

## Mergers and Acquisitions of Commercial Banks- Opportunities and Threates

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### **Abstract**

In the present boundary less world, Mergers and Acquisitions (M&A) are most widely prevalent in market-based economies. From production industry to service sector including banking sector and software business, companies / banks are working overnight and are busy preparing their consolidation plans. Consolidation increases the market control and contact, diversifies the products and services thereby reducing the risk and redefines the competitive perimeter by acquiring different businesses. It also provides the bank with new capabilities, technologies and products, helps to overcome entry barriers, ensures direct entry into novel markets with lesser operating expenses. In this study all aspects related with M&A or consolidations of commercial banks in India have been incorporated. Future potentials along with related risks or obstacles have also been discussed in summarized manner. The structured analysis of post-merger integration and due diligence process has also been narrated in this study. At the end this study highlights significant suggestions.]

### **INTRODUCTION:**

There are two ways of achieving growth, *organic* and *inorganic* for a commercial organization. An organization focusing on organic growth essentially aims at achieving business growth through enhanced customer base as well as higher marketing, both physical and financial, together with growth in revenue. On the other hand, an inorganic growth opportunity provides the organization with an avenue for attaining accelerated – in a way instantaneous – growth enabling it to skip a few steps on the growth ladder. Mergers and acquisitions (M & A) constitute one of the most important methods for securing inorganic growth. Mergers and acquisitions (M&A) as a critical tool of business strategy are now increasingly becoming popular not only in commodity producing corporate entities but also in financial service providers. From production industry to service sector including banking sector and software business, companies / banks are working overnight and are busy preparing their consolidation plans. Consolidation increases the market control and contact, diversifies the products and services thereby reducing the risk and redefines the competitive perimeter by acquiring different businesses. It also provides the bank with new capabilities, technologies and products, helps to overcome entry barriers, ensures direct entry into novel markets with lesser operating expenses.

After the introduction of financial reforms, dramatic changes have been observed in the structure of Indian banking business. **Narasimham Committee** suggested that financially weak banks should be merged with financially strong banks. Consequently, failures or continued vulnerabilities and stress

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in any one commercial bank, however small, could well lead to unfavorable perceptions. The Committee recommended formation of 3 – 4 large banks with international presence, 8–10 banks with national presence, local banks with regional presence, and presence of rural banks.

After the recommendations of Narasimham Committee, in the early nineties, New Bank of India merged with Punjab national Bank. It was a merger of a weak bank with a strong bank. In 1998, 20<sup>th</sup> Century Finance merged with Centurion Bank. In 1999, there were two mergers – Bareilly Corporation Bank merged with Bank of Baroda and Sikkim Bank merged with Union bank of India. In February 2000, Times Bank merged with HDFC Bank and in March 2001, Bank of Madurai merged with ICICI bank. ICICI Ltd. merged with ICICI bank on March 31, 2000, and converted itself into a Universal Bank.

The Benares Statue Bank Limited was merged with Bank of Baroda on June 20, 2002. Three mergers were also made in year 2002 viz.- Rajasthan Bank Financial Services Ltd. merged with The Bank of Rajasthan Ltd.; Andhra Bank Housing Finance Ltd. merged with Andhra Bank and Bank of India Finance ltd. & BOI Asset Management Company Ltd. merged with Bank of India. All branches of Global Trust Bank were merged with Oriental bank on 14 August, 2004, IDBI merged with IDBI Ltd on 1<sup>st</sup> January, 2005, Sangli Bank merged with ICICI bank in April, 2007 and South Indian Cooperative Bank merged with Saraswat Cooperative Bank in Sept. 2008.

At present, SBI is in the process of consolidating operations of its various subsidiaries and associate banks. Under this process, 'State Bank of Saurashtra' has been merged with Sate Bank of India in August, 2008. After that SBI has decided to acquire its subsidiary – 'State Bank of Indore'. The proposal of acquiring this subsidiary has been approved by the Board of State Bank of India. It is notable that SBI holds 98.05 per cent stake in State bank of Indore, which is the smallest stake among its six associate banks.

The SBI has 100 per cent stake in two other banks – State Bank of Hyderabad and State bank of Patiala. It is expected to take up shortly the merger of listed subsidiaries – State bank of Bikaner and Jaipur, State bank of Mysore and State Bank of Travancore. The merger of all associates of State bank with itself will take the total assets of the combined entity to Rs. 8, 00,000 crore which will place SBI as a global financial power house.

On 16<sup>th</sup> December, 2008, the SBI has merged its Mauritius-based subsidiary, 'Indian Ocean International Bank' (IOIB), with SBI International (Mauritius) to consolidate its operations in the African island nation. The new entity has begun operations as SBI(Mauritius). It is notable that IOIB has been operating in Mauritius since 1978. The bank has 11 fully-integrated branches in major cities and towns, including Rodriguez, and has a network of 10 ATMs. SBI had acquired a majority stake in the bank in April, 2005. SBI International, one of the first offshore banks to be established in Mauritius in 1990, began with a paid-up capital of \$10 million. Its assets at the end of March, 2008 were \$ 285 million as against \$113.53 million a year ago. The new entity, SBI (Mauritius), began operations from 25<sup>th</sup> October, 2008.

On the domestic front, SBI plans to merge 'SBI Commercial and International Bank' [SBICI], its

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wholly-owned subsidiary, with itself and also take over SBISAP Securities to make it a direct subsidiary. The acquisition of SBICI has been approved by the boards of SBI and SBICI and it is subject to necessary regulatory approvals. In the month of January, 2010, it has been decided by the Board of SBI that we will acquire banks situated in South-East Asia, particularly in Indonesia, Thailand and Philippines.

