Performance of Selected Public Sector Banks involved in Recent Mega Merger in India

Dr. L. Krishna Veni*[1] & Shreya Musti[2]
[1]*Professor, Siva Sivani Institute of Management, Secunderabad, Telangana, India-500 100*
[2]*PGDM Student, Siva Sivani Institute of Management, Secunderabad, Telangana, India-500 100*
[1]*kvenil@gmail.com* & [2]*shreya2018@ssim.ac.in*

Abstract

This study is aimed to analyze the performance and the profitability of Public sector banks during the period involved in the mega merger of April 2020 during the period of nine years i.e. from 2010-11 to 2018-19 for the selected PSBs under Merger 1(Canara Bank with Syndicate Bank and Merger 2(Union Bank of India with Andhra Bank and Corporation bank) with the help of the profitability and performance ratios. It further attempts to measure the performance of the PSBs linked with a merger from the investors' point of view and to provide some idea to the investors to invest in the PSBs using Tobin q Ratio. The data for this study has been drawn from www.investopedia.com and www.moneycontrol.com.The results conclude that Results reveal that the ROA of both the banks under merger1 and merger 2 ratios have dropped during the study period. The provisions for NPA held by banks involved in both merger1 and merger 2 also have caused negative ROA. Under the mergers of PSBs, the banks considered for this study have collectively shown Net Interest Margin which is fitting. In terms of Loans-to-Assets , it is clear from the results that Canara Bank has shown the synergy benefit from the Syndicate Bank under merger1. The banks under both mergers 1&2 have revealed suitable Net Interest Margin. Operating Profit Margin ratio during the study period indicates that both mergers might be limited since the banks are handling their operations in an organized way. Findings also reveal that the gradual decline in EPS and ROE Under both mergers represented that the negative effect might be limited as the banks share their benefits collectively. Tobin's Q ratio of both Merger 1&2 of PSBs has shown greater than 1 which means that the mergers are overvalued. Thus, it can be summed up that the banks considered for this analysis are earning a rate higher than its replacement cost, which would cause individuals or other banks to create similar types of businesses to capture some of the profits.

Keywords: Public Sector Banks, Mega Merger, Financial Performance, Profitability, Tobin's Q Ratio

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*Corresponding Author

1.Introduction

The banking sector plays a very significant role in the process of economic development of any country, therefore it is considered as one of the main financial pillars of the economy. In India for the first time in the year, 1969 nationalization banks were initiated with an aim to eliminate concentration of economic power in few hands and covert the class banking into mass banking and to diversify the flow of credit towards the priority sector comprising of agriculture and allied activities, small scale industries and small businesses. besides, it also aimed to foster a new class of entrepreneur in order to create, sustain and accelerate the economic growth of the economy.

Despite the significant performance of public sector banks (PSBs) since the nationalization, they have been suffering from many challenges like diseconomies of scale and growing Non Performing Advance(NPAs) , severe competition from private sector bank etc. Therefore Ministry of Finance has merged 10 PSBs into four mergers as listed below on 1st April 2020 as follows:

1. Punjab National Bank (Anchor bank) with Oriental Bank of Commerce & United Bank of India (Amalgamated banks)
2. Canara Bank (Anchor bank) with Syndicate Bank (Amalgamated bank)
3. Union Bank of India (Anchor bank) with Andhra Bank and Corporation bank (Amalgamated banks)
4. Indian Bank (Anchor bank) with Allahabad Bank (Amalgamated bank)

In this process of merger, banks which have fulfilled most of the banking fundamentals are declared as the Anchor banks (4) and the other PSBs are declared as the Amalgamated banks (6).

2.Review of Literature

Amardeep Kaur,,Moir Deep Singh (2014) explain that banks play an important role in the mobilization of deposits and expense of credit to different sectors of the economy. For that purpose 10 leading public and 10 private sector banks in India have been considered during 2001 to 2014 . The tools like CAGR, S. D, Mean and CV have been used to estimate the financial performance of banking sector. The results conclude that the private sector are working mainly for profit maximisation whereas the on PSBs are working to provide higher loans, credit facility and investment opportunities to weaker section. In the present era, government is working to give the boost to public sector banks to maintain their strong financial position. It also concluded that Basel I, II and III norms are necessary to strengthen the banking structure to focus on credit risk, capital management and adequate capital to stable any economy. Similarly, Basel III is supposed to reinforce banking capital requirements by increasing the bank liquidity and bank leverage. Capital requirement is the amount of capital a banks or other financial institution must hold as required by its financial regulator.

