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Merger of Bank of Rajasthan (BOR) with ICICI Bank: An Evaluation

AUTHOR

Dr. S. K. Sharma

Associate Professor
Department of Commerce,
HNB Garhwal Central University
Badshahithaul, Tehri Garhwal
Uttrakhand, India

Abstract

Indian banks are gradually but surely moving from a cluster of large number of small banks to small number of large banks .To drive however merging banks should keep in views the inherent strengths and weakness of both the entities. Since 1997, ICICI Bank has acquired smaller banks to increase its reach. Recent takeovers include Sangli Bank in 2007, ITC Classic Finance and Anagram Finance in the years 1997 and 1998 respectively. In 2000, the bank merged with the Bank of Madura and in 2005, it acquired Russia's Ivestitsionno Kreditny Bank. The merger of ICICI Bank and Jaipur-based BOR came into effect from 12 August after the Reserve Bank of India notified it. After the bank received permission for the merger in August 12, 2010, it said that it has successfully integrated the operations of the BOR with the ICICI Bank. The acquisition of Bank of Rajasthan by ICICI bank is the first consolidation of country's crowded banking sector since 2008. ICICI, the country's largest private sector lender, is offering the smaller bank's controlling shareholders 25 shares in ICICI for 118 shares of Bank of Rajasthan. The deal, which will give ICICI a sizeable presence in the northwestern desert state of Rajasthan, values the small bank at about 2.9 times its book value, compared with an Indian banking sector average of 1.84. Post-merger, ICICI Bank's branch network would go up to 2,463.The present paper is an attempt to throw the light on the merger of BOR with ICICI Bank. It also identifies the objectives of M&As. Some important motives and strategic issues regarding this merger have also been discussed. This paper is based mostly on secondary data. The study gives conclusion and some suggestions too.

Key Words: *Merger &Acquisition (M&A), Swap Ratio, Strategy.*

1. INTRODUCTION

For combating the challenge of change in terms of range of products, delivery channels, culture, structure and overall capabilities, Indian banks would require key structural changes viz. stress on efficiency, increase in productivity and improvement in profitability and adoption of innovative technology .All these can be acquired through speeding up of the process of merger/consolidation in banks. In common parlance mergers imply acquisition of business through the acquisition of shares carrying voting rights in a company, in a direct or indirect manner. When an acquisition is forced or unwilling act, then it is called take over. A merger involves a marriage of two or more banks. Merger facilitates synergies between merged organizations, generate efficiency improvements and increase competitiveness. It improves efficiency and achieves synergies.

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). 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. In the post-reform era, we have seen many mergers and acquisitions. New Bank of India, a nationalized bank and the private sector Nedungadi Bank Ltd were merged with Punjab national bank. Bareilly Corporation Bank was merged with Bank of Baroda. Times Bank and Centurion Bank of Punjab merged with HDFC Bank. Bank of Madura, ICICI Ltd and Sangli Bank was merged with ICICI Bank. Sikkim Bank was merged with Union Bank of India in 1999-2000. Global Trust Bank was merged with Oriental Bank of Commerce; United Western Bank was merged with IDBI Bank .Ganesh Bank of Kurundwad was merged with Federal Bank in 2006. Lord Krishna Bank was merged with Centurion Bank of Punjab. Centurion bank of Punjab was merged with HDFC Bank Ltd in 2008. Such mergers created larger and stronger bank. Mergers may be synergy based to derive economies of scale or market driven mergers between banks and financial institutions in the interests of furthering universal banking. Economies of scale refer to the lower operating costs (per unit) arising from spreading the fixed costs over a wider scale of production and economies of scope refer to the utilization of skill assets employed in the production in order to produced similar products or services. Merger and acquisition activity slowed down in 2007-08 in line with general trend in M&A globally, and moderation in industrial activity, domestically .Merger scenario comprises economic, technological, human, organizational and cultural strategic issuesIt is generally accepted that mergers promote synergies. The basic idea is that the combined will create more value than the individual banks operating independently. Economist refers to the phenomenon of the “2+2=5” effect brought about by synergy.

Objectives of Merger & Acquisition: The main objectives of consolidation in banking industry are as follows:

- To increase efficiency
- To maximize shareholder’s value
- To enhance profitability
- To gain market power
- To attain optimal size of business
- To capture large portion of the growing retail business
- To achieve economies of scale of operation
- To build up financial strength
- To withstand against global.

