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CRITICAL APPRAISAL OF MERGERS IN THE BANKING SECTOR

By- Sonali Hirani & Ayushi Agrawal

ABSTRACT

In a developing economy like India, the banking sector is one of the fastest-growing and significant areas, and it has shown major changes in terms of mergers and acquisitions in the recent past. The merger is undoubtedly a very useful tool that helps the weak banks to survive by merging them into strong banks. Post the era of liberalisation, small banks found it very difficult to compete in the global market and enhance its global reach due to limited capital availability and less operational efficiency. Thus, the merger with the large banks gives them an opportunity and support to face the global economy. Due to the cut-throat competition in the market, there is a possibility of only the big players surviving in the market and mergers help the weak banks to integrate their operations with the strong banks to get the benefits of economies of scale. Mergers and acquisitions are a faster and more efficient approach to expand into greater markets and technology space. However, the success of mergers in banks is not assured. There is added pressure on the merged banks to adapt to superior technology, have more global space, tolerate the changing customer behaviour, and more shareholder demands amongst many things.

The present paper would give a critical appraisal of mergers in the banking sector. It will highlight the impact of bank mergers on the various stakeholders and the various advantages and disadvantages associated with mergers. The paper will also delve into the history and the rationale of the merger along with shedding some light on the mergers in the times of Covid-19.

(I) BACKGROUND

Mergers and Acquisitions are very helpful tools for growth and expansion in any industry, and the banking sector should be no exception. It is one of many widely used strategies to maintain and strengthen the position of banks in the industry. The Finance Minister of India Nirmala Sitharaman had announced the mega plan of banks' merger in August 2019 with the intention to have public sector banks in the country which are financially viable and have a global reach which would further boost the economic growth.[1]This plan aimed at consolidating the ten public sector banks into four large public sector banks in order to improve the customer base, the balance sheet, and the financial stability of the banking sector in the country. This announcement was particularly significant due to the unstable economic condition of our country, and it becomes all the more significant at present because of the sinking economy as a result of the pandemic.

(II) HISTORY OF BANK MERGERS

The idea of bank mergers has existed in India since the year 1991 when a former Reserve Bank of India Governor M. Narasimham suggested merging smaller banks with larger banks to compete with global banks in the Narasimhan Committee. The idea proposed that the existing banks should be stronger, quality over quantity and ever since there has been a growth in mergers in the banking sector.[2]

[1] *Nirmala Sitharaman announces big reforms for Public Sector Banks*, THE ECONOMIC TIMES, (August 30, 2019), https://economictimes.indiatimes.com/news/economy/policy/
[2]Malvika Joshi, *Bank Consolidation: 5 mergers from the past*, LIVEMINT.COM, (24 August 2017), https://www.livemint.com/Industry/Hyd4eUUAGiudpodUZgyzgM/Bank-consolidation-5-mergers-from-the-past.html

The Reserve Bank of India approves bank mergers in India, and the procedure is as per the Bank Regulation Act, 1949, as amended from time to time.[3] The banks are classified into nationalised banks, regional rural banks, and private sector banks. Considering the past bank mergers, achieving an inorganic expansion of branch network and improvising the financial status of a bank were the major objectives, at least in the case of bank mergers like Bank of Rajasthan, Centurion Bank, and Lord Krishna Bank. Kotak Mahindra Bank's acquisition of ING Vyasa Bank in 2014, had a hint of economic merger & acquisition consideration, however, achieving inorganic expansion along with the value of financial consideration was the main reason for the merger.[4]

Taking into consideration that most of the bank mergers in the past have made a constructive impacting the economy, in August 2020, Finance Minister of India, Ms. Nirmala Sitharaman had announced to merge ten public sector banks into four entities in order to increase global competitiveness and presence of Indian banks globally. She also mentioned it would help to clean up balance sheets and become global scale lender banks. All this was for a future goal to make India a 5 trillion dollar economy by 2024.

(III) The rationale behind the merger of banks

The decision of the government to merge ten public sector banks into four public sector large banks is primarily aimed at improving the operating efficiency, management, governance, accountability, and monitoring of the banking sector in the country. The rationale is very evident that the banks which have bad loans and weak operating efficiency are consolidated into banks which are stronger in

[3] *Id*.
[4] Girnara Monaben Rameshbhai, *Merger and Acquisition in Banking Sector*, 12 IJARCSMS 61, 63 (December 2016).

customer base and efficiency. This is to ensure a smooth operation in the running of the banks. This decision is a good remedial measure to help the public sector banks capture more market share than before.[5]

Some of the public sector banks in India that are financially stricken have shown less credit growth in recent years. The non-performing assets of these banks have piled up high, and the high-risk bad loans have eroded their capital ratios and profitability. These increasing bad debts have made their exposure to big corporate lending like real estate and infrastructure difficult and access to the capital market has also been very limited. The weak public sector banks face the risk of defaulting bad loans, and this also reduces their capacity to lend. Thus, there is a requirement of huge capital growth so that the capital adequacy ratio required to be maintained under the Basel III norms is maintained by the banks. All these reasons have prompted the government to take this decision of mergers of banks, and this seemed to be the only viable option left, looking at the present unstable condition of the economy. The following can be the motives and rationales behind the mergers:

- **Increased access to market**

The stronger bank into which the weaker bank/banks have been merged has greater access to the market resources, and thus there is a possibility that the value for the shareholders may enhance. There would be a consequent increase in the market share and better price control with an increase in the profit for the banks.

