EMPERICAL STUDY ON MERGERS AND ACQUISITIONS IN INDIAN BANKING SECTOR

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Abstract

The Indian banking sector is an important constituent of the Indian financial system. The Indian Banking Industry has undergone transformation over the years, which changed its structure and functions. The banking industry has evolved and transformed itself from a social banking to a liberalized, modernized and technology-oriented industry. The Indian Economy's liberalization in the early 1990 has resulted in the conception of various private sector banks which resulted in great boom in the banking sector during the past two decades. Mergers and Acquisitions that have happened in Indian banking sector to understand the resulting synergies and the long-term implications of the merger. The findings suggest that to some extent Mergers and Acquisitions has been successful in Indian banking sector. The present study concentrates on significance of Mergers and Acquisitions and what impact on Indian Banking Sector.

Key Words: *Indian Banking Sector,* liberalisation, deregulation *Mergers and Acquisitions*

I. Introduction:

The Banking system in India has seen major changes during the last decade and has evolved stronger with effective regulatory mechanisms in place. Infact, India has been appreciated for the way in which the economy handled the recent global economic crises. The credit for this goes to the manner in which Reserve Bank of India as the central bank handled the situation and the way in which the banking system responded. The system has matured and is now on the threshold of many unique initiatives to make the banks in India reach out to larger sections of the society in a transparent, friendly and faster way. Treatment of the customer and efficiency in services are now focus areas of the banks. The banking sector reforms undertaken in India from 1992 onwards were basically aimed at ensuring the safety and soundness of financial institutions and at the same time at making the banking system strong efficient, functionally diverse and competitive. The reforms included measures for arresting the decline in productivity, efficiency and profitability of the banking sector. Furthermore, it was recognised that the Indian banking system should be in tune with international standards of capital adequacy, prudential regulations, and accounting and disclosure standards. Financial soundness and consistent supervisory practices, as evident in level of compliance with the Basel Committee's Core Principles for effective Banking Supervision, have made our banking system resilient to global shocks.

India has not faced any major economic/financial crises, though in 1990-91, there was some pressure on the external sector with the current account deficit and external debt servicing reaching large proportions. However, due to prudent macroeconomic policies, it was possible to return the country to a sustainable growth path.

As well as the long history of regulation and supervision, Indian banks have limited exposure to sensitive sectors such as real estate, equity, etc, strict control over off-balance sheet activities, larger holdings of government bonds, relatively well diversified credit portfolios, statutory restrictions on connected lending, adequate control over currency and maturity mismatches, etc, which has insulated them from the adverse impact of financial crisis and contagion. Banks in India have played a significant role in the development of the Indian economy. However, with the structural reforms initiated in the real economy from the early 1990s, it was imperative that a vibrant and competitive financial system should be put in place to sustain the ongoing process of reforms in the real sector.

The financial sector reforms have provided the necessary platform for the banking sector to operate on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability. The reforms also brought about structural changes in the financial sector and succeeded in easing external constraints on its operation, introducing transparency in reporting procedures, restructuring and recapitalising banks and enhancing the competitive element in the market through the entry of new banks. The ongoing revolution in information and communication technology has, however, largely bypassed the Indian banking system given the low initial level of automation. The competitive environment created by financial sector reforms has nonetheless compelled the banks to gradually adopt modern technology, albeit to a limited extent, to maintain their market share. Banks continue to be the major financial intermediaries with a share of 64% of total financial assets. However, non-bank financial companies and development finance institutions are also emerging as alternative sources of funding. In India, foreign banks account for only around 8% of the total assets of the banking system. Further, domestic households are not allowed to place deposits abroad. Similarly, conditions for accessing overseas capital markets by domestic corporates have been stringent, in terms of size, maturity, pricing, etc. The impact of the entry of foreign banks on domestic banks is likely to depend on various factors such as the structure, strength and competitiveness of domestic banks, the share of foreign banks, and the regulatory/supervisory framework. While the entry of foreign banks could definitely improve the competitive environment, they are not likely to weaken domestic banks. With better technology and expertise in offering specialised banking products such as derivatives, advisory services, trade finance, etc, foreign banks can enhance healthy competition and has a positive spill over effect on the domestic banks. The domestic banks would be under peer pressure to improve operational efficiency. It needs, however, to be recognised that the banking system in India is quite competitive with the presence of public, private and foreign banks. Thus, the major forces for change in the Indian context have been the following:

- Consistent and strong regulatory and supervisory framework;
- Structural reforms in the real and financial sectors;
- Commitment to adopt and refine regulatory and supervisory standards on a par with international best practices; and
- Competition from foreign banks and new-generation private sector banks

II. Privatisation of State Banks

State banks in India have, over the years, played a very significant role in the development of the economy and in achieving the objectives of the nationalisation undertaken in 1969 and 1980, namely to reach the masses and cater to the credit needs of all segments, including weaker sections, of the economy. The period 1969-90 witnessed rapid branch expansion and an adequate flow of credit to all sectors, including the neglected sectors of the country.

From 1990, however, it was recognised that steps were needed to improve the financial health of banks to make them visible, efficient and competitive to serve the emerging needs and enhance the efficiency of the real sector. While the role of the large state banks has not undergone any structural changes and they continue to serve the varying needs of the economy, what has changed significantly, as a result of the reform process, is the focus on their consolidation, efficiency, resilience, productivity, asset quality and profitability through liberalisation, deregulation and adoption of prudential standards in line with international best practices. As a part of financial sector reforms and with a view to giving the state banks operational flexibility and functional autonomy, partial privatisation has been authorised as a first step, enabling them to dilute the stake of the Indian government to 51%. The government further announced, in the union budget for the financial year 2000-01, to reduce its holding in nationalised banks to a minimum of 33% on a case-by-case basis. The major problems for gradual privatisation are likely to be resistance from staff to rationalisation of the branch network and emphasis on higher staff productivity. The optimal size of a bank depends on several factors and differs between countries depending on the level of economic development, the number and diversity of financial institutions/instruments, the competitive situation in the market, etc. Looking at the typical Indian situation, the big banks operating in international markets have to coexist with banks operating only at the national level, regional rural banks and cooperative banks, which will induce the necessary competition in the market. Most of the state banks have a strong national presence and are catering to the needs of various segments of the economy. It means, do not expect to split the state banks into smaller entities even after the gradual disinvestment of government equity in them. Rather, there is a possibility of consolidation for synergising business/regional strengths, and efforts in this area may be with the functional autonomy that will emerge as a result of such disinvestment.

III. History of Mergers & Acquisitions in Indian Banking Sector

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. After that government get 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 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

IV. Reasons for Merging Banks:

a) **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.
b) **Market competition Increase:** 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.
c) **Economies of scale:** Capability of generating economies of scale when firms are merged.
d) **Skill & Talent:** Transfer of skill takes place between two organisation takes place which helps them to improve and become more competitive.
e) **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.
f) **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.
g) Sick banks survived after merger & Enhanced branch network geographically.
h) Larger customer base (rural reach) & Increased market share.
i) 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.

V. Merger & Acquisition's in Indian Banking Industry

YEAR	ACQUIRER	TARGET	TYPE / MOTIVE
1993	Punjab National Bank	New Bank of India	Forced Merger
1993	Bank of India	Bank of Kard Ltd	Forced Merger
1996	State Bank of India	Kashinath Seth Bank	Forced Merger
1997	Oriental Bank of Commerce	Punjab Co-operative 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 Limited	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 Gujarat 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
2008	HDFC Bank Centurion	Bank of Punjab	Voluntary Merger
2008	State Bank of India	State Bank of Saurastra	Voluntary Merger
2010	ICICI Bank Ltd	The Bank of Rajasthan	Acquisition
2010	State Bank of India	State Bank of Indore	Acquisition

Source: Compiled from Report on Trend and Progress of Banking in India, RBI, Various Issues

VI. Advantages of the Public Sector Bank Mergers

- The bank's service delivery will see a huge improvement
- Mergers enable a large capital base that will aid the acquirer to offer a bigger loan amount
- Customers of the bank will have a much wider range of products they can choose from in mutual funds, insurance products, loans and deposits.
- The need for recapitalisation from the government will reduce after a merger.
- The bank will have an opportunity to establish technological advancements in their process.