2. PROFILE OF BANK OF RAJASTHAN

The Bank of Rajasthan (BOR) is a Rajasthan based private bank in operation since 1943, promoted by Manisngka Brothers of Bhiliwara (Rajasthan). However, promoters later changed hands to Bangurs and then Tayals who are now said to be responsible for the circumstances leading to present merger. Today bank has a nation vide presence with over 463 branches (111 ATMs) with prominence in the state of Rajasthan. The bank is credited with loyal customers, its own brand equity and even its logo comprises of a victory tower, a rising sun and a coin with stronghold in Rajasthan. It also pioneered mobile banking way back in 1960. The bank has a sponsored rural bank, Mewar Anchlic Gramin Bank since 1983. Bank of Rajasthan is a listed bank with its corporate office in Mumbai and registered office at Udaipur in Rajasthan. As on March 31, 2009, Bank of Rajasthan had 463 branches and 111 ATMs, total assets of Rs.17, 224 crore, deposits of Rs.15, 187 crore and advances of Rs.7, 781 crore. It made a net profit of Rs.118 crore in the year ended March 31, 2009, and a net loss of Rs.10 crore in the nine months ended December 31, 2009.

3. PROFILE OF ICICI BANK

On the other hand, ICICI Bank is the largest private sector bank and second largest bank in India. It has a assets base of Rs 3634 billion and a branch network of over 2000 branches, 5219 ATMs and has a presence in 19 countries, including India. ICICI Bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and through its specialized subsidiaries in the areas of investment banking, life and non-life insurance, venture capital and asset management. The Bank currently has subsidiaries in the United Kingdom, Russia and Canada, branches in United States, Singapore, Bahrain, Hong Kong, Sri Lanka, Qatar and Dubai International Finance Centre and representative offices in United Arab Emirates, China, South Africa, Bangladesh, Thailand, Malaysia and Indonesia. Our UK subsidiary has established branches in Belgium and Germany. Unlike Bank of Rajasthan which is only listed in India, ICICI Bank's ADR's are also listed at New York Stock Exchange. Its strategic focus has changed from balance sheet growth and market share enhancement to improving profitability and return ratios .The bank has significant profit reported in March 2010 at Rs 40.25 billion where as Rajasthan Bank reported loss in December 2009.

4. MIXED EVIDENCE OF MERGERS

Some important mergers have been discussed to reflect the mixed evidences. In the case of acquisition of Times Bank by HDFC bank (2000), both the bank shareholders have viewed it as a positive signal. At the time of merger, Times Bank was suffering with low profitability and high NPAs; the acquisition by HDFC bank has given relief to both shareholders and depositors of the bank. Similarly HDFC bank has gained out of retail portfolio of the Times Bank and subsequently emerged as largest private sector bank in India in 1999. In the case of acquisition of Bank of Madura (BOM) by ICICI bank (2001), BOM gained the opportunity of providing various services like treasury management solutions, cash management services to all of its customers. ICICI Bank increased its size by acquiring BOM and reached the position of a large size bank among the private sector banks way back in 1999. The analysis shows that upon the announcement of this merger, there was a significant rise in abnormal returns leading to increase in value for shareholders of BOM, but the shareholders of ICICI bank did not achieve any gains. This is not surprising because shareholders of a troubled bank stand to gain from a merger with a strong bank whereas the same may not be good news from the perspective of the strong acquiring bank. In the case of amalgamation of Bank of Punjab with Centurion Bank (2005), the amalgamation was an inevitable restructuring for both the banks as both intended to grow but experienced dismal performance. Both the banks came forward to build a growth oriented bank on the basis of each other's strengths. Centurion Bank had activity in western part of India where as Bank of Punjab has activity in northern part of the country. The combined entity's deposits have shown a growth of 20 percent, its advances increased by 41.7 percent and the ROA increased to 0.89 percent.

The strategic aspect of merger can be analysed on the basis of factors such as shareholder value, competition, geographical base and markets hare of companies in merger deal. Venkiteswaran (1997) has analysed the emerging scenario in the context of restructuring corporate India. Pawaskar (2001) studied the impact of mergers on corporate performance by comparing the post merger performance of the acquirer with its pre-merger performance. Akhavein et.al. (1997), covering mergers in the 1980s demonstrate that bank mergers are not just about adjusting inputs to affect costs, rather, they also involve adjusting output mixes to enhance revenues. These studies shows that banks merger tend to be associated with improvements in overall performance, in part because the banks achieve higher value output mixes. Some important strategic issues have been discussed. Consolidation does not lead to instant result and there is an incubation period before the results arrive. Mergers and acquisitions are sometimes followed by losses and tough intervening period before the eventual profits pour in. Patience, forbearance and resilience are required in ample measure to make any merger a success story.