- **Rapid Growth**

Mergers can be beneficial for banks that desire rapid growth in size, market, and diversification in the range of the services they offer. The process of internal

[5]Sanket Dhanorkar, *PSU Bank Mergers: Is it actually good news for shareholders?*, THE ECONOMIC TIMES, (September 9, 2019), https://economictimes.indiatimes.com/wealth/personal-finance-news/.

growth through developing the required production capacity is a time-consuming process, and a merger with an existing strong bank can help achieve this objective in a shorter period of time.

- **Economies of Scale**

The mergers help banks to achieve an efficiency of operations and significant growth, which aids them in reducing their expenses to a considerable extent. The mergers of banks also have an inherent advantage of reducing competition from the banking industry, and this helps to achieve economies of scale because rather than public banks competing amongst themselves, they can now compete together against the private sector banks.

(IV) IMPACT OF MERGER ON THE VARIOUS STAKEHOLDERS

Bank mergers will have a great impact on various stakeholders including the banking sector, the customers, the Indian economy, and the central government. There are enormous benefits of a merger such as a bigger market share, the generation of a new customer base, the possibility of a technology upgrade, and many more. As a result of the merger, the bank becomes larger in size, which makes it easier for it to retain and enhance its identity. The entire business of the bank is empowered to greater heights due to an increase in the customer base.[6] This way, it has the ability to prove to be very beneficial for the overall Indian economy, the banking sector, and the customers.

[6]Suresh Kumar, *Impact of Bank Mergers on the efficiency of banks: A study of merger of Bharat Overseas Bank with Indian Overseas Bank*, 3 IJARBSS 221, 230 (December 2013).

- **Banking Sector**

From the banking sector point of view, the overall risk is also minimised. There are several underperforming banks in the economy, and the merger of banks increases the chances of survival of such banks which further helps in keeping the trust of the customers intact. There is an unhealthy and intense competition among the public sector banks.[7] After the merger, the number of public sector banks will be six or seven. This will put an end to this competition, and these banks will now together give a tough competition to the private sector banks. The smaller banks will now be in a better position to compete internationally with a better level of services and efficiency. Professional standards and geographical outreach will also expand. The mergers will also improve the bargaining position of the banks, and the staff of the bank will also hope for better salaries and service conditions in the near future.[8]

Varying financial strength is exhibited by the banks that have been merged. The stronger banks such as the Indian bank and the Punjab National bank are merged with the smaller banks under the bank merger plan.[9]However, it cannot be ignored that when the stronger banks merge with, the weaker ones, the health of strong banks does suffer adversely. This leads to a fall in the share price of the strong banks such as what happened with the Indian bank that witnessed a steep fall in its shares just after it got merged with the Allahabad bank as a part of the merger plan. There is at least temporary financial deterioration that has happened, and it

[7]Ravi Kumar Undi & Basavaraj C.S., *A study of Mergers and Acquisitions in Public Sector Banks in India*, 5 EPRA IJMR 37, 39 (November 2019).
[8]*Id.*
[9]Christian U. Amu & Ezeji Emmanuel Chigbu, *Relationship between pre and post merger and Acquisition Banking Industry Performance in Nigeria*, 6 IJMP 850, 856 (September 2015).

remains to be seen if the operational benefits which the government believes will generate are able to compensate for this financial loss of the stronger banks.[10]

- **Customers**

Retail customers including the account holders of the amalgamating banks, are usually impacted by the merger. A merger happens between an anchor bank and the amalgamating bank or banks. For Instance, in April 2019, Vijaya Bank and Dena Bank merged into the anchor bank, the Bank of Baroda.[11] Herein, the retail customers of both these amalgamating banks are likely to get impacted, and the customers of the Bank of Baroda are not likely to suffer much impact. However, the shareholders of all the banks part of the merger will get affected by either the steep fall in the price of a share of the bank or the rise in the price of the share.[12]

Among the many implications for the customers as a result of the merger, the customer IDs and the bank account numbers of the customers would get changed. All the customers of the banks involved in the merger may get a new account number and the customer ID. Once the merger process ends, the account holders will have to get a new passbook from the bank. There may be a branch rationalisation exercise wherein the home branch of the customers may shut down. There may be new IFSC codes generated which the customers will have to update with various third party entities such as the income tax department, insurance companies, etc. There will be larger access to ATMs provided to the customers because of a larger branch network of the combined banks.

