p-ISSN: 2348-6848
e-ISSN: 2348-795X
Volume 02 Issue 11
November 2015

Mergers and Acquisitions in Indian Banking Sector

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ABSTRACT

This research paper looks at Mergers and Acquisitions (M&A's) that have happened in Indian banking sector to understand the resulting synergies and the long term implications of the merger. The paper also analyses emerging future trends and recommends steps that banks should consider for future. The paper reviews the trends in M&A's in Indian banking and then impact of M&A's has been studied in three leading banks of India. The study covers the area of performance evaluation of M&A's in Indian banking sector during the period from 2000 to 2013. The paper compares pre and post merger financial performance of merged banks with the help of financial parameters like, Net Profit margin, operating Profit margin, Return on Capital Employed, Return on Equity, earnings per share, capital adequacy ratio, dividend per share etc. The findings suggest that to some extent M&A's has been successful in Indian banking sector. The Government and Policy makers should not promote merger between strong and distressed banks as a way to promote the interest of the depositors of distressed banks, as it will have adverse effect upon the asset quality of the stronger banks.

Keywords: Strategic alliance, Capital adequacy, Mergers, Consolidation, Ratios, Acquisitions

INTRODUCTION

The banking system in India is significantly different from that of other Asian nations because of country's unique geographic, social, and economic characteristics. India has a large population and land size, a diverse culture, and extreme disparities in income, which are marked among its regions. There is high level of illiteracy among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. About 30 and 35 percent of the population resides in metro and urban cities and the rest is spreaded in several semi-urban and rural centers. The country's economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the "export led growth" as compared to other Asian economies, with emphasis on self-reliance through import substitution. It has been realized globally that M&A is only way for gaining competitive advantage domestically and internationally and as such the whole range of industries are looking for strategic acquisitions within India and abroad. The Banking system of India was 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 formed 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. Consolidation of Indian banking sector through M&A's on commercial considerations and business strategies are the essential pre-requisite. Consolidation has been a significant strategic tool and has become a worldwide phenomenon, driven by advantages of

scale-economies, geographical diversification, and lower costs through branch and staff rationalization, cross-border expansion and market share concentration.

II. RESEARCH METHODOLOGY

Objectives:

1. To study the trends of M&A's in Indian banking sector.
2. To study the performance of the banks in the pre and post M & A.

Sources of Data

The secondary data is collected for the study. In addition, the other required data were collected from various journals and magazines.

Limitation

1. The study ignores the impact of possible differences in the accounting methods adopted by different companies.
2. The factors which effect the M & A performance may not be same for all companies.
3. The cost of acquisition for mergers is not considered in the methodology.

Apart from this, few more merger were occurred in the Indian banking sector , the HDFC Bank acquired the Centurion Bank of Punjab on 23 May 2008. In the year 2010, on 13th August, the process of M&As in the Indian banking sector passed through the Bank of Rajasthan and the ICICI Bank. The Reserve Bank of India sanctioned the scheme of merger of the ICICI Bank and the Bank of Rajasthan. After the merger, ICICI Bank replaced many banks to occupy the second position after the State Bank of India (SBI) in terms of assets in the Indian Banking Sector.

IMPACTS OF MERGER & ACQUISITIONS

***1.* Growth:** Companies that desire rapid growth in size or market share or diversification in the range of their products may find that a merger can be used to fulfill the objective instead of going through the time consuming process of internal growth or diversification. The firm may achieve the same objective in a short period of time by merging with an existing firm.

***2.* Synergy:** The merged entity has better ability in terms of both revenue enhancement and cost reduction. Mergers and Acquisition allows firms to obtain efficiency gains through cost reductions (cost synergies) & revenue increases (revenue synergies).

***3.* Purchase Of Assets At Bargain Prices:** M&A'S have the opportunity to acquire assets, particularly land mineral rights, plant and equipment, at lower cost than would be incurred if they were purchased or constructed at the current market prices.

***4.* Enhanced Managerial Skills:** Occasionally a firm with good potential finds it unable to develop fully because of deficiencies in certain areas of management or an absence of needed product or production technology. If the firm cannot hire the management or the technology it needs, it might combine with a compatible firm that has needed managerial, personnel or technical expertise.

***5.* Acquiring New Technology:** To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

***6.* Broader Array Of Products:** When two firms merge they have diversified variety of products and after the merger each consumer in both the firms will be benefited with the range of products or services to choose from M&A's helps firms to widen its consumer portfolio but it also leads to a more diversified range of services .