5. MERGER OF BOR WITH ICICI BANK:AN EVALUATION

The acquisition of Bank of Rajasthan by ICICI bank is the first consolidation of country's crowded banking sector since 2008. There have been certain problems of mis-management and governance at the Bank of Rajasthan which led to the circumstances resulting in the proposed merger. This is the third acquisition by ICICI Bank. It had earlier acquired Bank of Madura way back in 2001 and the Maharashtra-based Sangli Bank in 2007. All 463 branches of Bank of Rajasthan are functioning as branches of ICICI Bank with effect from August 13, 2010.With the merger, the turnover of ICICI Bank would cross Rs4,00,000 crore. BOR has a total business of over Rs25, 000 crore, against nearly Rs3, 84,000 crore of ICICI Bank. After the bank received permission for the merger in August 12, 2010, it said that it has successfully integrated the operations of the BOR with the ICICI Bank. ICICI is offering to pay 188.42 rupees per share, in an all-share deal, for Bank of Rajasthan, a premium of 89 percent to the small lender's closing price on May25, 2010, valuing the business at $668 millions. ICICI Bank has entered into an agreement with certain shareholders for the proposed amalgamation at a share exchange ratio of 25 shares of ICICI Bank for 118 shares of Rajasthan Bank (a ratio of 1:4.72).

It is interesting to look at the factors influencing Swap ratio in the merger deal. The swap ratio was announced in favour of Bank of Rajasthan because of the desire of ICICI Bank to acquire a good bank from North Western India where they do not have a strong presence and geographically advantage. The deal, which will give ICICI a sizeable presence in the northwestern desert state of Rajasthan, values the small bank at about 2.9 times its book value, compared with an Indian banking sector average of 1.84.The shares of ICICI Bank

Table
Factors/ Motives for the Merger of BOR with ICICI Bank

Factor	BOR	ICICI
Edge	Stronghold in north India	Pan India presence with stronghold in western parts
Business Operations	All India	18 countries
Management Business strategy	Conservative, traditional banking Struggling to survive	Visionary, hunger for growth Aggressive, innovative and expanding
Branches	463	2000
ATMs	111	5219
Financial Results	Loss in December ,2009	Continuous profits
Listing	BSE, NSE	BSE, NSE, NYSE
Share price (24.5.2010)	Rs 166.70	Rs 832
One year high	Rs 166.70 (24.5.2010)	Rs. 1009 (6.4.2010)
Share exchange ratio	118 (4.72)	25 (1)
Value base on 24.5.2010	Rs. 19670	Rs. 20800
CASA Ratio	30%	41.7%
Gross NPA(31.3.2010)	232.81 Crore	9480.65 Crore
Merger benefit	Bank survives, future growth potential, beneficial to all stakeholders	Business/ Branch expansion in North Western India, long term shareholders value
Effective date of merger	August12,2010 (Notified by RBI)	

Source:www.icicibank.com/www.rbi.org.in

closed at Rs. 963.95, down 0.74%, while those of Bank of Rajasthan slipped 0.03% to Rs190.15 on the Bombay Stock Exchange. ICICI, the country's largest private sector lender, is offering the smaller bank's controlling shareholders 25 shares in ICICI for 118 shares of Bank of Rajasthan. The merger took place through a share-swap deal that valued BOR at around Rs.3, 000.crore, at a ratio of 4.72 shares of BOR for one share of ICICI Bank .The merger has given a boost to book size of the bank by Rs 15,000 crore in form of deposits, advances and other assets. The total book-size of ICICI Bank by the end of March 31, 2010, was Rs 3, 63,400 crore. Shares of BOR jumped close to 20 per cent on May25, 2010 to a 52-week high on the back of reports of the merger. The shares were locked in at the upper circuit at Rs 99.5 at around 2 p.m. Close to three crore shares of BOR were traded on BSE and NSE, making for a total turnover of Rs 27,431 lakh. ICICI Bank was down more than one per cent on both the exchanges. On the BSE, the scrip was down 1.45 per cent at Rs 889.35. The ICICI Bank ADR was trading at $38.61 down $0.86 or 2.18 per cent on the NYSE. ICICI bank added CASA deposits totaling over 210 billion rupees in the year ended March 2010, compared with 41.63 billion rupees of BOR. The negatives for ICICI Bank are the potential risks arising from BOR's non-performing loans and that BOR is trading at expensive valuations. As on FY-10 the net worth of BOR was approximately Rs 760 crore and that of ICICI Bank Rs 5,17,000 crore. For the December 2009 quarter, BOR reported a loss of Rs 44 crore on an income of Rs 373 crore.