Devanand and Rajendra Prasad (2015) exposes how the importance of commercial banks in the process of economic development has been stressed from time to time by the economic thinkers and progressive bankers in India. Banks play a positive role in the economic development of a nation as depositories of community's savings and as purveyors of credit. Indian banks have assisted the economic development during the past fifty-eight years (1949-2007) in an effective way. This study concluded that the banking sector has shown remarkable responsiveness to the needs of planned economy.

Janet Jyothi Dsouza (2016) elucidates that public sector banks, foreign banks, private sector banks , regional rural banks and co-operative banks are playing a vital role under the direction of the Reserve Bank of India . The banking industry underwent major changes in the era of liberalization. The economic reforms completely have changed the banking sector. Now the situations have changed drastically. The new generation banks with use of technology and professional management have gained a reasonable position in the banking industry. Against this backdrop,this study is mainly aimed to evaluate the financial performance of Indian Public sector banks. In this study Ratio analysis is used to evaluate the liquidity, and profitability and the priority sector advances given by the various PSBs.

Palamalai Srinivasan, John Britto (2017), in their study attempted to evaluate the financial performance of selected Indian commercial banks during the period from 2012-13 to 2016-17. This study has taken 16 commercial banks, 11 from public sector and 5 from private sector and the financial performance of these banks has been analyzed using the ratio analysis. Results reveal that the financial performance of private sector banks is relatively better than the PSBs during the study period. In addition, this study examines the impact of liquidity, solvency and efficiency on the profitability of the selected Indian commercial banks by employing the panel data estimations. The Fixed Effect and Random Effect models also have been applied. The empirical results revealed that the liquidity ratio and solvency ratio, and the turnover ratio and solvency ratio are positive and significant impact on the profitability of selected public and private sector banks.

Krishna Veni and Vinay Sai (2020) in their study exposed that the PSBs are playing an important role in the Indian economy since the nationalization of banks. This study mainly considers the selected PSBs involved in the mega merger on 1st April 2020. This study aims to examine the financial solvency and stability of ten public sector banks using ratio analysis and Altman Z score during the period 2009-10 to 2018-19. The results disclose that nine banks out of 10 banks except the Corporation bank are in sound health and far away from bankruptcy zone during the study period. further this study concludes that the Altman Z score value of all banks considered is in the safe zone since the Z score is greater than 2.99 in all years considered for the study. Andhra Bank occupied top position, however Syndicate Bank, Oriental Bank of Commerce (OBC) and Punjab National Bank (PNB) represented second, third and fourth position of their financial health on average. Therefore, it is evident that, the results of the Altman Z score values for all 10 PSBs considered for this study are in the safe zone except the Corporation Bank.

Liang Fu Rajeev Singhal& Mohinder Parkash (2016) explains that Tobin's q ratio has been widely used as a proxy for investment opportunities in the literature of finance. If Tobin's q is a valid proxy for investment opportunities, a positive relationship can be observed between the q ratio and future operating performance of a firm. Against this backdrop, this study provides the empirical evidence on the relationship between the q ratio and future operating performance for a sample of publicly traded US firms. The results show that firms with higher q ratios experience superior operating performance in the long run.

Md.Rostam Ali,Md. Shahed Mahmud and Reshma Pervin Lima (2016) exposes that the investors have lost confidence regarding the share market due to the share market crash in 2010-2011 in Bangladesh. Therefore, this study tried to rethink about the share market of Bangladesh and to increase the confidence of the investors. Against this backdrop, Tobin's Q ratio used to analyse the share market in this study. From the results it is found that, the value of Tobin's Q of the all sampling banks has gradually declined, which means that the value of the stock has moved from overvalued to undervalue. The value of Tobin's Q of the all sampling banks is less than one in the year 2014 except Dutch Bangla Bank Limited (DBBL). The average value of Tobin's Q of the banking industry is also decreasing and the average value of Tobin's Q of the banking industry is less than one in the year 2014. Thus, the average stock value of the banking industry has moved from overvalued to undervalue gradually. Further, the value of Tobin's Q of all sampling banks fell drastically from the year 2010 to the year 2011 as share market has been crashed in those years. As a result, the average value of Tobin's Q of banking industry also fell considerably from the year 2010 to the year 2011.

