Mergers & Acquisitions in Banking Sector: An analysis of the current position in India

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***Abstract*: With the enactment of Companies Act 2013, number of new provisions have been introduced which further supplement the idea of Merger & Acquisition amongst various companies. The same likewise been fortified as a way of strengthening and consolidation for banks and financial institutions. On one hand, in the case banks, while they are being acquired or merged, the overall assets and liabilities are clubbed together to increase the output as well the working capital of the company along with the enhancement of various other similar facets. However in financial institutions, though the efficiency of banks or financial institutions tends to enhance in a similar fashion as to a company, but the effects of such merger & acquisitions appear to the general public at large, along with the financial market in terms of policies as well as the legal framework. This paper analyses the concept and instances of Merger & Acquisition (M&A) in thebanking sector in India, along with the impact of such M&A upon the day-to-day activities & policies.**

Introduction

Mergers and acquisitions are most widely used strategy by firms to strengthen and maintain their position in the marketplace. M&A's are considered as a relatively fast and efficient way to expand into new markets and incorporate new technologies. One cannot say that the success of a firm is completely assured by going through such M &A's. However, a majority of M&A's fall short of their stated aims and objectives. Some failure can be explained and justified by financial and market factors. On the contrary, a considerable number can be traced, which has neglected those factors, which are related to human resources issues and activities.

Many histories of bank Mergers & Acquisitions (M&A) begin in the late 18th century. However, mergers coincide historically with the existence of banks. The interest comes from researchers and practitioners trying to explain the main reasons behind cross-border merger & acquisitions and theiroutcomes. Bank mergers & acquisitions come in waves and are changing the structure of the banking sector. These waves of bank M&A'sare responses to the driving forces for change such as information technology and the integration of international capital market. Mergers & Acquisitions are changing the structure of the banking industry but are not easy to accomplish successfully. M&As within the banking industry are currently widely discussed by practitioners and academics due to the fact that the context, scope, and purpose of M&As seem to have changed in recent years. Some previous studies in bank M&As claim that the performance will be reduced rather than increased as a result of M&A as a result of several factors, for instance, cultural differences and costs from necessary adjustments.

In response to those recent trends of growing Mergers & Acquisitions across the globe, or within a particular territory, there is a need to differentiate according to the type of M&A, the size of the banks involved and the target region of the world. Small and medium bank M&A's are mostly being carried out for economies of scale and to achieve a size that allows survival in the financial market. Large bank M&A's often have an element of strategic re-positioning and are intended in order to diversify the risks and to smooth income volatility. M&A necessarily involves organizational change, integrating some or all parts of the original organizations' functions and activities[1]. In today's rapidly evolving environment, the fact that many organizations are in desperate need of capital infusions translates into strategic opportunities. Some potential acquirers have strong cash positions and this could lead to successful deals with less competition. Furthermore, when two banks are merging the salaries of the acquired bank are generally lower, so it may be necessary to equalize them. These adjustment costs could have a negative impact on M&A performance. An important factor for the successful outcome of a merger is also the methodology of briefing enacted by the leaders and managers of the two banks during both the pre-merger and post-merger stages[2].

Mergers & Acquisitions: Meaning

The term mergers and acquisitions are often interchangeably used although together they include more than one form of transaction of acquiring ownership in other companies.The concept of **Merger** can be defined as "a combination of two or more companies in which the assets and liabilities of the selling firm(s) are absorbed by the buying firm[3]. Although the buying firm