#### OBJECTIVES OF THE STUDY:

- To examine the process of Mergers and Acquisition activity adopted by the commercial banks and to assess the validity of criticism leveled against its process.
- To evaluate and review the government plans and policies and schemes in the context of present and future activities of M & A in banking sector.
- To suggest the promotion of infrastructural facilities, improvement in the internal and external efficiency and reducing the cost of operation to offer quality services according to the present market driven economy.

#### RESEARCH METHODOLOGY:

To assess and evaluate the dimensional magnitude of the Mergers and Acquisitions of Indian Commercial banks, some important techniques & tools like - **Canvassing Schedules & Questionnaires, Objectifying Personal Interview, Opinion Polls and Published Records, etc.** have been used for collection of various data and information.

Data analysis and results of survey can be enumerated in the following manner -

#### Possibility of Mergers and Acquisitions of Commercial Banks

Type of Sample	Yes	No
Planners and Policy makers including Board of Directors	40	00
Shareholders of different Banks	36	04
Customers of Banks	34	06
Branch Managers & Employees of Banks	28	12
Legal consultants & Professional experts	32	08
General Public including intellectual personalities	36	04

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**Possibility of Mergers and Acquisitions of Commercial Banks – in Percentage**

Type of Sample	Yes (Percentage)	No (Percentage)
Planners and Policy makers including Board of Directors	100	00
Shareholders of different Banks	90	10
Customers of Banks	85	15
Branch Managers & Employees of Banks	70	30
Legal consultants & Professional experts	80	20
General Public including intellectual personalities	90	10

**OBSTACLES/ RISKS / PROBLEMS:**

**Though, there are certain advantages emanating from synergy on consolidation of banks, but Mergers and Acquisitions of banks can create some disadvantages and problems/dangers such as -**

- ❖ **Operational concerns and problems-** These problems need to be carefully listed out and analyzed to synchronies all these operational issues and make things hassle free for the customers of both the banks, particularly the acquired bank.
- ❖ During the survey it was found that the degree of work culture, customs and practices, lifestyles etc. differs according to the level of the acquired bank. Therefore, the cultural issues should be given due importance while the merging banks.
- ❖ Although ideologically banks should be free from caste, community, religion, place, cluster, group and political interests, over the years, many banks have been infected with such issues.
- ❖ Profitability issue of related banks can also create so many problems.
- ❖ The integration of the skill and knowledge of the employees of both the banks can also create significant hurdles during the process of M&A.
- ❖ **Human issues can create the following problems –**
  - Uncertainty and insecurity for the employees of the merging banks,
  - Fitting of the employees of the acquired banks into the acquirer bank,
  - Human relations between the two banks' employees,
  - Difference in the service conditions,
  - Matters relating to performance and competency levels,
  - Difference in the Promotional & developmental policies,
  - Redeployment of the employees in case of excess staff position etc.

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❖ **Other problems will arise during consolidation such as -**

- Regional flavors that the banks enjoy will destroy,
- Objections of creditors of merging banks,
- Judicial interpretations and elucidations,
- Different customers engaged,
- Service quality will suffer,
- Fees and other charges will rise,
- Problem of low credit availability for small and medium enterprise will worsen,
- Valuation of Intangible Assets – that may be more challenging factor.

### **CONCLUSION AND SUGGESTIONS**

In short, we can say that in the next five years, the activities of mergers and acquisitions will increase in the Indian banking sector. These activities will help to maintain capital adequacy of commercial banks. Even per unit cost of computerization will come down and the economies of scale will operate. The process has already begun, albeit slowly. There is a syndication of goals and some banks can tie-up into a strategic alliance. According to the expert's opinion, there is a back-office consolidation and a front – office competition. In this context, the following **impressive suggestions** should be well thought-out:

- ✓ In these days of global competition size does matter so that there should be not more than 6 to 7 banks in this country. Something like one solid bank in Karnataka, one in Tamilnadu, one in Rajasthan, may be two in Mumbai and one in West Bengal.
- ✓ In the next 5 years, consolidation of commercial banks will take place and it will help to maintain capital adequacy of banks. On the other hand, it will help in strategic management of funds, products, services, policies, programmes and other resources of the banks become imminent to reduce the cost of management in order to offset the dwindling financial margins.
- ✓ To survive and flourish in a global economy, consolidated commercial banks must respond to major trends reshaping markets.
- ✓ Global literature on both banking reforms and field level experience strongly suggests the need for aggressive use of Business Process Reengineering to further the strategic goals of merged banks.
- ✓ Paradox and conflicts are part of any individual or field and banking sector is no exception. As we know that in the present wave of consolidation, the advancement and innovation forge ahead, the paradoxical situation tends to blossom out of wide variety of fields promising diversified interests in potential areas.
- ✓ To achieve successful mergers, some major issues like - synchronizing the different software in vogue, varying systems and procedures of banks, manpower readjustment, work culture

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variations, realignment of business plans, enacting legal framework, strategies to achieve synergy etc. need to be addressed carefully with foresight.

- ✓ When we decide to consolidate the banks, the differences in work cultures are to be critically evaluated.
- ✓ The Indian commercial banks need to manage their advances portfolio in such a manner that risk factor is minimized to the level of their bearing capacity. They cannot afford to block their funds and dump them in their books as non- performing for a long time.
- ✓ The NPA should be eliminated as early as possible, even at the cost of sacrifice; else the bank may suffer from mismatch of assets and liabilities resulting in failure to meet the obligations.
- ✓ The management of the acquirer bank should develop its team for due diligence and post – merger integration, to avoid any conflict in the M&A process and Initial issues and some related issues should be given due weight age.
- ✓ For consolidation of a non-banking finance company with a banking company, the banking company should obtain the approval of the RBI after its Board approves the scheme of amalgamation but before submission of it to the High Court for approval.

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