	April 2, 2005
28	Bank of Punjab Ltd.	Centurion Bank Ltd	October 1, 2005
29	Ganesh Bank of Kurundwad Ltd	Federal Bank Ltd	September 2, 2006
30	United Western Bank Ltd.	IDBI Ltd	October 3, 2006
31	Bharat Overseas Bank Ltd.	Indian Overseas Bank	March 31, 2007
32	Sangli Bank Ltd.	ICICI Bank Ltd.	April 19, 2007
33	Lord Krishna Bank Ltd.	Centurion Bank of Punjab Ltd.	August 29, 2007
34	Centurion Bank of Punjab Ltd.	HDFC Bank Ltd.	May 23, 2008
35	The Bank of Rajasthan	ICICI Bank Ltd.	August 13, 2010
36	Kotak Mahindra Bank	ING Vyasa Bank	November 20, 2014

Table 1: List of Merger and Acquisitions (M&As) in Indian Banking Industry since post Liberalization regime.

Source: Report on Trend and Progress, RBI, Various Issues, VIII competition and consolidation.

### **Need for the Study:**

The Banking system of India started in 1770 and the first Bank was the Indian Bank known as the Bank of Hindustan. Later on, some more banks like the Bank of Bombay-1840, the Bank of Madras-1843 and the Bank of Calcutta-1840 were established under the charter of British East India Company. These Banks were merged in 1921 and took the form of a new bank known as the Imperial Bank of India. For the development of banking facilities in the rural areas the Imperial Bank of India partially nationalized on 1 July 1955, and named as the State Bank of India along with its 8 associate banks (at present 7). Later on, the State Bank of Bikaner and the State

Bank of Jaipur merged and formed the State Bank of Bikaner and Jaipur.

The Indian banking sector can be divided into two eras, the pre liberalization era and the post liberalization era. In pre liberalization era government of India nationalized 14 Banks on 19 July 1969 and later on 6 more commercial Banks were nationalized on 15 April 1980. In the year 1993 government merged The New Bank of India and The Punjab National Bank and this was the only merger between nationalized Banks, after that the numbers of nationalized Banks reduced from 20 to 19. In post liberalization regime, government had initiated the policy of liberalization and licenses were issued to the private banks,

which lead to the growth of Indian Banking sector. The second Narasimham Committee (1998) had suggested mergers among strong banks, both in the public and private sectors. The facts and figures of mergers in Indian banking sector is as follows. During pre-nationalization period from 1961 to 1968, 46 mergers have taken place, in the nationalized period from 1969 to 1992 the number of mergers were 13. During the post reform period i.e. starting from 1993 to 2006, 21 mergers have taken place out of which 13 were forced mergers, 5 were voluntary merger, 2 were convergence of financial institution into bank and 1 was due to other regulatory compulsions.

The Indian Banking Industry shows a sign of improvement in performance and efficiency after the global crisis in 2008-09. The Indian Banking Industry is having a far better position than it was at the time of crisis. Government has taken various initiatives to strengthen the financial system. The economic recovery gained strength on the back of various monetary policy initiatives taken by the Reserve Bank of India.

### **Hypothesis:**

Mergers and Acquisition improve the financial performance of a bank.

### **Objectives of the Study**

- To analyze the impact of merging of Bharat Overseas Bank on the financial performance of Indian Overseas Bank.

### **Scope of the Study:**

The current study considers a public sector bank.

- Merger of Bharat Overseas Bank with Indian Overseas Bank and in the year 2007.
- Performance is evaluated taking into consideration 4 years prior to merger and 4 years after merger data.

### **Research Methodology:**

The performance of the banks has been evaluated based on the following financial measures:

- **Operating Profit Per Share(Rs.)** = Operating Profit/ Number of Shares
- **Net Operating Profit Per Share(Rs.)** = Net Operating Profit/ Number of Shares
- **Net Profit Margin** = (Net Profit/ Revenue)\*100
- **Return on Net Worth** = Net Income/ Shareholder's Equity

it is also referred as (**Return on Equity**)

- **Earnings Per Share** = Net Income / Weighted Average Common Shares Outstanding
- **Book Value per Share** = Total Common Stocks Holders Equity / No. of common shares

To analyze the impact of merger, pre and post merger data of the above ratios is considered excluding the year of merger.

