A Study on Mergers and Acquisition of Banks and a Case Study on SBI and its Associates

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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 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. The study covers the area of performance evaluation of M&A's in Indian banking sector during the period. The paper compares pre and post merger financial performance of merged banks with the help of financial parameters. 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. It also studies the State Bank of India and its Associates merger with the pros and cons of the banks and the employees of the banks. The required data are collected from secondary source.

Keywords: *Mergers, Acquisitions, State bank of India and it associates*

I. INTRODUCTION

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.

The year 1968 witnessed an ordinance issued by the Government of India and 14 large commercial banks in the country were nationalized. These fourteen banks, back then, contained a whooping eighty five per cent of the total bank deposits in our country. 1980, was witness to yet another round of nationalization and six more commercial banks came under the government control. With this huge leap, an enormous ninety one per cent of the banking sector came under direct control of the Indian Government. With this, the number of nationalized banks in India rose to twenty. Sometime later, in the year **1993**, the government took yet another stride towards economic prosperity and made a turn towards **merger of banks**. The New Bank of India was merged with the Punjab National Bank (PNB). This was the **first merger between nationalized banks**, ever witnessed in Indian history and consequently, the number of nationalized banks in India was reduced from twenty to nineteen and that remains the same till date

In today's global marketplace, banking organizations have greatly expanded the scope and complexity of their activities and face an ever changing and increasingly complex regulatory environment. It has been realized globally that mergers and acquisition 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.

A. Meaning of Merger

A merger is a deal to unite two existing companies into one new company. There are several types of mergers and also several reasons why companies complete mergers. Most mergers unite two existing companies into one newly named company. Mergers and acquisitions are commonly done to expand a company's reach, expand into new segments, or gain market share**.**

B. Meaning of Acquisition

An acquisition is a corporate action in which a company buys most, if not all, of another firm's ownership stakes to assume control of it. An acquisition occurs when a buying company obtains more than 50% ownership in a target company. As part of the exchange, the acquiring company often purchases the target company's stock and other assets, which allows the acquiring company to make decisions regarding the newly acquired assets without the approval of the target company's shareholders.

II. LITERATURE REVIEW

Several studies have been conducted to examine the impact of mergers and Acquisition. Anand Manoj & Singh Jagandeep (2008) studied the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. These mergers were the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank, the ICICI Ltd with the ICICI Bank, the Global Trust Bank merged with the Oriental Bank of commerce and the Bank of Punjab merged with the centurion Bank. The announcement of merger of Bank had positive and significant impact on share holder's wealth. The effect on both the acquiring and the target banks, the result showed that the agreement with the European and the US Banks Merger and Acquisitions except for the facts the value of share holder of bidder Banks have been destroyed in the US context, the market value of weighted Capital Adequacy Ratio of the combined Bank portfolio as a result of merger announcement is 4.29% in a three day period (-1, 1) window and 9.71 % in a Eleven days period (-5, 5) event window. The event study is used for proving the positive impact of merger on the bidder Banks.

Sinha Pankaj & Gupta Sushant (2011), studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions(M&As) it came to the point that companies may have been able to leverage the synergies arising out of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on

the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency etc.

III. RESEARCH METHODOLOGY

A. Need For The Study

Since the early 1990s, the structure of the banking sector has significantly changed due to the deregulation and liberalization, accompanied by divestment of public sector banks, entry of foreign banks and merger of many banks in India and in the world. In the post reform period about 25 bank mergers took place in India. These mergers have important implication on the performance and profitability in the banking system. Therefore from the point of view of both managerial and policy interests, it is extremely important to know the impact of these merges on the efficiency levels of banks and their temporal behaviour so as to understand how the banking industry has been reacting to these emerging challenges and which banks are performing better than others in this period of transition.

B. Objectives

1. To study the reforms of Indian banking sector.
2. To study the performance of the banks in the pre and post M & A
3. To study the trends of M&A's in Indian banking sector.
4. To study on merger of SBI and its associates

C. Research Methodology

Secondary data: E-Journals, Manuals, articles and online resources.

D. Limitations Of The Study

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.
4. Analysis and Interpretation

IV. INDIAN BANKING SECTOR-BANKING REFORMS

Narasimhan Committee:

The Narsimhan Committee, to file a report regarding the reforms in the Indian Banking Sector, was **set up in the month of December, 1997**. It submitted a report with the following suggestions, on April 23, 1998.

- 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.

Raghuram Rajan Committee:

Raghuram Rajan contributed a guest column, in the month of **April 2009**, for *The Economist*, and it was in this column that, he recommended a regulatory system, which may reduce boom-bust financial cycles. His suggestions for the banking sector in India were –

- India is a vast nation in itself, hence, given this fact, it is practically impossible to control the flow of capital and therefore, the economy will always be uncertain and volatile.
- In order to develop into large banks, it is required that an entry point be offered in the system, which can be used by the bodies.
- Technological advances may help in evolving small banks and reduce the costs of operation.
- Encouragement must be provided to the professional markets, in full swing.
- Underperforming PSU's were suggested to be sold.
- Markets to be banned, in order to reduce or eliminate creation of slightest uncertainty among the investors.
- The regulation of trade to be brought under the control of SEBI (Securities and Exchange Board of India).
- He also suggested an open-minded outlook towards merger of banks and takeovers.
- Encouragement should be given to participation in the domestic market by the foreign firms.

Must aim to create such an environment for the investors, which has high scope for innovation and is accepting towards the same.

A. Impacts Of Merger & Acquisitions

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

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 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.

B. 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 is 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

- 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.

Mergers and acquisitions have definitely shaped the Indian Banking sector. Though there seem to be different opinions on this particular matter, yet there is always hope for an improvement in the current situation after bank mergers.