VII. Recent Merged Public Sector Banks in India

In a move to restructure and redefine the country's banking space, in 2021, the government of India merged 10 public Sector (PSU) Banks in to 4 banks. A merger is an agreement between entities where they pool in their assets and liabilities and become one entity. The merger of Public Sector Banks (PSBs) is where the PSBs are merged with 'anchor' banks as of today India has 12 Public Sector Banks, including Bank of Baroda and State Bank of India

List of Merged Public Sector Banks in India 2021

Anchor Bank		Banks Merged
Punjab National Bank	{	Oriental Bank of Commerce United Bank of India
Canara Bank	←	Syndicate Bank
Indian Bank	←	Allahabad Bank
Union Bank of India	{	Andhra Bank Corporation Bank
Bank of Baroda	{	Dena Bank 1st April, 2019 Vijaya Bank 1st April, 2019
State Bank of India	{	State Bank of Bikaner and Jaipur State Bank of Hyderabad State Bank of Mysore State Bank of Patiala State Bank of Travencore Bharatiya Mahila Bank (2017)

VIII. 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 fulfil 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:** Mergers and Acquisitions' 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 funds but 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:** 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 Mergers and Acquisitions 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 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 of 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.

IX. Impact on Indian Banking Sector:

❖ Post-merger, public sector banks (PSBs) have seen an improvement in profitability in the year ended March 2021 despite the coronavirus pandemic induced disruptions.

❖ In Financial Year 2021, 10 PSBs reported a combined net profit for the first time in five years. Only two public sector banks, Punjab & Sind Bank and Central Bank of India reported a net loss for the year. The key reason for PSBs to post a combined profit of Rs 31,817 crore was the end of their legacy bad loan problem. Other factors include lower cost of funds, reduced operating expenses and higher gains on bond portfolios amid declining bond yields.

❖ Last year, the merging entities posted huge losses in the fourth quarter before the integration, which contributed to the Rs 26,015 crore loss among public sector banks in Financial Year 2020. This year, however, the acquiring banks made profits with Indian Bank topping the list at Rs 3,004 crore followed by Union Bank at Rs 2,905 crore.

❖ The pandemic year 2020-21 has seen most PSBs remain preoccupied with the merger integration process. The bad loan cycle that involved large corporate loans during Financial Year 2016-17 to Financial Year 2019-20 manifested mostly on PSB balance sheets. Many lenders saw their capital erode below the mandated regulatory minimum when mergers among PSBs were seen as the only way out. The amalgamation of these banks came into effect from April 1, 2020.

❖ While the benefits of the merger could be measured in figures related to profitability, the human impact of the big bang bank merger is huge and cannot be measured by financial numbers. That apart, state-owned banks continue to lag private peers in terms of mirroring efficiency parameters. Further, anaemic loan growth and spike in stressed loans amid an unprecedented health crisis as well as inept digital abilities has been a drag on PSBs’ overall performance.

❖ Having done two rounds of bank consolidation earlier, the central government in 2019 decided to merge six disparate and weak PSBs into four in one stroke — the biggest consolidation exercise in the banking space. Punjab National Bank (PNB) took over Oriental Bank of Commerce and United Bank of India; Allahabad Bank became part of Indian Bank; Canara Bank subsumed Syndicate Bank; and Andhra Bank and Corporation Bank merged with Union Bank of India. Earlier, State Bank of India (SBI) with five of its associate banks while Vijaya Bank and Dena Bank were merged with Bank of Baroda.