[1] . Seo, M., Hill, N.S. (2005), Understanding the human side of merger and acquisition: An integrative framework. The Journal of Applied Behavioural Science, Vol. 41, No. 4, pp. 422-443.
[2] . Walter, I. (2004), Mergers and acquisitions in banking and finance: what works, what fails, and why. Oxford University Press, UK.
[3] . Mergers & Acquisitions From A to Z, Second Edition by Andrew J. Sherman; Milledge A. Hart

may be a considerably different organization after the merger, it retains its original identity." In other words, in a merger one of the two existing companies merges its identity into another existing company or one or more existing companies may form a new company and merge their identities into a new company by transferring their businesses and undertakings including all other assets and liabilities to the new company (hereinafter referred to as the merged company). The shareholders of the company (or companies, as the case may be) will have asubstantial shareholding in the merged company. They will be allotted shares in the merged company in exchange for the shares held by them in the merging company or companies, as the case may be, according to the share exchange ratio incorporated in the scheme of merger as approved by all or the prescribed majority of the shareholders of the merging company or companies and the merged company in their separate general meetings and sanctioned by the court.

"An acquisition", according to Krishnamurti and Vishwanath (2008) "is the purchase of by one company (the acquirer) of a substantial part of the assets or the securities of another (target company). The purchase may be a division of the target company or a large part (or all) of the target company's voting shares." Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and niche compared to expanding on its own. Acquisitions are often paid in cash, the acquiring company's shares or a combination of both. Further, an acquisition may be friendly or hostile. In the former case, the companies cooperate in negotiations; in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer. Acquisition usually refers to a purchase of a smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as a reverse takeover.

The Companies Act, 2013 seems to be opening up new and simple avenues for mergers, acquisitions and restructuring operations in India. It is expected that the new legislation will reduce shareholders' litigation and propagate their rights. It endeavors to make restructuring a smooth and transparent procedure.The Companies Act, 2013 (2013 Act) has seen the light of day and replaced the 1956 Act with some sweeping changes including those in relation to mergers and acquisitions (M&A). The new Act has been highly supported by corporate organizations and lawyers for its business-friendly corporate regulations, enhanced disclosure norms and providing protection to investors and minorities, among other factors, thereby making M&A smooth and efficient. Its recognition of inter-se shareholder rights takes the law one step forward to an investor-friendly regime. While the 2013 Act is appreciated by many, it poses some practical difficulties for companies in structuring their transactions. While it has been a long wait since the 1956 Companies Act, the law has taken steps forward to give a new dimension to corporate restructuring. The Act seeks an alignment with other laws such as Income Tax and exchange control provisions to facilitate its efficient implementation. The Rules, which are yet to be finalized, will also play a crucial role in this.

Working of mergers and acquisitions in banking sector

The process of consolidation ascertains that thecompany so acquired transfers all its shares, assets and liabilities to the acquiring company by means of share or cash exchange. In its turn, acquisition assumes that the acquiring bank takes over ownership of other banks and combines all their operations within the framework of a sole new alliance. The process of acquisition assumes that two or more banks may operate as independent legal entities, though they are usually prone to corporate control changes. Finally, by means of takeover one bank obtains management control over another bank. Therefore, one bank acquires not less than 25% of the voting power in another bank[4]. The idea of mergers and acquisitions has become a necessity in a banking sector following the adverse effects of a global financial crisis. A huge number of international and national banks worldwide have engaged in mergers and acquisitions. This has helped many banks to benefit from the opportunities of economies of scale, which they would not do by operating as independent financial structures. Banks take advantage of mergers and acquisitions by growing their operations and minimizing their expenses at considerable rates. Furthermore, the formation of banking alliances reduces the number of players on financial markets and therefore lessens competition in the banking industry[5].

Mergers and acquisitions are growing even in Indian economy particularly, with theimplementation of economic reforms in 1991, a favorable economic and regulatory environment has encouraged businesses to resort to consolidation route to establishing big size business firms, improve efficiency and develop competitiveness. However, with global evidence of value destruction by mergers and acquisitions, it becomes imperative to study if shareholders in Indian companies are able to make any significant long term gains.