[10] *Id.*
[11] *Id.*
[12] PSU bank mergers: *Customers of which bank are likely to be impacted and how*, THE ECONOMIC TIMES, (March 31, 2020), https://economictimes.indiatimes.com/wealth/personal-finance-news/.

The interest rates on various deposit schemes may also be impacted as a result of the merger. Along with the customers, the shareholders involved in the mergers will be greatly impacted. The amalgamating banks' shareholders will be allotted the shares of the anchor bank in a ratio that is pre-decided. It depends on the price of the shares after the merger, whether this impact will be positive or negative.[13]

- **Indian Economy**

India's economic scenario, at present, is very disturbing. The GDP is at an all-time low, and it is very significant at this stage to revive the economy. The bank mergers can boost the economy in the way by reducing the number of non-performing assets which would further help in curbing bad loans.[14] The increased balance in the savings and current account balance would increase the capacity of the banks to lend, and the banks would be in a better position to absorb the shocks which would further help in reaping economies of scale. The efficiency in operations and management and global reach will also improve with a lesser number of banks. There will be a reduction in the cost of doing business, and the problem of technical inefficiency will also greatly reduce. All in all, the diversification of risk management as a result of the merger of banks is likely to be beneficial for the Indian economy.[15]But it is difficult for the bank mergers to save the sinking economy. There is a possibility that the stronger banks merger with the weaker one may prove to be counterproductive. There has to be

[13] *Banks merger in India: Is it good for Indian Economy*, MBAUNIVERSE.COM (April 02, 2020), https://www.mbauniverse.com/group-discussion/topic/business-economy/banks-merger-in-india#:~:text=After%20the%20mergers%2C%20there%20will,Banks%20to%20boost%20economic%20growth.
[14]Prashanth Perumal J., *How will mergers affect public sector banks*, THE HINDUSTAN TIMES, (September 8, 2019), https://www.thehindu.com/business/Industry/.
[15]*Id*.

restructuring in the merged banks, which could lead to unemployment for many (even though the government has assured that no employee will lose his job). This

would lead to a lack of job opportunities in an economy that is already facing unemployment on a large scale.[16]

The burden of the central government will also come down exponentially from a regulatory perspective because now less number of public banks will have to be monitored and controlled. The government will be in a better position to meet the standard of the stringent norms under BASEL III, more specifically, the capital adequacy ratio.[17]

(V) PROS AND CONS OF BANK MERGER

The merger of banks is generally for the betterment of the economy; however, it does not only come with advantages but also with certain disadvantages. It is pertinent to study the merger and its impact on the country. Various analysts have tried to evaluate how an economy can perform with the merger but fail to understand that these mergers do affect not only external affairs but also the internal administration of these banks.

PROS

- **Cost-Effective**

[16]Prince Chandak, *Can Public Sector Banks' Mergers Revive India's Coronised Economy?*, MODERNDIPLOMACY.EU (April 21, 2020), https://moderndiplomacy.eu/2020/04/21/can-public-sector-banks-mergers-revive-indias-coronised-economy/.
[17]Manjunath Narasagondar, *Recent Mergers and Acquisitions in Indian Banking Sector- A study*, 3 JETIR 690, 693 (October 2016).

During a merger, there is also an amalgamation of employees, this, in turn, will reduce the load on the banks to maintain high-paid employees and it will be on the banks to select a single managing director, a single chief executive officer,

and a single executive director, etc. All these personnel is highly paid, and the merger will, in turn, reduce costs used on salaries resulting in higher savings.[18]

- **Larger customer base**

Each bank has its own customers widespread in different geographical locations all over the country. The merger will help banks gain an overall larger customer base with a bigger geographical penetration, and in turn, extend its reach and have a higher impact performance-wise.

- **Strengthening weaker banks**

In a merger of a large-scale bank and a small-scale bank, the smaller bank has more to gain. The bigger bank not only has the finance to strengthen a small bank but also better quality of personnel to configure and solve problems of the smaller bank.

- **Improvement in performance**

The credit portfolio of the banks and the non-performing assets (NPAs) will be dealt with more efficiently, as consolidation would help prevent more resources

[18]Peter S. Rose, *The impact of mergers in banking: Evidence from a nationwide sample of federally chartered banks*, 39 JOURNAL OF ECONOMICS AND BUSINESS 289, 300 (November 1987).

being spent in the same area and would help strengthen banks to deal with stocks[19].

- **Technological Advancement**

The introduction of e-banking and various financial instruments/derivatives will attract more customers for the bank and improvise efficiency in banking. This, in turn, will allow national banks to compete with global banks, resulting in boosting the Indian economy.