**Paired t-test:** is applied to find whether there is significant difference in ratios before and after merger of the selected bank.

**Source of Information:** The data is collected from the website [www.moneycontrol.com](http://www.moneycontrol.com). Data Accessed on November 2016. Based on Consolidated Values.

## Data Analysis

**Merger of the Indian Overseas Bank (acquirer bank) and Bharat Overseas Bank (acquired bank) on 31<sup>st</sup> March, 2007:**

### About Indian Overseas Bank:

Indian Overseas Bank (IOB) was founded on 10<sup>th</sup> February 1937 by Shri M Ct

M Chidambaram Chettyar, with the twin objectives of specialising in foreign exchange business and overseas banking, with 3 branches at Chennai, Karaikudi and Rangoon. It was nationalized in the year 1969 having 208 with an asset mix of Rs.156 crores. In the year 2000 IOB has tied up with Dabur-All State Insurance to market the joint venture's life insurance products. Merger of Bharat overseas bank with IOB is of first of its kind as the merger was between public sector bank and private sector bank. Bharat Overseas Bank was originally designed to anchor Indian banks' overseas operations. The provocation was the Thai government asking Indian Overseas Bank to close its Bangkok branch in 1969 after its nationalisation. The government withstood the Thai pressure for four years and in 1973, following an RBI initiative, six private banks teamed up with Indian Overseas Bank to form Bharat Overseas Bank. Indian Overseas Bank owns 30 per cent in Bharat Overseas Bank. The other stockholders with their respective proportion of holding is as follows. Bank of Rajasthan - 16%, Vysya Bank -14.66%, Federal Bank - 10.67%, Karur Vysya Bank 10%, South Indian Bank -10 and Karnataka Bank - 8.67%. The Indian government has now reached an understanding with Thailand.

The RBI has allowed Krung Thai Bank Public Co to set up shop in India and Thailand is ready to reciprocate the gesture. So, there will be no problem in Indian Overseas Bank taking over Bharat Overseas Bank. RBI norms require commercial banks to have an equity base of Rs 300 crore. Besides, they must have a diversified holding with no single entity owning more than a 5 per cent stake. In March 2005, Indian Overseas Bank had an asset base of Rs 50,815 crore and capital of Rs 544.80 crore. Bharat Overseas Bank's asset base is Rs 3,214 crore on a capital base of Rs 15.75 crore. Its net worth is, however, Rs 198.39 crore against Indian Overseas Bank' Rs 2,575 crore.

Indian Overseas Bank acquisition of Bharat Overseas Bank will give it a lot of synergy,

in terms of the branch network in the country and also the lone overseas branch. IOB has branches in Singapore, Hong Kong, Sri Lanka and a representative office in Malaysia. It has applied to the Reserve Bank of India to open a branch in New Zealand and a representative office in Vietnam. This acquisition gave IOB a larger presence in the East Asian region thus help increasing its overseas business.

The table 2 presents the data of various financial ratios of Indian overseas bank. In the pre merger scenario for the considered 4 years, the following financial ratios Operating Profit per share (Rs.), Net Operating Profit per Share (Rs.) exhibited mixed trend, Return on Net Worth showed decreasing trend but whereas the Net Profit Margin, Earnings Per Share and Book Value per share showed an increasing trend.

Financial Ratios	Before merger 4 years			
	As on 31 Mar'2003 (-4)	As on 31 Mar'2004 (-3)	As on 31 Mar'2005 (-2)	As on 31 Mar'2006 (-1)
Operating Profit Per Share (Rs)	11.09	14.84	18.21	17.52
Net Operating Profit Per Share (Rs)	88.11	81.79	82.5	86.5
Net Profit Margin	10.52	11.40	14.27	16.44
Return on Net Worth (%)	32.1	30.25	29.85	28.55
Earnings Per Share	9.35	9.41	11.96	14.38
Book Value per Share	32.81	35.43	44.67	56.08

**Table 2:** Financial Ratios of **Indian Overseas Bank Pre Merger**  
**Source:** Financial statement of Indian Overseas Bank retrieved from moneycontrol.com

In the post-merger scenario table 3, it was observed that Operating profit per share, Net profit Margin Return on Net Worth and Earnings Per Share showed mixed trend during the considered 4 years post scenario.

