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Consolidation in Banking Sector Through Mergers and Acquisition

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ABSTRACT

Public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2 percent and 6.5percent respectively . Consolidation is an effective means to acquire competitive size , geographic expansion, huge loan portfolios ,improved technology ,product diversification and reduced transaction costs in Indian banking sector. . More over, bigger the size, better would be a bank's capital adequacy ratio and risk management capabilities. So the size does matter. Banks in India need to be large to keep pace with the global aspiration of Indian corporates that are growing in size. This paper exhibits the objectives, needs and advantages of consolidation in banking sector in India. It also emphasis banks consolidation in Indian perspectives and motives of merger and acquisition in India.

1. INTRODUCTION

Globalization, technological advancement , deregulation and intense competition have opened up the new opportunities, for banks but at the same time , they have been led to complexity , consolidation and restructuring. Public sector banks (PSBs) are the backbone of the Indian economy . Public sector banks account nearly 70 % of the market share in India, offering quality product and services to a diverse clientele and doing well under core business as well as earning . While the scale of activities has gone up, this has also resulted in a lot of additional requirements . Skilled manpower , modern and innovative technology, operational efficiency, improvement in profitability, soundness and achieving competitive advantage, are the basic requirements of a successful bank. Banks have increasingly diversified in to traditional activities , as a result of which several financial conglomerates have emerged, while some of banks tried to achieve the scale through internal growth , many a time mergers and acquisitions (M &As) are considered to be the best route to achieve scale. As India prepares for competitive times, more banks are planning to combine for competitive advantage . The Raghuram Rajan Committee, in general, has recommended to encourage , but not force, consolidation amongst Public Sector Banks (PSBs). The Committee has observed that given the fragmented nature of the Indian banking system and the small size of the typical bank, some consolidation may be in order for banks that aim to play on a larger stage. The committee also suggested wider use of technology to reach out to masses for financial inclusion. There are two myths on public sector bank consolidation in India that are obtaining currency. First, that as many bank mergers destroy shareholder value globally, public sector bank merger is a bad idea in India. Second, bank mergers create value by synergies that arise out of rationalization of overlapping branches and so must be opposed by unions to protect employee jobs.

Indian banks have to concentrate an asset quality and earning which are determinant of internal capital generation. Profitability and risk management are two key aspects to assess financial performance of public sector banks .The performance of bank will obviously be better with higher profitability and lower risk in view of global phenomenon of consolidation and convergence M. Narasimhan committee

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suggested mergers among strong banks both in public and private sector .The phenomenon of mergers in the banking sector has not been a recent one in India. Major recommendations made by Narsimhan committee in banking sector reforms are summarized as in table-1 below.

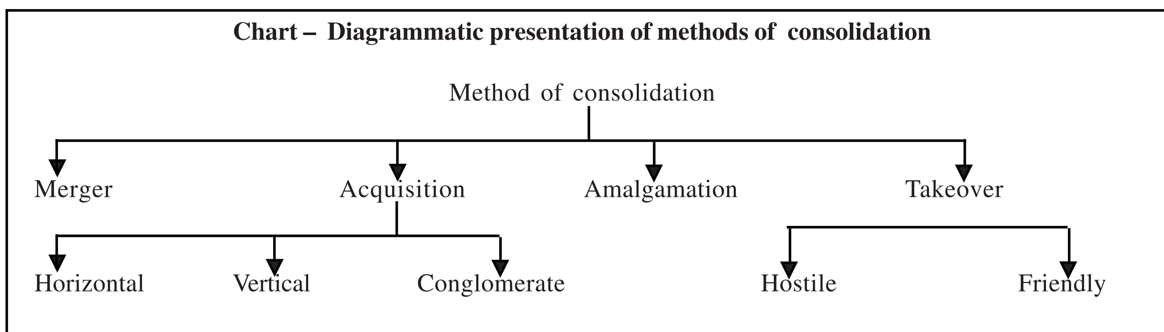
bank with invest able surpluses could generate substantial profits.

- The geographical and regional spread would get widened when banks with different stronghold merge. Based on principles of synergy , the business volume

Table 1: Major recommendation made by NarasimahanCommittee in 1991 and 1998

1991	1998
i) Merger banks to reduce numbers	i) More strong banks
ii) Free Bank Broads from Government from interference move to three-tier structure.	ii) Free Bank Boads from Broads interference move to three-tier structure.
iii) Fix capital adequacy level at 8 percent.	iii) Review capital adequacy norms
iv) Ensure autonomy to bank.	iv) Consider whether autonomy is consistent with public ownership.