- Mergers of banks, first mooted by the Narasimham Committee more than a quarter century ago, began in India in the 1960s in order to bail out the weaker banks and protect the customer interests. In the post liberalisation period, the quest to create an Indian bank that would be in the league of global giants had been continuing since 1990.
- Credit growth continues to remain steady at lower levels of 3-4% year-on-year growth for PSBs, however with better asset quality and profitability position, most of the public banks are well placed to support the growth if the credit growth improves. Notwithstanding, the improvement in the reported gross non-performing assets (NPA) (9.4% as on March 2021 from 10.7% as on March 2020) and net NPA (3.1% vs 3.8%) in Financial Year 2021, the overdue loan book across banks remains high.
- Going ahead, there are underlying concerns, which if not addressed could result in larger and potentially weaker banks.
- With incremental growth from the corporate sector staying low, and retail being the key engine for credit growth, PSBs will need to keep enhancing their lending abilities and improve turnaround time by digitally sanctioning the loans by enhancing their customer profiling through online tools. When the corporate credit cycle rebounds over the medium term, the ability of the banks to implement sufficient risk filters in credit selection and incorporate the learnings from the previous credit cycle while sanctioning new loans to corporates is something which remains to be seen.

After Merged Status of Anchor Banks

Merged entity	**Total Assets (Rs. Lakh Cr)**	**Gross NPA**	**No. of Branches**	**Employees**	**Advances (Rs. Cr)**	**Deposits (Rs. Cr)**
PNB+OBC+UBI	12.7	14%	10769	101802	674230	1106332
Canara Bank +Syndicate Bank	11.54	9%	10416	88213	639048	1010874
Union Bank of India + Corporation Bank +Andhra Bank	10.71	14%	9315	78202	590982	923805
Indian Bank + Allahabad Bank	6.26	10%	6007	41629	364010	538071

After Merged Status of Indian Banking Sector 12 PSUs (6 Merged and 6 Independent)

Merged Banks	Independent Banks
SBI	UCO Bank
Bank of Baroda	Indian Overseas Bank
Canara Bank	Punjab and Sind Bank
Indian Bank	Bank of Maharashtra
Punjab National Bank	Central Bank of India
Union Bank of India	Bank of India

Oriental Bank of Commerce (OBC) and United Bank of India will be merged into Punjab National Bank (PNB). After the merger, these together will form the second-largest public sector bank in the country, after State Bank of India (SBI). Syndicate Bank will be merged into Canara Bank, which will make it the fourth-largest public sector lender. After the merger, there will be 12 PSUs - six merged banks and six independent public sector banks.

X. Findings, Conclusions and Suggestions

The banking industry has been undergoing major Mergers and Acquisitions in the recent years, with a number of global players emerging through successive. Mergers and Acquisitions in all sectors including banking. The decline in the performance of merging firms cannot be attributed to merger alone. But in future, there are strong prospects of improvements in profitability. But overall, results indicate that mergers led to higher level of cost efficiencies for the merging banks. Merger between distressed and strong banks did not yield any significant efficiency gains to participating banks. However, the forced merger among these banks succeeded in protecting the interest of depositors of weak banks but stakeholders of these banks have not exhibited any gains from mergers. 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. Therefore, the Government and policy makers should be more cautious in promoting merger as a way to reap economies of scale and scope. Banks can work towards a synergy-based merger plan with minimisation of technology-related expenditure. There is also a need that merger or large size is just a facilitator, but no guarantee for improved profitability. The thrust should be on improving risk management capabilities, corporate governance and strategic business planning. In the short run, attempt options like outsourcing, strategic alliances, etc. can be considered. Banks need to take advantage of this fast-changing environment, where product life cycles are short, time to market is critical in deciding who wins in future. The Government should not go for Mergers and Acquisitions as a means of bailing out of weak banks. The strong banks should not be merged with weak banks, as it will have adverse effect upon the asset quality of the stronger banks. The strong banks should be merged with strong banks to compete with foreign banks and to enter in the global financial market.

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