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AN INVESTIGATION OF MERGERS IN INDIAN BANKING SECTOR POST GOVERNMENT'S ANNOUNCEMENT OF MEGA MERGER IN 2019 FOR PUBLIC SECTOR BANKS

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ABSTRACT

Mergers and acquisitions are important processes of Indian banking industry which aim at increased competitiveness and efficiency through consolidation of business, increasing product line, expense reduction and increased market power. But the critical question here is whether banks have actually achieved improved economies of scale or not in the mergers took place in different phases of banking sector. In the past few years major changes have been observed in Indian banking scenario in terms of mergers and acquisitions due to financial system deregulation and M & A is used as a very helpful strategy for the survival of weak banks by merging into larger banks. In the recent time, there have been numerous reports in media on variety of topics for Indian banking sector including preparedness of banks to meet the fast approaching Basel III dead line by March 2020, number of increasing NPA's in weaker banks etc. Indian economy also grew at its slowest pace in over six years in the quarter ending June 2019. In the light of these facts, Indian government has taken a decision of forced merger of 10 PSB's into 4 banks.

KEYWORDS: *Banking Industry, Mergers, Economy, Acquisitions*

INTRODUCTION

The process of merger and acquisition is extensively used for restructuring of the business organizations and in today's free market economies it has become a global phenomenon as banks constantly need to evolve to remain competitive in the world market. Now a days banking follows no geographical and territorial boundaries as the banking business is increasingly becoming global business that is why failure of bank can do more harm and have widespread implications to the economy than a failure of agricultural or manufacturing company. Whole lot of challenges cropped up for Indian banking industry since Indian economic reform of 1991. The increased competition in global market after liberalization has prompted the Indian banking companies to go for mergers and acquisitions as an important strategic choice.

As the finance minister Nirmala Sitharaman on August 30, 2019 announced the mega plan of banks merger with the aim of having financially strong Public sector banks in India, 10 public sector banks are going to be merged into four and this merger is expected to bring and develop fewer but powerful global sized banks to boost economic growth. As per many studies conducted in past most mergers have proved to be an overall success for weaker banks but to verify this observation there are no concrete parameters. This paper is an attempt to understand the results of mergers in the banking industry which have been done in past and also to interpret the advantages and challenges of proposed mega merger.

OBJECTIVES

1. To understand the benefits and dangers of Bank mergers and acquisitions.

2. To present an overview of phase wise merger in the banking sector.

METHODOLOGY

The study is completely based on secondary sources which include articles from newspapers, annual reports of selected banks, research publications and RBI database etc.

LITERATURE REVIEW

Berger et. al (1999): proffers an excellent literature review on the issues of impact of mergers on efficiency and operating performance of banks and analysis of mergers impact on the overall market value of both the target banks and bidder. The issues identified above are the study of post merger operating expenses, accounting profits and efficiency ratios which were compared to pre-merger performance of the banks. Here the merger was assumed to improve performance in terms of reducing costs increasing profitability and revenues. **Berger and Humphrey (1994)** reported that in many studies which examined pre-merger and post-merger financial ratios, operating cost and profit ratios were not impacted. **Gourlay et al. 2006** analyzed that over the period of 1991-92 to 2004-05 mergers of the banks improved the efficiency of the merging banks. According to **Pilloff and Santomero (1997)** most studies have failed to find positive relationship between improved efficiency, performance, stock holder, wealth and merger activity. A study of **(Chong et. al 2006)** mergers in Malaysian banks shows that the wealth of the acquired banks has been destroyed after forced mergers. **Wheelock and Wilson (2004)** in a survey found that expected mergers in US banking is positively related to banks size, management rating, geographical locations and competitive positions of banks and merger activity is negatively related to market concentration. Improvement in economics of scale and substantial gains are expected to come from cost savings in mergers.

MERGER IS BANKING SECTOR (Phase wise)

On the basis of policy initiative of the government the period from 1961 to 2019 is divided into various phases.

Phase-wise mergers in banking sector are presented in table below:

S.No.	Phase	Period	No. of mergers
1	I Pre nationalization Period	Mergers during 1961 to 1969	46
2	II Post nationalization Period	Mergers during 1969 to 1991	13
3	III Post liberalization Period	Mergers during 1991 to 2015	22
4	IV Consolidation of Banks	Mergers during 2015 to till date	9
Total			90

Source: Compiled by the Author

Phase I – Pre nationalization period (1961-1969)

In the pre nationalization period several banks were operating in private sector and a major chunk of mergers i.e. 46 banks have taken place in that period. In the history of banking in India the major initiative of banking sector was establishment of Reserve bank of India in the year 1935 and enactment of banking regulation act 1949. During the first phase of pre nationalization, banks were experiencing periodic failures and the growth was also very slow. People were having less confidence in banks due to which deposit mobilization was very low. RBI, as a central banking authority of India, formulated the schemes of reconstitutions and obligatory mergers of weak banks with financially sound and strong banks to reinforce the banking system. Over a period from 1961 to 1968 total 46 banks mergers took place, out of which maximum number of mergers i.e. 30 had taken place in the year 1961 itself another 10 in the year 1964; 3 in 1965 and in the years 1962, 1963 and 1968 one merger took place. Most of the mergers were between private banks in order to protect customer's interest by restructuring of weak banks.