Amalgamation of business entities is a worldwide phenomenon. The mergers and acquisitions in thefinancial sector of India appear to be driven by the objective of leveraging the synergies arising out of the consequences of M&A process. However, such structural changes in the financial system can have some public policy implications.Though banks are per se regarded as a corporate body even within the scope of Companies Act[6], but there are special laws for the regulation of day-to-day activities of banks and hence these special laws are preferred over the general laws being given under the companies act. Procedures for merger, acquisition and amalgamation of banking companies are clearly defined in **Section 44(A)** of the Banking Regulation Act 1949. According to the Act, a banking company will have to place a draft before its shareholders and the draft will have to be

[4] . DeYoung R Evanoff, D and Molyneux P. 2009, "Mergers and Acquisitions of Financial Institutions: A Review of the Post-2000 Literature," Journal of Financial Services Research, vol.36, no.2, pp. 87-110.

[5] . Hannan and Pillof 2006; Goddard et al. 2009; Hernando et al. 2009)

[6]. Section 2(9), Companies Act 2013. According to which, a banking company means a company as defined in clause(c) of Section 5 of the Banking Regulation Act, 1949.

approved by a resolution passed by a majority in number, representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose. Notice of every such meeting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association indicating the time, place and object of the meeting, and shall also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities. If there is any shareholder, who has voted against the scheme of amalgamation at the meeting or has given notice in writing at or prior to the meeting of the company concerned or to the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the Reserve Bank, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares (to be paid to the dissenting shareholder shall be final for all purposes). If the scheme is sanctioned by the Reserve Bank, by an order in writing, it becomes binding not only on the banking companies concerned but also on all their shareholders to abide by the law.TheBanking Regulation Act 1949 also empowers the Reserve Bank of India to the extent that it has the power to apply to Central Government for suspension of business by a banking company and to prepare ascheme of reconstitution for amalgamation[7]. Reserve Bank ensures that there is good reason to do so and may apply to the Central Government for an order of moratorium in respect of a banking company. The Central Government, after considering the application made by the Reserve Bank under sub-section (1), may make an order of moratorium[8] staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it thinks fit and proper and may from time to time extend the period so however that the total period of moratorium shall not exceed six months. During the period of moratorium, if the Reserve Bank is satisfied that it is (a) in the public interest; or (b) in the interests of the depositors; or (c) in order to secure the proper management of the banking company; or (d) in the interests of the banking system of the country as a whole. Apart from this, it is necessary so to do, the Reserve Bank may prepare a scheme (i) for the reconstruction of the banking company, or (ii) for the amalgamation of the banking company with any other banking institution (in this section referred to as "the transferee bank"). Apart from this, there are some more guidelines for amalgamation. According to **Accounting Standard (AS) 14**, 'Accounting for Amalgamations', amalgamations fall into two broad categories[9]. The first category includes those amalgamations, where there is a genuine pooling not only of the assets and of liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. These kinds of amalgamations are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category, those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company or the businessof the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase.

In the banking sector, mergers and acquisitionstake a form of "horizontal merger" going with the assumption thatthe combined entities represent similar businessand are performing the same commercial activities[10]. Incases where some non-banking financial institutions providethe same services as banks, they are also subjectto themerger with other banks. Mergers andacquisitions inthebankingsectorarethewayforthebankstoseek new opportunities and gain strategicbenefits on financial markets, as well as extendtheir customer base. Most importantly, thesebusiness alliances enable the banks to growand internationalize. While more structurescombine their business within the framework of oneentity, the latter grows dynamically and wins acompetitive edge over rivals. Suchgrowth is known as "Inorganic growth," is equally opted by state and privatebanks internationally.

Merger & Acquisition: Analysis of the impact in banking sector

The success of these M&A'sdepends on to a large extent upon a banks' ability to assess the relatedness of the assets of both banks and the cultural differences as well as to being able to integrate the two banks[11]. Furthermore, when two banks are merging the salaries of the acquired bank are generally lower, so it may be necessary to equalize them. These adjustment costs could have a negative impact on the outcomes of these mergers and acquisitions. An important factor for the successful outcome of a merger is also the methodology of briefing enacted by the leaders and managers of the two banks during both the pre-merger and post-merger stages[12].