- **Tax Benefits**

With the merger, there would be a lesser burden of all the banks paying taxes and will be concentrated on the merged bank. The tax saved can be used for various other purposes serving for the development of the bank.[20]

- **Economically beneficial**

The merger of banks will serve to create a stronger banking infrastructure in the country. It would help to reduce bad loans, manage liquidity, and improve overall profitability.[21]

CONS

- **Scare of Collapse**

While the merger of banks helps growth, it can also collapse if the weakness of the small bank transfers to the bigger bank. In 2004, Global Trust Bank and

[19] *Id.*
[20] Ishwarya J, *A study on mergers and acquisitions of banks and a case study on SBI and its associates*, JOURNAL OF TREND IN RESEARCH AND DEVELOPMENT 22, 24 (25 September 2019).
[21] *Id.*

Oriental Bank of Commerce merged but this merger was challenging, as the Global Trust Bank had failed to make disclosures about its performance where huge losses had incurred, and a significant amount of non-performing assets were accumulated by the Global Trust Bank.[22]However, Oriental Bank of Commerce hadn't had it easy but managed to overcome these challenges over time.

- **Clash in Corporate Cultures**

Each bank has a different way of functioning, different morals, and values it follows; however, during a merger, there could be a conflict in determining the culture to be followed. The same conflict could also occur from other internal areas, for example, managerial styles. Hence, it is crucial that the banks discuss this prior and come to a mutual understanding to avoid any such conflict.

- **Redundancy**

As a result of the merger, banks would, unfortunately, lose their top personnel. The merger of banks would also reduce branches in the same locations, reduce office size, and impact the jobs in the market, ultimately reducing the employment rate and affecting the economy.

- **No power to the customers**

The customers, who are supposed to be the 'king', would have no power in the decision of which bank's culture it would like to follow. This could possibly lead to customers changing their banks.

[22] *Id.*

- **Demolition of Decentralisation**

Smaller banks generally have a strong regional presence, though merging with a bigger bank could decentralise its operations and could lose personal touch with existing customers in smaller regions.

(VI) BANK MERGERS IN TIMES OF COVID-19

India's economy has taken a big bullet due to the coronavirus outbreak; the GDP has dropped drastically, and pressure is added to the Reserve Bank of India to configure existing policy rates. There is also a scare on the increase of the non-performing assets (NPAs) this year. The banking sector is most definitely in the first sector to be hit and would also be the last to recover from this situation. With a lack of liquidity in the market, the private sector banks may have to decrease lending, but the public sector banks are the backbone of the Indian economy and will have to play the role of catalysts in reviving the economy.[23]

As stated by the Finance Minister of India, Ms. Nirmala Sitharaman, the 12 public sector banks were merged into 4 public sector banks as of April 1, 2020, despite the nationwide lockdown. There is no clarity on the current performance of these public sector banks though some banks have reported that there would be no layoffs of employees despite the major merger and lockdown situation, which seems promising for now, it is unpredictable what the future holds.[24] The Ministry of Finance has also conveyed its future plans to privatise a few governments owned banks in an attempt to make them stronger. The Reserve Bank of India is apparently working on this scheme.[25]

[23] *Mega bank consolidation on track*, TIMES OF INDIA, (March 26, 2020), https://timesofindia.indiatimes.com/business/.
[24] *Id*.
[25] *Bank privatization: India plans to reduce number of state owned lenders to just five*, THE ECONOMIC TIMES, (July 21, 2020), https://economictimes.indiatimes.com/industry/banking/finance/banking/privatisation-drive-india-plans-to-reduce-number-of-state-owned-banks-to-just-five-say-sources/articleshow/77066632.cms?from=mdr.

(VII) CONCLUSION

In today's scenario, when the country is facing the most devastating state of affairs as far as its economy is concerned, mergers of banks to save the banking sector is a crucial step. These are times when the banks are facing the ever worst bad loan problems, and thus there is a great need for the merger of weak banks with the strong banks to save the sinking banking sector and thus the economy. However, with the potential benefits of the mergers discussed above, they can also bring damage to the banking sector if the execution and the post operations are not managed properly. The needs of all the stakeholders involved in the anchor and the amalgamating banks have to be kept in mind, and it has to be seen that they do not suffer in this process and there is the smooth integration of the banks involved.

The effects of the mergers that have taken place in the last year and this year during the time of the pandemic will be perceived in the end. It can only be hoped that the merging exercise takes place in a manner which creates an environment of trust and there is the utmost amount of confidence and agreement among the shareholders, employees, and customers of all the banks involved in the merger. There will be a win-win situation for all the stakeholders if the people, the work operations, and the vision are nicely blended together to result in synergic effects for the banking sector.