***7.* Income Tax Advantages:** In some cases, income tax consideration may provide the financial synergy motivating a merger. Tax concessions act as a catalyst

p-ISSN: 2348-6848
e-ISSN: 2348-795X
Volume 02 Issue 11
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for a strong bank to acquire distressed banks that have accumulated losses and unclaimed depreciation benefits in their books.

***8.* Own Developmental Plans:** The purpose of acquisition is backed by the acquirer companies own developmental plans. A company thinks in terms of acquiring the other company only when it has arrived at its own development plan to expand its operation having examined its own internal strength. It has to aim at suitable combination where it could have opportunities to supplement its funds by issuance of securities; secure additional financial facilities eliminate competition and strengthen its market position.

***9.* Strategic Purpose:** The Acquirer Company view the merger to achieve strategic objectives through alternative type of combinations which may be horizontal, vertical, product expansion, market extensional or other specified unrelated objectives depending upon the corporate strategies.

***10.* Corporate Friendliness:** Although it is rare but it is true that business houses exhibit degrees of cooperative spirit despite competitiveness in providing rescues to each other from hostile takeovers and cultivate situations of collaborations sharing goodwill of each other to achieve performance heights through business combinations.

MERGER AND AMALGAMATION: BANKING REGULATION ACT, 1949

Under Banking Regulation Act, presently there is no provision for obtaining approval of the Reserve Bank of India for any acquisition or merger of any financial business by any banking institution. In other words, if a banking institution desires to acquire non-banking finance company there is no requirement of approval of the Reserve Bank of India.

Further, in case of merger of all India financial institution with own subsidiary bank, there was no expressed requirement for obtaining the approval of Reserve Bank of India, under the provisions of the Banking Regulation Act or the Reserve Bank of India Act. Such approval is required only in the context of relaxation of regulatory norms to be complied by a bank However, for a regulator, it is a matter of concern to ensure that such acquisitions or mergers do not adversely affect the concerned banking institutions or the depositors of such banking institutions. The Competition Commission of India will approve M&A (Mergers and Acquisitions) in banks except in the case of banks that are under trouble. In such cases, the RBI will have the final authority. So, Bank mergers in India are often viewed as shotgun marriages. The merger of the banking companies in India attract Section 44 A of the Banking Regulation Act 1949 unlike other companies which are bound by Section / s 390 – 396 of Indian Companies Act 1956.

The guidelines on merger and amalgamation of banks announced by the Reserve Bank in May 2005 stipulated the following:

- The draft scheme of amalgamation is approved individually by two-thirds of the total strength of the total members of board of directors of each of the two banking companies.
- The members of the boards of directors who approve the draft scheme of amalgamation are required to be signatories of the Deed of Covenants as recommended by the Ganguly Working Group on Corporate Governance.
- The draft scheme of amalgamation is approved by shareholders of each banking company by a resolution passed by a majority in number representing two-thirds in value of shareholders, present in person or by proxy at a meeting called for the purpose.
- The swap ratio is determined by independent values having required competence and experience; the board should indicate whether such swap ratio is fair and proper.

• The value to be paid by the respective banking company to the dissenting shareholders in respect of the shares held by them is to be determined by the Reserve Bank. The shareholding pattern and composition of the board of the amalgamating banking company after the amalgamation are to be in conformity with the Reserve Bank's guidelines.

• Where an NBFC is proposed to be amalgamated into a banking company in terms of Sections 391 to 394 of the Companies Act, 1956, then it is required to obtain the approval of the Reserve Bank before the scheme of amalgamation is submitted to the High Court for approval.

MAJOR MERGER AND ACQUISITIONS IN INDIAN BANKING SECTOR SINCE ECONOMIC LIBERALIZATION

In India, consolidation of banks through Merger and Amalgamation is not a new phenomenon, which has been going on for several years. Since the beginning of modern banking in India, through the setting up of English Agency House in the 18th century, the most significant merger in the pre- Independence era was that of the three Presidency banks founded in the 19th century in 1935 to form the Imperial Bank of India (renamed as State Bank of India in 1955). In 1959, State Bank of India acquired the state-owned banks of eight former princely states. In order to strengthen the banking system, Travancore Cochin Banking Enquiry Commission (1956) recommended for closure / amalgamation of weak banks. Consequently, through closure/ amalgamations that followed, the number of reporting commercial banks declined from 561 in 1951 to 89 in June 1969. Merger of banks took place under the direction of the Reserve Bank during the 1960s. During 1961 to 1969, 36 weak banks, both in public and private sectors, were merged with other stronger banks. This way been several bank amalgamations were seen in India in the post-reform period. In all, there have been 33 M&As since the nationalization of 14 major banks in 1969. Of these mergers, 25 involved mergers of private sector banks with public sector banks, while in the remaining eight cases, mergers involved private sector banks. Out of 33, 21 M&As took place during the post-reform period with as many as 17 mergers/ amalgamations taking place during 1999 and after.