Chart – Diagrammatic presentation of methods of consolidation



2. BENEFITS OF CONSOLIDATION

There are several benefits of consolidation and some of them are as follows :

- As competition heats up ,many banks having bigger size ,will command more in market .A bigger bank would have more staff strength , greater geographical reach , more financial resources , more delegated power and less operational and transactional costs due to economies of scale .A bigger financial conglomeration can easily withstand external assaults more effectively .
- Consolidation can help banks with complimentary expertise to boost up their combined talents as well as on presenting a vastly improved performance .For instance , a foreign bank with proven merit in treasury operation when merged with a

and geographical reach of consolidated entity automatically increase by many folds .

- The larger size , greater geographical penetration and enhanced market image and other synergic factors would inevitably increase the bargaining power of the new bank . In a competitive world where the battle is fierce ,a better bargaining power position is always an invaluable asset .
- The business in near future is unlikely to remain localized but bound to go global. In view of the saturating environment at domestic front , banks will have to venture overseas without any hesitation .Initial foray into overseas market are always made through strategic alliances and joint ventures .A merged entity with bigger market size , greater geographical spread , sound financial position , good image , greater resistance etc . would

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necessarily be successful in the overseas. All these virtues also help in acquiring tender and bids.

- The consolidation entity can serve the end user i.e. the customer in a better way through providing single window service by offering a variety of services like conventional banking , merchant banking ,mutual funds , insurance etc . Under one umbrellas leading to innovative and origin of new hybrid products and services like banc assurance.

3. RISKS ASSOCIATED WITH CONSOLIDATION

- When two banks merge into one then there is an inevitable increase in the organization .Big size may not always be better .The size may get too widely and go beyond the control of the management .The increased size may become a drug rather then an asset.
- 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 . All may not be up to the plan which explain why there are high rate of failure in mergers.
- Consolidation mainly comes due to the decision taken at the top .It is a top heavy decision and willingness of the rank and file of both entities may not be forthcoming . This leads to problem of industrial relations deprivation , depression and de-motivation among the employees. Such a work force can never churn out good results . Therefore , personal management at the highest order with humane touch alone can pave the way .
- The structure , systems and the procedures followed in two banks may be vastly different ,for example, a public sector bank or an old generation bank and that of a technologically superior foreign bank . The erstwhile structures, systems and procedures may not be conducive in the new milieu. A thought overhauling and systems analysis has to be done to assimilate both the organization s. This is a time consuming process and requires lot of cautions approaches to reduce the frictions.
- There is a problem of valuation associated with all mergers. The shareholder of existing entities has to be given new shares . Till now a foolproof valuation system for transfer and compensation is yet to emerge .
- There is also a problem of brand projection .This become more complicated when existing brands themselves have a good appeal . Question arises whether the earlier brands should continue to be projected or should they be submerged in favour of a new comprehensive identity . Goodwill is often towards a brand and its sub-merger is usually not taken kindly.

4. CONSOLIDATION AND CORE BANKING SOLUTION

The consolidation will make it convenient to introduce core banking solution(CBS) at maximum number of branches due to its being cost effective .

The CEOs of the bank have been stressing on the advantages of core banking solution . One of the biggest benefits from moving to core banking system is that transaction cost will be sufficiently reduce , by around 15 % to begin with , but much more in due course . The core banking solution ,in addition , will be able to handle large number of customers , large number of user ,and large number of transactions ,viz. to the extent of 25 millions transaction a day for each of large banks .Without consolidation ,the handling of large number of transaction may not be possible in future

for small sized banks. Besides this , expanding the implementation of real time gross settlements, electronic fund transfer at more centers , maximize the use of electronic clearing system , electronic banking, e-cheques , paperless handling of inter bank clearing transaction all will be conveniently possible after consolidation with the help of core banking solution and technology upgradation. It would also provide a solution to minimize the problems faced by the banks having different technology.

5. MOTIVES FOR MERGER & ACQUISITION

Some important motives of the merger are as follows:

Growth or Diversification: One of the important motives that attract mergers is impulsive growth. Organizations that intend to expand need to choose between organic growth and acquisition driven growth. Since the former is very slow , steady and time taking , firms that are dynamic and ready to capitalize on opportunities prefer the later.

