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Impact of Merger and Acquisition in Indian Banking Sector

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ABSTRACT

The paper aims to understand the behavior of various "Mergers and Acquisitions in Indian Banking Sector." A large number of international and domestic banks all over the world are engaged in merger and acquisition activities. One of the principal objectives behind the mergers and acquisitions in the banking sector is to reap the benefits of economies of scale. Mergers and Acquisitions are important corporate strategy actions that aid the firm in external growth and provide it competitive advantage. In today's globalized economy, mergers and acquisitions (M&A) are being increasingly used world over, for improving competitiveness of companies through gaining greater market share, broadening the portfolio to reduce business risk, for entering new markets and geographies, and capitalizing on economies of scale etc. Today, the banking industry is counted among 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 therefore, it has become the most preferred banking destinations for international investors. A relatively new dimension in the Indian banking industry is accelerated through mergers and acquisitions. It will enable banks to achieve world class status and throw greater value to the stakeholders. The main objective of this paper is to analyze whether the bank has achieved financial performance efficiency during the post merger & acquisition period specifically in the areas of profitability, leverage, liquidity, and capital market standards. This study is testing the impact of merger and acquisition of banks and provides insights about their role after merger on banks profitability.

Key Words: Impact, Merger , Acquisition , Indian Banking, Profitability, liquidity, Leverage

I. INTRODUCTION

Bank in general terminology is referred to as a financial institute or a corporation which is authorized by the state or central government to deal with money by accepting deposits, giving out loan and investing in securities. The main role of banks is the growth of economy by providing funds for investment. In recent times banking sector has been undergoing a lot of changes in terms of regulations and effects of globalization. These Changes have affected this sector both structurally and strategically. With the changing Environment, many different strategies have been adopted by this sector in order to remain efficient and to surge ahead in the global arena. One such profitable strategy is the process of consolidation of the banks. There are several ways to consolidate the banking industry; the most common adopted by banks is merger. Merger of two weaker banks or merger of one healthy bank with one weak bank can be treated as the faster and less costly way to improve profitability then spurring internal growth (Franz H Khan 2007). The main motive behind the merger and acquisition in the banking industry is to achieve economies of scale and scope. Mergers also help in the diversification of the products, which help to reduce risk.

Mergers and acquisitions have been long known to direct the merging entities towards positive synergies, enhanced resources and hence, overall increase in the profit statements. Mergers among different banks are classified as horizontal mergers. The deal is always expected to be beneficial for both merging firms. Mega amalgamations raise hopes to redefine the scenario. Merger is the combination of two or more entities by purchase acquisition whereby the identity of one of the entities remain while the others are being dissolved. The reasons behind the merger transactions are basically gaining market share, competitive advantage, increasing revenues and risk and product diversifications. With the global financial crises, it is noticeable that mergers and acquisitions have considerably increased. Corporations employed such combination not only for the sake of competitiveness but to maintain a firm foothold in the industry as well. This has led to the significant transformation in the business landscape.

The Indian banking sector can be divided into two eras, the pre liberalization era and the post liberalization era. In the pre liberalization era, Government of India nationalized 14 banks as 19 July 1965 and later on 6 more commercial banks were nationalized as 15 April 1980. In the year 1993 government merged the New Banks of India and Punjab National banks and this was the only merged between nationalized banks after that the number of Nationalized Banks reduces from 20 to 19. In the 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 Indian banking industry has shown a sign of improvement in performance and efficiency after the global crises in 2008-2009. The Indian banking industry having far better position now than it was at the time of the crises. Government has taken various initiatives to strengthen the financial system. The economic recovery gained strength on the bank of variety of monetary policy initiatives taken by the RBI. The Government of India has adopted the route of mergers among others with a view to restructure the banking system. Many small and weak banks have been merged with other banks mainly have to protect the interests of depositors. These may be classified as forced mergers. When a specific bank shows serious symptoms of sickness such as huge NPAs, erosion in net worth or substantial decline in capital adequacy ratio, RBI imposes moratorium under section 45(1) of Banking Regulation Act 1949 for a specific period on the activities of sick bank. In the moratorium period RBI identifies strong banks and asks that bank to prepare a scheme of merger. In the merger scheme, normally the acquiring takes up all assets and liabilities of the weak bank and ensures payment to all depositors in case they wish to withdraw their claims.