Phase II – Post nationalization Period (1969-1991)

In year 1969, 14 commercial banks were nationalized with total deposits of Rs. 50 crores and government took control over 84% of total branches later in 1980, 6 banks were nationalized with a total deposit of Rs. 200 crores.

The purpose of nationalization was to prevent some big business houses from concentration of economic power, controlling of banks and maximization of wealth in few hands. This was also the beginning of expansion phase and banking commission was appointed in 1969 with the motive to recommend changes in banking policies, procedures and banking structures. From 1969 to 1990 total 13 bank mergers took place in India between public sector and private sector banks.

Phase III Post liberalization period (1991-2015)

This phase is known as post liberalization period. Several reforms were initiated by government to revive Indian economy popularly known as globalization or liberalization or structural adjustments. On July 24, 1991, the government of India announces new economic policy which deregulated industrial economy in substantial way and in the process of liberalization and globalization the major step was wide ranging financial sector reforms in banking sector, insurance sector and capital market which also included the deregulation of interest rates and introduction of foreign private sector competition. From the period 1991 to 2015, 22 mergers took place out of which 13 mergers took place between public sector and private sector banks and 9 mergers were forced mergers due to high Non-Performing Assets (NPA's) and financial sickness of the banks.

Phase IV Consolidation of Banks (2015-17)

The consolidation or unification of banks happens in order to make stronger bank rather than having large number of weak banks in the industry. Indian finance minister, Nirmala Sitharaman announces Mega merger of 10 Public sector banks into 4 banks on 30th August, 2019 to take the country out of economic slowdown. The Indian government believes that bigger banks have more capacity and ability to lend to large projects, primarily in the power sector and infrastructure.

THE NEW PECKING ORDER IN INDIAN BANKING

		Business (₹ trn)	Market share (%)
1	State Bank of India	52.05	22.5
2	PNB+OBC+UBI*	17.95	7.7
3	HDFC Bank	17.5	7.6
4	Bank of Baroda	16.13	7.0
5	Canara Bank + Syndicate Bank	15.2	6.6

*PNB: Punjab National Bank, OBC: Oriental Bank of Commerce, UBI: United Bank of India
**Corporation Bank
Note: Figures till March 2019

		Business (₹ trn) (%)	Market share
6	Union Bank + Andhra Bank + Corp Bank**	14.59	6.3
7	ICICI Bank	12.72	5.5
8	Axis Bank	10.6	4.6
9	Bank of India	9.04	3.9
10	Indian Bank + Allahabad Bank	8.08	3.5

Source: RBI

Illustration source: www.businessstandard.com

As India's Gross Domestic product (GDP) growth was pulled down to 5% in the April-June quarter 2019, the economy is facing sharp deceleration in manufacturing output but the commencement of consolidation exercise is a step taken to provide strong financial base to country **(FICCI President SandipSomany www.manycontrol.com)**

ADVANTAGES AND DISADVANTAGES OF BANKS MERGER

Advantages of Bank Mergers in India

- Larger banks are capable of facing global competition and mergers help in reducing the banking operation cost and NPA's.
- For the banks, risk management and retaining the identity as a larger bank becomes easier also the decisions regarding high lending requirement can be taken promptly.
- Mergers help the economy in several ways i.e. generation of new customer base, empowerment of business, better efficiency ratio for banking operations as well as business operations, technology up gradation and increased hold in market share.
- Mergers minimize overall risks and increases profitability and also the chances of survival of weak banks increases. By merging into stronger bank, weaker banks get the benefit of large scale operations.
- Larger banks can offer more products and services which is helpful for integrated growth of banking sector. The objective of broadening the geographical reach of banking and financial inclusion can be achieved better with merger of large PSB's.
- Short term and long term liquidity can be managed in a better way by larger banks, also with larger capital base and higher liquidity the need of central government to recapitalize the public sector banks can be reduced.

Disadvantages of mergers and acquisitions in Indian Banking:

- There is a compliance need in every decision. Which can lead to friction and rift as the risk taking abilities of different organizations are different and it might lead to downfall of the organization as a whole.
- The people and culture are different of a merged bank so merging can lead to poor culture fit. If the executives are not committed enough in the whole process of merger, risk of failure increases which is not good for economy.
- Human resource management is also one of the complicated issues of merger. Customers also get impacted with the mergers and acquisition of banks. If the customer issues and problems are not managed carefully it may lead to loss of business.
- Many banks are established with regional banking requirements. Merger may destroy the purpose of catering regional needs.

- Fall of larger banks are more dangerous to economy rather than fall of weak banks. During the global financial crisis large banks had collapsed while the smaller ones had survived. If a giant bank books huge losses or incurs high NPA's, it will be difficult for the entire banking system to sustain.

CONCLUSION

Mergers and acquisition in Indian banking sector so far have happened to provide the safeguard and hedging weak bank against their failure. All the merged entities after mergers and acquisitions have performed in a better way and are continuously growing. The small sized and medium sized banks are under the threat of economic pressure or environment due to outdated technology, inadequacy of resources, weak financial structure, lack of proper management and product innovations etc. The announcement of Mega merger of 10 PSB's into 4 is a major step taken by government to revive the banking sector & economy.

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