MERGER AND ACQUISITION IN INDIAN BANKING – PRESENT SCENARIO

In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's banking growth story. The first banks were Bank of Hindustan (1770-1829) and The General Bank of India, established 1786 and since defunct. The largest bank, and the oldest still in existence, is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955. The Government of India issued an ordinance and nationalised the 14 largest commercial banks in 1969. These banks have 85 per cent of bank deposits in the country. A second round of nationalisation of 6 more commercial banks took place in 1980. Nationalisation took place so that government gets more control

of credit delivery. With the second round of nationalisation, 91% of banking business was held by the Government of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank.

THE INDIAN BANKING SECTOR:

The history of Indian banking can be divided into three main phases :
Phase I (1786- 1969) - Initial phase of banking in India when many small banks were set up
Phase II (1969- 1991) - Nationalisation, regularisation and growth
Phase III (1991 onwards) - Liberalisation and its aftermath

REASONS FOR BANK MERGER

***1)* Merger of weak banks:** Practice of merger of weak banks with strong banks was going on in order to provide stability to weak banks but Narsimhan committee opposed this practice. Mergers can diversify risk management.

***2)* Increase market competition:** Innovation of new financial products and consolidation of regional financial system are the reasons for merger. Markets developed and became more competitive and because of this market share of all individual firm reduced so mergers and acquisition started.

3) Economies of scale: Capability of generating economies of scale when firms are merged.

4) Skill & Talent: Transfer of skill takes place between two organisation takes place which helps them to improve and become more competitive.

5) Technology, New services and Products: Introduction of e- banking and some financial instruments / Derivatives. Removal of entry barrier opened the gate for new banks with high technology and old banks can't compete with them so they decide to merge.

6) Positive Synergies: When two firms merge their sole motive are to create a positive effect which is higher than the combined effect of two individual firms working alone. Two aspects of it are cost synergy and revenue synergy.

Few other reasons are :-

- Sick banks survived after merger & Enhanced branch network geographically.
- Larger customer base (rural reach)& Increased market share.
- Attainment of infrastructure & restrict competition and prevent overcrowding of banks & utilize under and unutilized resources so that the banks can compete the foreign banks in global era

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Table-1: LIST OF M&A'S IN INDIAN BANKING INDUSTRY SINCE POST LIBERALIZATION REGIME

YEAR	ACQUIRER	TARGET	TYPE/MOTIVE
1993	Punjab National Bank	New bank of India	Forced Merger
1993	Bank of India	Bank of Karad.Ltd.	Forced Merger
1996	State bank of India	Kashinath Seth Bank	Forced Merger
1997	Oriental bank of commerce	Punjab cooperative bank ltd.	Forced Merger
1997	Oriental bank of commerce	Bari Doab bank ltd.	Forced Merger
1999	Union bank of India	Sikkim bank ltd.	Forced Merger
2000	HDFC bank ltd.	Times bank	Voluntary Merger
2001	ICICI bank	Bank of Madura	Voluntary Merger
2002	ICICI bank	ICICI Ltd.	Voluntary Merger

2002	Bank of Baroda	Benaras State bank ltd.	Forced Merger
2003	Punjab National Bank	Nedungadi Bank ltd.	Forced Merger
2004	Bank of Baroda	South Gujrat Local Area Bank	Forced Merger
2004	Oriental bank of Commerce	Global trust bank	Forced Merger
2005	Centurion bank	Bank of Punjab	Voluntary Merger
2006	Federal bank	Ganesh bank of Kurandwad	Forced Merger
2006	IDBI bank	United western bank	Forced Merger
2006	Centurion bank of Punjab	Lord Krishna Bank	Voluntary Merger
2007	ICICI bank	Sangli bank	Voluntary Merger
2007	Indian overseas bank	Bharat overseas bank	Compulsory Merger

Source: Compiled from Report on Trend and Progress of Banking in India, RBI, various issues.