Background of M&As: in Indian Banking Industry: The banking system of India was started in 1770 and the first bank was the Indian bank knows 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 culcutta-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 July 1955 and was named as the state bank of India along with its 8 associate banks(at 7%). Later on, the state bank of Bikaner and the state bank of Jaipur merged and formed the state bank of Bikaner and Jaipur. Improvement of operational and distribution efficiency of commercial banks has always been issue for discussion in the Indian policy background and Government of India in consultation with Reserve Bank of India (RBI) have, over the years, appointed several committees to suggest structural changes towards this objectives. Some important committees among these are The Banking commission-1972 and 1976, and committee for functioning of public sector Banks-1978. All these committees have emphasized on restructuring of the Indian banking system with an aim to improve the credit delivery and also recommended in favour of having three to four large banks at the all Indian level and remaining at regional level. However, the thrust on consolidation has emerged with the Narasimham committee (1991) emphasizing on convergence and consolidation to make the size of Indian commercial banks comparable with those of globally active banks. Further, the second Narasimham committee (1998) had suggested mergers among strong banks/ financial institutions would make for greater economic and commercial sense and would be a case where the whole is greater than the sum of its part and have a “force multiplier effect”.

OBJECTIVES OF THE STUDY

- To understand the purpose of mergers and acquisitions
- To know about the benefits of mergers and acquisitions
- To examine the effects of merger
- To study recommendations of expertise.
- To recognize banking awareness regarding mergers and acquisitions in general

II. RESEARCH METHODOLOGY

Primary and secondary data collection tools are used for the study. In the primary data collection direct observation has been used. Various web sites have been observed and studied and in the secondary data collection various study material and research works which have been done on mergers and acquisitions have been studied. Important and related data has been gathered and used for this research work. For the purpose of evaluation, investigation data is collected from Merger and Acquisitions (M&A’s) of the Indian banking industry. The financial and accounting data of banks is collected from companies Annual Report to examine the impact of M&A’s on the performance of banks. Financial data has been collected from Bombay Stock Exchange (BSE), National Stock Exchange (NSE), Securities and Exchange Board of India (SEBI), Money control for the study and other websites.

III.PURPOSE OF MERGERS AND ACQUISITIONS

The purpose for an offer or company for acquiring another company shall be reflected in the corporate objectives. It has to decide the specific objectives to be achieved through acquisition. The basic purpose of merger or business combination is to achieve faster growth of the corporate business. Faster growth may be had through product improvement and competitive position. Other possible purposes for acquisition are short listed below: -

- Procurement of supplies:
- Revamping production facilities:

• Market expansion and strategy:
• Financial strength:
• General gains:
• Own developmental plans:
• Strategic purpose
• Corporate friendliness

IV.BENEFITS OF MERGERS AND ACQUISITIONS

Growth or diversification: 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 tome 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. In addition such a strategy is often less costly than the alternative of developing the necessary production capability and capacity.

Increased Managerial Skills or Technology: 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. Of course, any merger, regardless of specific motive for it, should contribute to the maximization of owner.

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.

Recommendations: • It stressed on the use of merger of banks, to enhance size as well as operational strength for each of the banks.

• It made a recommendation for the merger of the large banks in India, with an attempt to make them stronger, so they stand mighty fine in international trade.
• It recommended speeding up of computerization in the Public Sector Banks.
• It established that the legal framework must be strengthened, in order to aim for credit recovery.
• It suggested that there be 2 to 3 banks in India that be oriented internationally, 8-10 national banks and a vast network of local banks to help the system reach the remote corners of India.
• It lay stressed that bank mergers must take place among entities of similar size. This implies that weak banks merge with the weak ones while large banks with the larger and competitive ones.
• It also suggested the confinement of local banking network to the boundaries of states or a few districts. Evaluation of the manner of staffing, training process and the remuneration policy of PSU Banks.
• It stated that the enhancement in banking risk can be directed and equated to increase in capital adequacy.
• Suggested the review of the RBI Act, the Nationalization Act, Banking Regulation Act, as well as the SBI Act.
• It stressed on professionalization of banking boards.