In the light of the above discussion, it is found that there are no exclusive studies on the public sector banks involved in the recent mega merger to understand their performance and the profitability prior to the merger, therefore this present study attempts to analyse the following objectives:

1) To measure the performance and profitability of the Public sector banks associated with recent mega merger and
2) To estimate the performance of the PSBs linked with merger from the investors' point of view and to provide some idea to the investors to invest in the PSBs

3.Research Methodology

The methodology of this study is briefed as follows:

In this context, the present study considers the sample of only two mergers 2&3 out of the above cited four mergers of April 2020 (in the introduction) and the respective banks associated with them in order to understand by the performance of them by doing the fundamental analysis. They are named as Merger1 and Merger2 in the present study as shown below:

Merger 1: Canara Bank (Anchor bank) with Syndicate Bank (Amalgamated bank)

Merger 2: Union Bank of India (Anchor bank) with Andhra Bank and Corporation bank (Amalgamated banks)

This study is based on secondary data and the basic data for this study has been drawn from websites such as www.investopedia.com and www.moneycontrol.com. The study considers the period of nine years i.e. from 2010-11 to 2018-19 for the selected PSBs in order to analyse their past performance both independently and collectively based on the merger.

Tools and Variables used:

Performance and Profitability Ratios

For evaluating the performance of selected banks the ratios like Return on Assets, Loan to Assets and Net Interest Margin are used. Further, four ratios like Net Profit Margin, Operating Profit Margin, Return on Equity and Earnings per Share are considered for analysing the profitability of selected banks involved in mega merger of PSBs in India. Besides, this study focused on valuing the synergy by using Tobin's Q method for recent two years 2018 &2019.

Tobin’s Q Ratio:

Tobin’s Q represents the ratio of the market value of a firm's share capital to the replacement cost of the firm's share capital. Tobin’s Q is greater than one(>1) means stock is overvalued and if it is less than one(<1) means stock is undervalued. Again, Tobin’s Q is equal to one means stock is valued. This ratio expresses the relationship between market valuation and intrinsic value. In other words, it is a means of estimating whether a given business or market is overvalued or undervalued.

An undervalued company, one with a ratio of less than one (<1), would be attractive to corporate raiders or potential purchasers, as they may want to purchase the firm instead of creating a similar company. This may lead to increased interest in the company, which would increase its stock price, which would, in turn, increase its Tobin's Q ratio.

An overvalued company, one with a ratio higher than one (>1), they may see increased competition. A ratio higher than one indicates that a firm is earning a rate higher than its replacement cost, which would cause individuals or other companies to create similar types of businesses to capture some of the profits. This may lead to reduce the existing firm's market shares, lessen its market price and cause its Tobin's Q ratio to fall.

The profitability and performance ratios and Tobin’s Q are estimated by using the M.S. Excel.

4.Data Analysis

The estimates or calculated Key Financial ratios to measure the performance the profitability of selected public sector banks during the study period of 9 years (2010-11 to 2018-19)are discussed below. Further the results of Tobin’s Q (ratios) are discussed to evaluate whether a given business or market of the Public Sector Banks considered for this study is overvalued or undervalued.

Key Financial ratios used for evaluating the performance of selected PSBs:

Table1 Return on Assets (ROA)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	0.66	0.71	0.93	0.67	0.5	-0.53	0.12	-0.99	-0.83
Canara Bank	1.19	0.87	0.69	0.49	0.49	-0.5	0.19	-0.68	0.04
Merger1	0.93	0.79	0.81	0.58	0.5	-0.52	0.16	-0.84	-0.4
Andhra Bank	0	0	0.88	0.26	0.34	0.26	0.07	-1.4	-1.11
Corporation Bank	0.98	0.92	0.74	0.25	0.25	-0.21	0.22	-1.82	-2.96
Union Bank	0.88	0.68	0.69	0.47	0.46	0.33	0.12	-1.07	-0.59
Merger 2	0.62	0.53	0.77	0.33	0.35	0.13	0.14	-1.43	-1.55

Table 1 reveals that the ROA of both the banks under Merger1 viz., Canara Bank, and Syndicate bank has shown moderate ratios until 2014-15 with 0.49 and 0.50, however, these ratios have dropped in subsequent years.