Synergy : Synergy is a phenomenon where2+2=>5; it implies group efforts are always greater than sum of individual efforts. This translates into the ability of business combination to be more profitable than the sum of the profits of the individual firms that were combined.

Strategic: The strategic reasons could vary from one deal to another . At a time if two firms have complimentary business interests, mergers may result in strengthening their position in market.

Managerial efficiency : Some acquisitions are motivated by the belief that acquirer can better manage the target resources and subsequently the value of the firm will rise.

Market entry: Some firms use the acquisition as a strategy to enter in to new market as a result they build platform for them.

Tax shields: This plays an important role in acquisition if the stressed firm has accumulated losses and unclaimed depreciation benefits in their books. Such acquisition can eliminate the acquiring firms liability , hence benefiting for a merger with these firms.

Vision of Banks in India: The banking scenario in India has already gained all the momentum, with the domestic and international banks gathering pace. The focus of all banks in India has shifted their approach to 'cost', determined by revenue minus profit. This means that all the resources should be used efficiently to better the productivity and ensure a win-win situation. To survive in the long run, it is essential to focus on cost saving. Previously, banks focused on the 'revenue' model which is equal to cost plus profit. Post the banking reforms , banks shifted their approach to the 'profit' model, which meant that banks aimed at higher profit maximization.

Need for consolidation : Globalization coupled with technological developments has shrunk the boundaries by which financial service and products are being provided to the customer residing in any part of the global . Further ,due to innovations and improvements in service delivery channels, the trend of global banking has now been marked by twin phenomena of consolidation and convergence . The trend towards consolidation has been driven by the need to attain meaningful balance sheet size and market share in the face of intensified competition , whereas the trend towards convergence is driven across the industry by the need to provide most of the financial services such as banking , insurance , investment , cash management , etc to the customer under one roof.

6. CONSOLIDATION IN INDIAN BANKING PERSPECTIVES

The banking industry in India has been in process of consolidation and transformation ever since 1961 .The banking

regulation Act 1949 empowers the regulator with the approval of government to M&A weak banks with stronger banks . Majority of the merger in India have been crafted to bail out weak banks to safeguard deposition interest and protect the financial system .Prior to 1999, M&A of banks were primarily adopted by the weak financial of the bank being merged ,whereas in the past –1999 period , these have also been merger between heals banks driven by business and commercial consolidation . The Narasimham committee –II (1998) recommended a new phenomenon on the new generation mergers in banking system with existing banks to merger in to 3-4 international banks at the top most level , 8-10 national banks engaged in universal banking at the next level and local and rural banks confined to specific region .The committee strongly advocate for the merger among strong banks so as to device the inbuilt benefit of merger i.e. cost benefit ,reduce risk and other benefits.

Since the beginning of modern banking in India through the setting up of English Agency House in the 18th century,

Table –2 : List of Banks merged since nationalization

S.No.	Name of the bank	Merged with	Date of merger
1	Bank of Bihar Ltd.	State bank of India	November8,1969
2	National Bank of LahoreLtd	State bank of India	February20,1970
3	Miraj State Bank Ltd	Union Bank of India	July 20,1985
4	Lakshmi Commercial Bank Ltd	Canara Bank	August 24, 1985
5	Bank of cochin Ltd	State bank of India	August 26 ,1985
6	Hindustan Commercial Bank Ltd	Punjab National Bank	December 19, 1988
7	Trader Bank Ltd	Bank of Baroda	May 13, 1988
8	United Industrial Bank Ltd	Allahabad Bank	October 31,1989
9	Bank of Tamilnadu Ltd	Indian overseas bank	February20,1990
10	Bank of Thanjavur Ltd	Indian Bank	February20,1990
11	Parur Central Bank Ltd	Bank of India	February20,1990
12	Purbanchal Bank Ltd.	Central Bank of India	August 29,1990
13	Mew Bank of India	Punjab National Bank	September4,1993
14	Kash Nath Seth Bank Ltd	State bank of India	January 1,1995
15	Bari Doab Bank Ltd	Oriental Bank of commerce	April 8,1997
16	Punjab Co-op. Bank Ltd	Oriental Bank of commerce	April 8,1997
17	Bareilly Corp. Bank Ltd	Bank of Baroda	June 3 ,1999
18	Sikkim Bank Ltd .	Union Bank of India	December22,1999
19	Times Bank Ltd .	HDFC Bank Ltd.	February 26, 2000
20	Bank of Madura Ltd.	ICICI Bank Ltd.	March 10 ,2001
21	ICICI Ltd.	ICICI Bank Ltd.	May 3,2002
22	Benaras State Bank Ltd.	Bank of Baroda	June 20, 2002
23	Nedungadi Bank Ltd .	Punjab National Bank	February 1,2003
24	South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 26 2004
25	Global Trust Bank Ltd	Oriental Bank of commerce	August 14 ,2004
26	IDBI Bank Ltd.	IDBI Ltd.	April 2,2005
27	Bank of Punjab Ltd.	Centurion Bank Ltd	October 1,2005
28	GaneshBankof Kerundwaad	Federal Bank Ltd	September 2,2006
29	United Western Bank Ltd	IDBI Ltd.	October 3,2006
30	Bharat Overseas Bank Ltd	Indian Overseas	March 31 ,2007
31	Sangli Bank Ltd	ICICI Bank Ltd.	April 10,2007
32	Lord Krishna Bank Ltd.	CenturionBank of Punjab Ltd.	August 29, 2007
33.	CenturionBank of Punjab Ltd.	HDFC Bank Ltd.	May 23, 2008
34.	Bank saurashtra	State bank of India	2008