The productivity of ICICI Bank is high compared to Bank of Rajasthan. ICICI recorded a business per branch of 3 billion rupees compared with 47 million rupees of BOR for fiscal 2009. But the non-performing assets (NPAs) record for BOR is better than ICICI Bank. For the quarter ended Dec 09, BOR recorded 1.05 percent of advances as NPA's, which is far better than 2.1 percent recorded by ICICI Bank. With this merger, the number of ICICI branches has gone up to 2,500 with 372 branches in Rajasthan. Incepted in 1943, BOR has a network of over 463 branches and a customer-base of over 20 lakh. In the December quarter, the bank's net profit declined to Rs 44.7 crore as against Rs 49.21 crore in the year-ago period while its total income dropped to Rs 373.7 crore from Rs 419.8 crore. After merger the employees of the acquired bank are a part of ICICI *parivar/* family and the customers of erstwhile Bank of Rajasthan would be able to use the services and branches of ICICI bank to complete their transaction and vice versa. It has been the smoothest, seamless and fastest integration of two banks. Over 4,500 employees of erstwhile BOR have been inducted into the ICICI family with proper fitment. With the technology integration, customers will get access to a common interface of the branches of both the banks.

6. STRATEGIC VALUE ISSUES

On the basis of above discussion some important strategic issues/ decisions have been observed as below;

- This is based on an internal analysis of the strategic value of the proposed amalgamation, average market capitalisation per branch of old private sector banks and relevant precedent transactions. The proposed amalgamation would substantially enhance ICICI Bank's branch network, already the largest among Indian private sector banks, and especially strengthen its presence in northern and western India. The integration of BOR would help ICICI Bank to increase its branch network by 25% to about 2,500 across the country. It will also give greater visibility to the bank in the western and northern parts of the country. In our view, the main benefit of the merger for ICICI Bank is BOR's branch network, concentrated in northern states like Rajasthan (60% of total branch network), Punjab, Haryana and Delhi. Bank of Rajasthan was the only potential acquisition target
- ICICI Bank, the country's largest private sector lender, is offering the smaller bank's controlling shareholders 25 shares in ICICI for 118 shares of Bank of Rajasthan. The deal, which will give ICICI a sizeable presence in the northwestern desert state of Rajasthan, values the small bank at about 2.9 times its book value, compared with an Indian banking sector average of 1.84. Post-merger, ICICI Bank's branch network would go

up to 2,463. ICICI Bank has a large branch networks concentrated mostly in the south.

- According to analysts, the swap ratio works out to a premium of 89.4 per cent over BOR's current market price. The merger is not likely to have any material impact on ICICI Bank's capital and the only advantage is a readymade branch network. With a Tier-I capital of above 13 per cent, the impact on ICICI Bank's capital would be less than 3 per cent.
- The loans and advances, investments, properties and the deposit profile has been quite satisfactory. The bank has well-diversified loans and advances. It has close to three million customers and has a granular deposit structure. The current account savings account is at around 30%. ICICI Bank is also focusing on growing Casa (current account and savings account). This merger will help in that as well as Bank of Rajasthan has a Casa of 30 per cent and ICICI Bank 41.7 per cent at the end of the financial year 2009-10.

7. CONCLUSION AND SUGGESTIONS

Moreover, bigger the size better would be a bank's capital adequacy ratio and risk management capabilities. Banks in India need to be large to keep pace with the global aspiration of Indian corporate that are growing in size. In order to save Bank Of Rajasthan bank from further sinking and to keep guard the interests of all concerned including employees, perhaps, merger seems to be a wise idea. The option of ICICI Bank or any other bank is not the issue here. If Bank of Rajasthan was to survive, the merger became inevitable and this has been done timely at an appropriable moment. Continuous loss of BOR with weak management and the desire of ICICI Bank to achieve more strength with in a less span and their urge for relentless expansion enable both the banks to be merged. This merger will strengthen the core competence, reduce operating cost and leverage large business volume. HR issues, cultural issues and the aspect of integration of technology have been given priority while resolving the merger of both the banks. An effective consolidation process with synergy gains and tactical initiatives will go a long way in making the Indian banking industry competitive enough to face competition in dynamic global business environment.

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