Prior to 1999, the amalgamations of banks were primarily triggered by the weak financials of the bank being merged, whereas in the post-1999 period, there have also been mergers between healthy banks, driven by the business and commercial considerations. Recently the process of M&As in the Indian banking sector is generally market driven. As given in the policies and objective of mergers, most of the mergers have taken place voluntarily for strategic purposes. The Reserve Bank of India has been encouraging the consolidation process for the small banks that are facing difficulty to compete with large banks which enjoy enormous economies of scale and scope. Most of the amalgamations of private sector banks in the post nationalization period were induced by the Reserve Bank in the larger public interest, under Section 45 of the Act. In all these cases, the weak or financially distressed banks were amalgamated with the healthy banks.

The over-riding principles governing the consideration of the amalgamation proposals were:

(a) protection of the depositors' interest;
(b) expeditious resolution;
(c) avoidance of regulatory forbearance.

The amalgamations of the erstwhile Global Trust Bank and United Western Bank with public sector banks are the recent examples of such mergers. Even in such cases, commercial interests of the transferee bank and the impact of the amalgamation on its profitability were duly considered. The mergers of many weak private sector banks with the healthy ones have brought the Indian banking sector to a credible position, as the CRAR of all private sector banks in the country was more than the minimum regulatory requirement of nine per cent as at end-March 2007.

FINDINGS

Mergers and amalgamations involved relatively smaller banks, the largest number of mergers took place with ICICI Bank, Bank of Baroda and Oriental Bank of Commerce (each one of them was involved in three mergers). ICICI Bank replaced many entities to occupy the second position in the Indian banking sector after State Bank of India. In the Banker's list out of the top 1000 banks of the world (July 2007), there were 27 Indian banks (as compared with 20 in July 2004).

The mergers of regional rural banks (RRBs) took place on a large scale in India since September 2005. Mergers of RRBs were largely policy driven in pursuance of the recommendations of the Committee on the "Flow of Credit to Agriculture and Related Activities".

The Committee Report submitted in June 2004 recommended restructuring of RRBs in order to improve the operational viability of RRBs and take advantage of the economies of scale. In order to reposition RRBs as an effective instrument of credit delivery in the Indian financial system, the Government of India, after consultation with NABARD, concerned State Governments and the sponsor banks to intimate initiated State-level sponsor bank-wise amalgamation of RRBs to overcome the deficiencies prevailing in RRBs and making them viable and profitable units.

CONCLUSION

Mergers in India have also been used as a tool for strengthening the financial system. Through a conscious approach, the weak and small banks have been allowed to merge with stronger banks to protect the interests of depositors and to avoid possible financial contagion that could result from individual bank failures and also to reap the benefits of synergy. Thus, the Indian approach has been different from that of many other EMEs, wherein the government was actively involved in the consolidation process. For instance, in East-Asia, after the banking crisis in 1997, the government led the process of bank mergers in order to strengthen capital adequacy and the financial viability of many smaller and often family-owned banks.31 In these crisis ridden countries, the involvement of the government was inevitable, as viable but distressed institutions were hardly in a position to attract potential buyers without moving some non-performing loans to an asset management company and/or receiving temporary capital support. After nationalization of banks in 1969, India did not allow entry of private sector banks until January 1993, when these barriers were removed; India also liberalized the entry of foreign banks in the post-reform period. And further these liberalized measures resulted in entry of many new banks (private and foreign). Accordingly, the number of banks increased during the initial phase of financial sector reforms. However, the pace of consolidation process gathered momentum from 1999-2000. The growth in the financial performance depicts the steady increase in the performance of Banks. The major Mergers and Amalgamations deals are also extensively dealt with. Having studied the background of the Indian banking sector, the next chapter involves a detailed financial analysis of five mergers and Amalgamations that have taken place in India. The impact of mergers and amalgamations on the performance of the banks both pre and post amalgamations era has been determined.

SUGGESTIONS

The empirical findings of this study suggest that trend of merger in Indian banking sector has so far been restricted to restructuring of weak and financially distressed banks. The Indian financial system requires very large banks to absorb various risks that have been emerged from operating in local and global market. The prime factors for future mergers in Indian banking industry included the Basel –II environment, challenges of free convertibility and requirement of large investment banks. Therefore, the Government and policy makers should be more cautious in promoting merger as a way to reap economies of scale and scope.

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November 2015

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