Net Operating Profit per share showed decreasing trend and Book Value per share showed increasing trend during the same period.

Financial Ratios	Post merger 4 years			
	As on 31 Mar'2008 (+1)	As on 31 Mar'2009 (+2)	As on 31 Mar'2010 (+3)	As on 31 Mar'2011 (+4)
Operating Profit Per Share (Rs)	28.16	35.48	17.57	25.98
Net Operating Profit Per Share (Rs)	153.43	200.27	207.58	210.13
Net Profit Margin	13.94	11.87	6.14	8.04
Return on Net Worth (%)	25.35	22.31	11.13	13.13
Earnings Per Share	22.07	24.34	12.98	17.33
Book Value per Share	87.05	109.06	116.54	131.96

**Table 3:** Financial Ratios of **Indian Overseas Bank Post Merger**  
**Source:** Financial statement of Indian Overseas Bank retrieved from moneycontrol.com

Table 4 presents the descriptive statistics such as Mean and Standard deviation along with analysis of the various ratios of Indian overseas bank. The average ratios of Operating Profit Per share, Net Operating profit per share, Earnings Per Share and Book Value per share of post merger was found to be more compared before merger. This indicates that in the post merger scenario the financial performance of the Indian overseas bank has improved in terms of these ratios. However, the mean ratios of Net profit margin and Return on Net Worth of post merger were found to be less compared to pre-merger.

To know whether there is significant difference in the financial ratios before and after merger, paired t-test is applied using SPSS.

Financial Ratios		Mean	S. D Standard Deviation	t-value	p-value
Operating Profit Per Share (Rs)	Pre	15.42	3.23	-3.5642	<b>0.018853*</b>
	Post	26.80	7.37		
Net Operating Profit Per Share (Rs)	Pre	84.725	3.06	-7.81841	<b>0.002178*</b>
	Post	192.85	26.61		
Net Profit Margin	Pre	13.16	2.71	4.5121	<b>0.0101*</b>
	Post	9.998	3.55		
Return on Net Worth (%)	Pre	30.19	1.47	3.0172	<b>0.02844*</b>
	Post	17.98	6.92		
Earnings Per Share	Pre	11.275	2.4	-4.39	<b>0.0109*</b>
	Post	19.18	5.06		
Book Value per Share	Pre	42.24	10.53	-4.752	<b>0.0088*</b>
	Post	111.15	18.68		
<b>Table 4: Analysis of Financial Ratios of Indian Overseas Bank</b>					
*Significant at 5 percent.					

The summary of the analysis presented in table 4. Operating profit per share, Net operating profit per share, Net profit Margin, Return on Net Worth, Earnings Per Share and Book Value per Share, the p-value is less than 0.05, it can be concluded that there is significant difference in these ratios before after merger. However we cannot conclude that there is a positive impact of merger on Indian Overseas Bank as the t- value of some of the ratios is negative. Negative t-value indicates that performance of the bank was better prior to merger.

## Conclusion

The banking industry is one of the rapidly growing industries in India. It has transformed itself from a sluggish business entity to a dynamic industry. The growth rate in this sector is remarkable and 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 has accelerated through mergers and acquisitions. Mergers in banking sector are a form of horizontal merger because the merging entities are involved in the same

kind of activity. By the way of Mergers and acquisitions in the banking sector, the banks can achieve significant growth in their operations, minimize their expenses to a considerable extent and also competition is reduced because merger eliminates competitors from the banking industry. Based on the analysis of 4 years pre and post merger financial ratios merger data of Indian overseas bank, it can be concluded that Operating profit per share, Net operating profit per share, Net profit Margin, Return on Net Worth, Earnings Per Share and Book Value of the share it can be concluded that there is significant difference in these ratios before after merger.

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