Though, one can say that it is difficult to assess the impact of banking M&A's on the new organization because it is often difficult to unravel the direct impact of M&As from the impact of other factors, such as globalization, increasing competition, or high

[7] . Section 45, Banking Regulation Act, 1949.

[8] . Sub section (2), Section 45, Banking Regulation Act, 1949. It refers to the temporary suspension of a law to allow a legal challenge to be carried out.

[9] . https://www.mca.gov.in/Ministry/notification/pdf/AS_**14**.pdf.

[10] . *https://www.icsi.edu/portals/70/EDSG29062013.**pdf.***

[11] . Marks, M.L., Mirvis, P.H. (2011), Merge ahead. A research agenda to increase merger and acquisition success. Journal of Business Psychology, Vol. 26, pp. 161-168.

[12] . Kling, G., Ghobadian, A., Hitt, M.A., Weitzel, U., Regan, N. (2014), The effects of cross-border and cross-industry mergers and acquisitions on home-region and global multinational enterprises. British Journal of Management, Vol. 25, pp. 116-132.

technology change. Commercial banking activities have several characteristics that make them a particular focus for M&A transactions. These include:

1) High-cost distribution and transactions infrastructures such as branch networks and IT platforms that lend themselves to rationalization.

2) Overcapacity brought on by traditions of protection and distortion of commercial banking competition, and sometimes by the presence of public-sector or mutual thrift institutions and commercial banks (such overcapacity presents an opportune target for restructuring, in the process eliminating redundant capital and human personnel).

3) Slow-growing markets that rarely outpace the overall rate of economic growth and usually lag it due to encroaching financial disintermediation, exacerbating the overcapacity problem;

4) Mature products that make innovation difficult in the production of financial services, combined with sometimes dramatic innovation on the distribution side, notably Internet-based commercial banking.

The organizational culture within the banking industry has focused mainly on growth and market competition. These factors have not changed the nature of core M&A activities (pre-merger due diligence, valuation, post-merger integration etc.), but the key managers must take into account additional factors during both the pre- and post-merger stages.

Apart from these factors, even the Management plays a very significant role in the positive growth of a firm[13]. Personal interests of key managers are considered avery important factor in banking M&A and not always a negative factor. M&A's in the banking sector would probably be limited, if key managers were not personally interested in the performance, size and prestige of their institution. The personal interests would presumably increase the motivation of key managers directly involved in M&A's which will enhance the likelihood of a successful M&A. Nevertheless, in cases of large M&A's top managers may be tempted by their professional ambitions to pursue increases in size, purely for the sake of size, without paying due attention to the strategic and managerial consequences.

However, for mergers involving fewer banks, certain characteristics in connotation to the Management emerge as being of particular importance to anoverall outcome which can be brought under as follows:

1) The quality of Human Resource Management (HRM) due diligence,

2) The existence and handling of regional cultural differences,

3) The extent and quality of communications; and

4) The use of integration advisors to facilitate the process.

Such crucial factors have even enabled various researchers to reach to the conclusion that, the continuation of the fame or brand name is more apparent than the others, the preservation of culture, leadership and decision making are crucial to achieving the M&A strategic aims[14]: for example, a higher degree of autonomy would be appropriate if the target bank has excellent skills (like the workforce ability to minimize wastes and/or customer-orientation) that are important to preserve.

Key Issues and Challenges in banking sector

The biggest challenges which came across frommergers and acquisitions of banks is the implication of consolidation on employment, profitability, market share, human motivation and technology. Since the merger exercise is in its infancy stage in India, the past experience of post-merger implications on theeconomy can be taken into considerations to devise and monitor of themerger. Employees or most affected party of mergers. The UNI Europe Report estimated that 1, 30,000 jobs have been lost in the last 10 years as a result of mergers and acquisitions[15].