Further, it can be inferred from Table 1 that the ROA of the banks under merger2, Union bank of India, Andhra Bank, and Corporate bank has recorded moderate ratios till 2016-17 with 0.12, 0.26, and 0.22 ratio but dropped to negative ratio in 2018-19 and 2019-19. Merger1 and Merger 2 also recorded negative ROA due to provisions for NPA held by banks.

Table 2 Loan to Assets (LTA)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	0.68	0.68	0.69	0.69	0.67	0.65	0.67	0.65	0.66
Canara Bank	0.63	0.62	0.59	0.61	0.6	0.59	0.59	0.62	0.62
Merger 1	0.66	0.65	0.64	0.65	0.64	0.62	0.63	0.64	0.64
Andhra Bank	0.66	0.67	0.67	0.64	0.68	0.65	0.62	0.62	0.64
Corporation Bank	0.61	0.61	0.61	0.62	0.64	0.6	0.54	0.57	0.54
Union Bank of India	0.64	0.68	0.67	0.65	0.67	0.66	0.63	0.59	0.6
Merger 2	0.64	0.65	0.65	0.64	0.66	0.64	0.6	0.59	0.59

From Table 2, it is evident that the Loans-to-Assets of the Syndicate bank stayed stable throughout the study period as it was following the RBI norms and as a result, Canara bank is getting the synergy benefit from the Syndicate bank.
It is evident from table 2 that the Loans-to-Assets of the Union Bank of India, Andhra Bank, and Corporate bank remained in good proportion. Therefore, the benefit would be more than the present position after Merger 1.

Table3 Net Interest Margin (NIM)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	2.29	2.05	1.91	1.81	1.82	1.94	2.09	2.02	2.13
Canara Bank	2.08	1.97	1.69	1.76	1.76	1.76	1.81	1.91	2.05
Merger 1	2.19	2.01	1.8	1.79	1.79	1.85	1.95	1.97	2.09
Andhra Bank	3.04	2.95	3.01	2.56	2.23	2.66	2.49	2.61	2.69
Corporation Bank	2.04	1.92	1.77	1.7	1.8	1.8	1.79	2.18	2.57
Union Bank of India	2.63	2.59	2.41	2.22	2.21	2.05	1.96	1.9	2.06
Merger 2	2.57	2.49	2.4	2.16	2.08	2.17	2.08	2.23	2.44

Table 3 exhibits that the Net Interest Margin of the Syndicate bank was stable, which represents the overall profitability of the bank, and Canara bank is to gain synergy benefit from the Syndicate bank. Based on the values shown in Table 3, the Net Interest Margin of the Syndicate bank (2.13), and Canara Bank (2.05), it is evident that with Merger1 these banks together have shown Net Interest Margin of 2.09 which is fitting.
It is clear from Table3 that the Net Interest Margin of the Union Bank of India, Andhra Bank, and Corporate bank was in good proportion during the study period. So, after the Merger1, all the three banks may have a synergy benefit more than the level shown during the study period. It is evident that the Net Interest Margin of the Andhra bank (2.69), Corporate bank (2.57) while Union Bank of India (2.06) in 2018-19, with the Merger2, have shown Net Interest Margin of 2.44 which is fitting.