C. Recent Trends in Banks Regarding the Merger and Acquisition

Name of the acquiring bank	Bank targeted	Year in which the merger took place
Kotak Mahindra Bank	ING Vyasa Bank	2014
ICICI Bank	Bank of Rajasthan Ltd.	2010
HDFC Bank	Centurion Bank of Punjab	2008
Indian Overseas Bank	Bharat Overseas Bank	2007
Federal Bank	Ganesh Bank of Kurandwad	2006
Industrial Development Bank of India	United Western Bank	
Centurion Bank of Punjab	Lord Krishna Bank	
ICICI Bank	Sangli Bank	
Bank of Punjab	Centurion Bank	2005
Industrial Development Bank of India	IDBI Bank Ltd.	2004
Bank of Baroda	South Gujarat Local Area Bank	
Oriental Bank of Commerce	Global Trust Bank	
Punjab National Bank	Nedungadi Bank Ltd.	2003

ICICI Bank	ICICI Ltd.	2002
Bank of Baroda	Banaras State Bank Ltd.	
ICICI Bank	Bank of Madura	2001
HDFC Bank Ltd.	Times Bank Ltd.	2000
Bank of Baroda	Bareilly Co-op Ltd.	1999
Union Bank of India	Sikkim Bank Ltd.	
Oriental Bank of Commerce	Bari Doab Bank Ltd.	1997
Oriental Bank of Commerce	Punjab Co-op Ltd.	1996
State Bank of India	Kashinath State Bank	1995
Bank of India	Bank of Karad Ltd.	1994
Punjab National Bank	New Bank of India	1993

D. Merger of Sbi and Its Associates

The Union cabinet on June 15, 2016 approved the merger of the five subsidiaries of State Bank of India (SBI) with the parent, as the Indian banking system moves into a phase of consolidation.

The cabinet approved the merger of the subsidiaries namely State Bank of Mysore ,State bank of Travancore, State Bank of Hyderabad, State Bank of Patalia ,State Bank of Bikaner and Jaipur along with Bhartiya Mahila Bank Ltd with SBI. SBI's merger with subsidiaries will see the combined entity's balance sheet at a whopping Rs.37 trillion, making it one of the top 50 banks in the world.

What does a bank merger, which has been in discussion for over a decade, mean for the banks in focus and the overall banking system? The amalgamation of five associate banks of the State Bank of India (SBI) with the parent is the biggest merger in recent times. It will make SBI—already the country's largest commercial lender by assets and deposits—even larger.
The union cabinet has approved the proposal whereby State Bank of Bikaner and Jaipur (SBBJ), State Bank of Travancore (SBT), State Bank of Mysore (SBM), State Bank of Patiala and the State Bank of Hyderabad will merge with SBI. The Bharatiya Mahila Bank (BMB) will also be merged with SBI, as part of the move.

The move comes at a time when SBI—like several other state-run banks—is struggling to cope with rising bad loans. Its net profit for the three months ended March 31, 2016 slumped 66 percent from the year-ago period, due to higher provisioning for bad loans.

Three of the associate banks, SBBJ, SBT and SBM, are listed on the stock exchanges and investors have cheered the merger move. Stocks of the associate banks moved up sharply when the cabinet clearance for the move came on June 15, but have retraced since then, partly due to profit booking and also due to fears of a British exit from the European Union.

SBT stock is up 1.3 percent, SBM up 12.12 percent and SBJJ up 2.4 percent since the merger was approved by the cabinet. SBI's stock, on the other hand, has shed 1.2 percent in the period. There are some very clear long-term benefits from the merger, but it will come with short-term pain. Cost savings will come from common treasury operations and audits. Branch rationalisation will also be a medium- to long-term benefit. But there will be tricky issues which SBI and the government will have to face, relating to integration of manpower, restructuring job profiles and remuneration to staff.

E. Some of the pros and cons are as follows:

Pros:

1. Currently, no Indian bank features in the top 50 banks of the world. With this merger, visibility at global level is likely to increase.
2. Branch rationalization, if executed well, would be one of the key synergy benefits from the merger
3. The merger benefits include getting economies of scale and reduction in the cost of doing business.
4. After the amalgamation it can withstand the strong competition from private sector banks and can accumulate more resources to channelize trained manpower across its branches.
5. The merger of SBI and its associate banks will result in the network increase of SBI and its reach would multiply.
6. Cost savings on account of treasury operations, audit, technology, etc, would lower cost-to-income ratio in the long term.
7. Any introduction of new technologies and features by SBI will uniformly be available to all customers of SBI, its associates and subsidiaries.
8. Shares of SBI and its associates will post tremendous earnings in the stock exchange thereby benefiting stake holders.

Cons:

1. Immediate negative impact would be from pension liability provisions (due to different employee benefit structures) and harmonization of accounting policies for NPA (non-performing assets) recognition.
2. The associate banks are on a totally different footing as they have regional flavour and regional focus compared to nationalistic SBI culture.
3. Various internal conflicts and disputes may arise with regard to promotion, pension and other potential issues.
4. Post the merger, SBI's employee costs could rise by Rs 23 crore a month.

F. FINDINGS AND SUGGESTIONS

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. The thrust should be on improving risk management capabilities, corporate governance and strategic business planning
4. 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.
5. The Government should not go for M&As as a means of bailing out of weak banks. The strong banks should not be merged with weak banks, as it will have adverse affect upon the asset quality of the stronger banks.

6. The strong banks should be merged with strong banks to compete with foreign banks and to enter in the global financial market.

CONCLUSION

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 present study indicates that the pre and post- Mergers and Acquisitions of selected banks in India have no greater changes in profitability ratio; a few banks are satisfactory during the study period. Similar decline in performance is observed matching firms. Thus, 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. The prime factors for future mergers in Indian banking industry included the 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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