According to this report in India about 11% of over eight lakh, strong bank employees opted for first ever voluntary retirement scheme. Now other challenges and problems of mergers may be as follows:

- Highly innovative product portfolio may be created amongstthe customers but only a few smart customers can take the benefits of product offered by merged banking entities.

[13] . Marks, M.L., Mirvis, P.H. (2011), Merge ahead. A research agenda to increase merger and acquisition success. Journal of Business Psychology, Vol. 26, pp. 161-168
[14] . Fiordelisi, F. (2009), Mergers and acquisitions in European banking. Palgrave Macmillan, UK.
[15] . International Journal of Multidisciplinary Research Vol.1 Issue 4, August 2011, ISSN 2231 5780

- The branch closers can create job losses and backroom operations may reduce face to face interaction of the service providers with the customers.
- The workload of employees will be highly specific and at some point of time, even become complicated due to financial conversions. Therefore a burdened employee may not be able to respond to customer effectively.
- Highly technical nature of banking operations may create problems to thesimple and non-techno public as a majority of the consumers in India might lack such technical know-how of the banking transactions.
- The focus of banks would be highly professionalized and the efforts of big banks will be directed towards making more and more profits and less concentration on consumer's grievances.

Conclusion

In the light of the recent trends in the banking sector and the bits of knowledge from the cases highlighted in this research, one can list some steps for the future which banks should consider, both in terms of consolidation and general business. Firstly, banks can work towards a synergy-based merger plan that could take shape latest by 2009 end with minimisation of technology-related expenditure as a goal. There is also a need to note that merger or large size is just a facilitator, but no guarantee for improved profitability on a sustained basis. Hence, the thrust should be on improving risk management capabilities, corporate governance, and strategic business planning. 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 and first mover advantage could be a decisive factor in deciding who wins in future. Post-M&A, the resulting larger size should not affect agility. The aim should be to create a nimble giant, rather than a clumsy dinosaur. At the same time, lack of size should not be taken to imply irrelevance as specialized players can still seek to provide niche and boutique services. Persistent growth in Indian corporate sector and other segments provide further motives for M&As. Banks need to keep pace with the growing industrial and agricultural sectors to serve them effectively. A bigger player can afford to invest in required technology. Consolidation with global players can give the benefit of global opportunities in funds' mobilization, credit disbursal, investments and rendering of financial services. Consolidation can also lower intermediation cost and increase reach to underserved segments.

In light of the patterns in the managing an account area and the bits of knowledge from the cases featured in this investigation, one can show a few stages for the future which banks ought to consider, both as far as solidification and general business. Right off the bat, banks can work towards a cooperative energy based merger arrange for that could come to fruition most recent by 2009 end with minimisation of innovation related consumption as an objective. There is likewise a need to take note of that merger or substantial size is only a facilitator, however no assurance for enhanced gainfulness on a supported premise. Consequently, the push ought to be on enhancing hazard administration capacities, corporate administration, and vital business arranging. In the short run, endeavor choices like outsourcing, key unions, and so forth can be considered. Banks need to exploit this quick evolving condition, where item life cycles are short, time to advertise is basic and first mover preferred standpoint could be a conclusive factor in choosing who wins in future. Post-M&A, the subsequent bigger size ought not influence dexterity. The point ought to be to make a mammoth, instead of an awkward dinosaur. In the meantime, absence of size ought not be taken to suggest unimportance as specific players can even now look to give specialty and boutique administrations. Persevering development in Indian corporate area and different fragments give promote thought processes to M&As. Banks need to keep pace with the becoming modern and agrarian areas to serve them viably. A greater player can bear to put resources into required innovation. Combination with worldwide players can give the advantage of worldwide open doors in assets' preparation, credit disbursal, speculations and rendering of monetary administrations. Union can likewise bring down intermediation cost and increment reach to underserved sections.

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