Key Financial ratios used for evaluating the profitability of the selected PSBs:

Table 4 Net Profit Margin (NPM)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	9.15	8.6	11.7	9.19	7.04	-7.08	1.56	-14.79	-11.91
Canara Bank	17.54	10.64	8.42	6.16	6.17	-6.38	2.71	-10.23	0.74
Merger 1	13.35	9.62	10.06	7.68	6.61	-6.73	2.14	-12.51	-5.59
Andhra Bank	0	0	9.98	3.04	3.9	3.06	0.96	-18.98	-14.71
Corporation Bank	15.47	11.56	9.35	3.12	2.98	-2.6	2.88	-22.99	-40.53
Union Bank of India	12.65	8.49	8.58	5.77	5.55	4.19	1.69	-16.02	-8.65
Merger 2	9.37	6.68	9.3	3.98	4.14	1.55	1.84	-19.33	-21.3

From Table 4 it can be inferred that the Net Profit Margin of Syndicate bank was negative during the years 2015-16 ,2016-17 and 2018-19 though it was positive during the first
five years of the study period. Whereas in the case of Canara Bank, there is a gradual decline in the Net Profit Margin, since this bank has spent more than its earnings. After the Merger1 the earnings may be followed. Thus, it can be inferred that the merger is contributing to the Net Profit Margin of the banks mutually.
It also reveals that the Net Profit Margin of the Union Bank of India, Andhra Bank, and Corporate bank remained negative during the year 2018-19 as the banks have spent more than their earnings (Table 4) during the study period. After the Merger2 the earnings may be tracked effectively, so it is evident that Merger2 contributing to the Net Profit Margin of the banks.

Table 5 Operating Profit Origin (OPO)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	1.15	1.55	4.84	2.07	-2.71	-17.89	-13.46	-27.68	-22.14

Canara Bank	5.29	1.15	-0.82	-3.77	-4.22	-17.46	-15.54	-27.06	-13.3
Merger 2	3.22	1.35	2.01	-0.85	-3.465	-17.68	-14.5	-27.37	-17.72
Andhra Bank	-10.81	-7.58	1.87	-6.27	-5.26	-5.81	-11.83	-32.18	-25.51
Corporation Bank	1.72	0.1	-1.12	-6.04	-4.59	-11.54	-12.98	-36.11	-52.52
Union Bank of India	0.26	-3.14	-1.56	-3.83	-5.42	-7.08	-13.5	-31.26	-21.78
Merger 3	-2.94	-3.54	-0.27	-5.38	-5.09	-8.14	-12.77	-33.18	-33.27

Table 5 reveals that the Operating Profit Margin of Canara Bank and Syndicate bank was negative almost in the last four years of the study period. this might be because the banks might have spent more than their earnings. In 2018-19 the average Operating Profit Margin of both the banks has come down to -17.72 which indicates that Merger 1 has a negative effect. Thus, it indicates this merger might be limited as the banks shall carry out their operations have to move in an organized way.

From Table 5 the Operating Profit Margin of Union Bank of India, Andhra Bank, and Corporate bank was negative throughout the study period and this might be because these banks might have spent more than their earnings. According to the values shown in the Table5, in 2018-19 the average OPM of the banks involved in Merger 2 the OPM has declined to -33.27, which indicates that with the Merger2 the negative effect might be limited as the banks shall carry out their operations in an organized way.

Table 6 Earnings Per Share (EPS)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	20.03	22.89	33.3	28.21	24.38	-24.82	4.21	-34	-17.12
Canara Bank	97.83	74.1	64.83	54.48	58.59	-53.61	20.63	-70.47	4.71
Merger 1	58.93	48.5	49.07	41.35	41.49	-39.22	12.42	-52.24	-6.21
Andhra Bank	26.05	24.03	23.04	7.67	10.82	8.6	2.56	-42.12	-21.66
Corporation Bank	98.5	101.67	96.74	35.75	6.97	-5.48	5.17	-35.3	-30.06
Union Bank of India	39.71	34.07	38.93	27.99	28.05	20.42	8.08	-69.45	-25.08
Merger 2	54.75	53.26	52.9	23.8	15.28	7.85	5.27	-48.96	-25.6

Table 6 exposes that the EPS of Syndicate bank had a gradual decline and remained negative by the end of the study period being -17.12 when compared to that of EPS of Canara bank which was 4.71. The observation indicates that with the merger the negative effect might be limited as the banks shall segment their EPS.

It can be inferred that the EPS of Union Bank of India (-25.08), Andhra bank(-21.66), and Corporate bank (-25.08) have shown a gradual decrease (negative) By the end of the study period. Thus, it shows that with the Merger2, the negative effect might be limited as the banks shall segment their EPS.