Banking Awareness regarding Mergers and Acquisitions in general : Banks must insist on making the complete process transparent for their shareholders. Banks should try not to merge at the stake of the value of shareholders. Shareholders own the amount they invest in the bank and hence, they have all rights to have necessary details such as the financial conditions, details of merger, etc. with regard to the merger that is to take place. At times, the commission may raise an objection to merger of banks so as to safeguard the interests of the nation. This nature of restriction has been noticed primarily where cross border bank mergers are concerned. This is due to the fact that consolidation of bank with a foreign entity which has a strong hold might eliminate the local banks and hence create unwanted issues. Commissions have generally not been seen restricting any merger based on the deposits held by the bank or its total number of branches. But, there may be certain situations in which they might if the merger has the potential to raise competition related issues, etc. When to big entities undergo a merger then in attempt to decrease the potential confrontational effects on the competition due to low market shares of the bank in a particular area, the commission may notify the merging firms to decrease the shares and deposits they hold. Mergers in any area if creating problems, they can be offset by divestment.

Mergers and Acquisitions in few banking organizations are covered here:
1**. Merger of ICICI Bank with Bank of Madura in 2001**: ICICI one of the largest financial institution was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian Industry. In 1990's, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group offering a wide variety of products and services both directly and through a number of subsidiaries and affiliates like ICICI Bank. In 2001, the ICICI merged with the Bank of Madura to expand its customer base and branch network.

Merger of Centurion Bank with Bank of Punjab in 2005: Bank of Punjab (BOP) and Centurion Bank (CB) have been merged to form Centurion Bank of Punjab (CBP). RBI has approved merger of Centurion Bank and Bank of Punjab effective from October 1, 2005. The merger is at a swap ratio 9:4 and the combined bank is called Centurion Bank of Punjab.

Merger of IDBI bank and United Western Bank ltd. In 2006: The Reserve Bank of India told IDBI acquire the distressed United Western Bank, which the central bank had put under moratorium by the RBI on September2, 2006. Since IDBI is adequately capitalized, it will not have to pump money into United Western Bank, which has a net worth of Rs 70 crore (Rs 700 million). However, IDBI had pay United Western Bank shareholders Rs 150.55 crore (Rs 1.5 billion) at Rs 28 a share, which works out to a 31 per cent premium over United Western Bank's closing price of Rs 21.45 on the Bombay Stock Exchange.

Merger of HDFC and Centurion bank of Punjab in 2007: HDFC Bank approved the acquisition of Centurion Bank of Punjab for Rs 9,510 crore ($2.4 billion) in one of the largest mergers in the financial sector in India in February, 2008. Centurion Bank of Punjab shareholders got one share of HDFC Bank for every 29 shares held by them. Post-acquisition, HDFC Bank became the second-largest private sector bank in India. The acquisition was also India's 7th largest ever.

Merger of HSBC, Canara bank and Oriental Bank of Commerce in 2009: Canara HSBC Oriental Bank of Commerce Life Insurance Co Ltd has informed that it has got the license to operate in India. Three banking majors have joined hands to offer services in Insurance sector. Two major in Public Sector banks, Canara Bank and OBC, have joined hands with global banking and investment services major HSBC to offer innovative insurance products to Indian consumers.

CONCLUSIONS

Mergers and Acquisitions played a very important role in Banking Sector. The small and medium size banks are working under threat from the economic environment which is full of problems for them, viz, inadequacy of resources, outdated technology, on-systemized management pattern, faltering marketing efforts, weak financial structure, technique obsolescence and lack of product innovations. Their reorganization through merger could offer re-establishment of those in viable banks of optimum size with global presence. Merger and acquisition in Indian banking so far has been to provide the safeguard and hedging weak bank against their failureGrowth is an important aspect for any organization. Various challenges and problems faced by the Indian banking sector and the economy have made mergers and acquisitions activity not an unknown phenomenon in Indian banking industry. Historically, mergers and acquisitions activity started way back in 1920 when the Imperial Bank of India was born when three presidency banks (Bank of Bengal, Bank of Bombay and Bank of Madras) were reorganized to form a single banking entity, which was subsequently known as State Bank of India. Globally mergers and acquisitions have become a major way of corporate restructuring and the financial services industry has also experienced merger waves leading to the emergence of very large banks and financial institutions. It drives the organization to create synergy and value creation by way of diversification and improved management. The banking system in India has undoubtedly earned numerous outstanding achievements, in a comparatively short time, for the World's largest and the most diverse democracy. There have been several reforms in the Indian banking sector, as well as quite a few successful mergers and acquisitions, which have helped it, grow manifold.

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