Source: Report on Trend and Progress, RBI, (Various Issues).

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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).

There have been several bank amalgamations 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 . 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 (Leeladhar, 2008).

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 banks. (Table -2)

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. 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 comprise economic, technological, human, organizational and cultural strategic issues.

Consequent to banking ector's reforms , India banks have emerged relatively stronger in terms of range of products and services ,capital adequacy , asset quality , profitability , productivity and overall balance sheet strength vis-à-vis their counterparts in other Asian countries .But, they are likely to encounter new challenges , particularly with implementation of Basel II norms and opening up of banking sector for the entry of foreign banks. An analysis by Standard & Poor's has shown that Indian banks are ahead of China, Indonesia ,Philippines and Vietnam . But the banking sectors of Australia, New Zealand, Singapore ,Hong Kong, Japan and Thailand are ahead of Indian banks. However the acquisition of a globally competitive size for Indian banks is a major challenge**.**. According to the RBI annual report 2007 –08 , the year witnessed maximum merger in financial services i.e. 15.7 % and acquisition activity was also the largest i.e. 17.9 % in the sector .

The' Too Big to Fail' argument that is being cited in the US to limit the size of banks is a poor reason to prevent consolidation in India. In this context it is vital to explain that the State Bank of India is perhaps big but not too big. The balance sheet size of SBI is about $250 billion. Some of larger banks in the world have a balance sheet size of $3 trillion, several times larger than SBI. Due to relatively smaller size Indian banks are unable to compete globally. More over, bigger the size, better would be a bank's capital adequacy ratio and risk management capabilities. So the size does matter. Banks in India need to be large to keep pace with the global aspiration of Indian corporates that are growing in size.

7. CONCLUSIONS AND SUGGESTIONS

According to the Reserve Bank of India , the total capital requirements in the five year 2007 –08 to 2011-12 are projected to go up by about INR 5,70,000 crores assuming that bank maintain capital to risk –weight assets ratio (CRAR) at 12 percent . As a result requirement of Public Sector Banks (PSBs) are projected to go up by about INR 3,70,000 crores . Banks will have to plan for raising capital resources to support such potential growth

Facing the challenge of change in terms of range of products, delivery channels, culture , structure and overall capabilities 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 consolidation in banks. Merger facilitates synergies between merged organization , generate efficiency improvements and increase competitiveness. Merger provides services at lower prices . It improves efficiency and achieve synergies. 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 .The word MERGER may be takes as an abbreviation which means:-

M-Mixing
E-Entities
R-Resources for
G-Growth
E-Enrichment
R-Renovation

The factors favoring growth , enrichment and renovation should be taken into due consideration before steeping into the process of mergers and acquisitions so that the abbreviation truly comes ......to be fruitful. To have a strong base in global banking and financial system , Indian banks have to go beyond peripheral issues and tackle significant issues like profitability efficiency and technology while achieving economies of scale through consolidation and exploring available cost effective solutions.

An effective consolidation process with synergy gains and tactical initiatives by the Government 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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