Table 7 Return on Equity (ROE)

Bank	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Syndicate Bank	15.74	16.34	20.95	15.7	12.54	-15.32	2.85	-24.06	-17.4
Canara Bank	22.43	15.91	12.57	10.1	10.21	-10.75	3.96	-14.51	1.16
Merger 1	19.085	16.125	16.76	12.9	11.375	-13.04	3.405	-19.285	-8.12
Andhra Bank	0	0	15.27	4.98	6.34	4.91	1.53	-31.54	-21.16
Corporation Bank	19.79	18.19	14.99	5.56	5.57	-4.73	4.65	-39.81	-40.43
Union Bank of India	18.79	13.75	13.75	10.03	9.71	6.65	2.36	-20.9	-12.15
Merger 2	12.86	10.65	14.67	6.86	7.21	2.28	2.85	-30.75	-24.58

Table 7 exposes that the ROE of Syndicate bank recorded a gradual decline (negative) towards the end of the study period with -17.40 whereas the ROE of Canara bank (1.16) has shown an increase in the year 2018-19.

This observation indicates that with the Merger1 the negative effect might be limited as the banks shall segment their ROE.
Ii is also evident from Table 8 that the ROE of Union Bank of India (-40.43) , Andhra bank –(21.16)and Corporate bank(-12.15) has revealed a gradual decrease towards the end of the study period. Thus, the results reveal that with the Merger2, the negative effect might be limited as the banks shall segment their ROE.

Table 8 Tobin's Q ratio of the PSBs involved in two Mergers

Bank	2018	2019
Syndicate Bank	1.52	2.38
Canara Bank	8.14	18.98
Merger1	4.83	10.68
Andhra Bank	0.9	1.63
Corporation Bank	4.93	12.75
Union Bank of India	2.77	4.89
Merger 2	2.87	6.42

Table 8 represents the Tobin's Q ratio of both Merger 1&2 of Public Sector Banks(PSBs) considered for this study in the years 2018 and 2019. It can be inferred from the values of Tobin's Q ratio that Merger 1 (Syndicate Bank is merged with the Canara Bank) and Merger 2 (Andhra Bank, Corporation Bank are merged with Union Bank of India) have indicated Tobin's Q ratio greater than 1(>1) which means that the mergers are overvalued (except Andhra Bank in 2018). It is also clear that all banks involved in both mergers have recorded higher values in 2019 compared to 2018, which represents that these banks are doing good thus attracting potential investors.
From the results, it is found that the value of Tobin's Q of all sampling banks is gradually increasing means moving the value of the stock from undervalued to overvalued. The value of Tobin's Q of all sampling banks is greater than one in the years 2018 and 2019 (except Andhra Bank in 2018). Thus, the banks considered for this analysis are earning a rate higher than its replacement cost, which would cause individuals or other banks to create similar types of businesses to capture some of the profits.

5.Summary Conclusions

It is obvious from the above analysis, that these two mergers will be helpful in the long run as ROA of both mergers shows an improvement with combined assets utilization. From this study conclude that there are high levels of stressed assets due to priority lending, they are yet to be declared as NPAs. Both Merger 1and Merger 2 are getting benefits in terms of Loans-to-assets and Net Interest Margin.
Under the mergers of PSBs, the banks considered for this study have collectively shown Net Interest Margin which is fitting. Operating Profit Margin ratio during the study period indicates that both mergers might be limited since the banks may carry out their operations in an organized way. Under both mergers, the gradual decline in and ROE and EPS denotes that the negative effect might be limited as the banks share their benefits collectively.
Further, Tobin's Q ratios conclude that both the mergers are overvalued and show that the PSBs have performed well thus attracting the investors among the banks associated with both mergers. Canara Bank under merger1 and Corporation Bank under merger 2 have drawn more attention by the investors in years 2018 and 2019. Between the two mergers, merger1 has recorded higher Tobin's Q ratios than merger 2 during the same time. This may lead to reduce the existing market shares of these banks and lessen their market price and may cause their Tobin's Q ratio to fall. However, these results are subjected to certain limitations which are quite unpredictable economic environment, thus based on the results, the investors may not predict the exact future and take the investment decisions.

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