# CHAPTER-1

# INTRODUCTION

Every organization whether it is manufacturing sector or service sector like bank, insurance etc. is relentlessly in a course of self-appraisal and in looking for devices for appraising its own contemporary performance in comparison with the various targets, past achievements and operative and financial parameters. Business judgment and policy formulation characteristically depend on such types of indicators. The competency of banks, which converts its resources to output by making its best allocation, is essential for the growth and development of an economy. Since banking sector plays enormous role in the progress of an economy, it has received unsullied interest from researchers and economists. The swift progresses in IT (information technology) have directed to the radical expansion of new banking services and financial instruments. The competition among banks at national and international level has amplified and it has induced the banking industry to progress their efficiency and productivity. Moreover, the government have adopted diverse policies and procedures, which were drafted by policy makers, think tanks and civil society in coordination with officials of the government authority. Among such policies, the consolidation of banks appeared to be one of the best desirable strategies. It can typically be characterized as activities involving acquisitions, takeovers, demerger, amalgamation, internal corporate restructuring, corporate control as well as changes in the proprietorship arrangement of firms in any industry. Actually, M&As (merger and acquisitions), which takes place to accomplish economies of scale, to persuade diversifications of the products, to boost profitability along with technological

change and deregulation and to lessen the various risk as well, can happen through in-house and exterior means. There are two approaches for growth and development of any bank. Internally, firm can manage growth by way of increasing firm’s infrastructure activities and customer base and thus enhances profits and revenues through organic path (called normal growth of a bank). Externally, inorganic way via corporate re-structuring such as merger and acquisitions (M&As), de-merger, takeover, acquisition etc. offers immediate solution for growth and development of a bank (called abnormal growth of a bank). Therefore, Merger and Acquisition (M&A) could be taken as an inorganic path of growth. Consequently, mergers and acquisitions are noteworthy corporate strategic measure that assists the merged entity in external growth and afford it competitive advantage. In the global market, where the M&As has become a vibrant strategy for achieving growth such as economies of scale, enhancing efficiency, penetrating to new markets and building new capabilities etc. For consolidation of bank under financial service sector, M&As is the most commonly adopted method used by banking industry out of various divergent option available to them. M&As of two feeble banks or merger of one strong bank with one weak bank can be construed as the quicker and cheapest avenue to develop profitability than stimulating internal growth.

The growing tendency towards M&As world-wide, has been ignited by intensifying competition. M&As have been taking place in corporate as well as banking sector to abolish financial, operations and managerial weakness in addition to augment growth and expansion, to generate stakeholders value, to motivate good health of the business with reference to meet challenges in face of hard competitive in globalized market. The main energetic factor for marriage (merger) of bank is severe competition among the various

bank on the same sectors, which puts focus on low cost of products, technological advantage, explore new geographical area, reduce the non-performing assets (NPA), cost efficiency and profitability etc. The “too big to fail” principle is the important aspect behind the bank merger followed by the authorities. It is an intended decision to rise the value to the stakeholders as well as the bank. As an inorganic growth strategy, M&A are pathways to achieve efficiency and to create value. It is widely used strategy by firms to strengthen and maintain their position in the market place. The important aspect of inorganic growth create synergetic value such as to cut costs, reach international market place, benefit of economies of scale, investment in latest information technology for tactical advantages, aspiration to broaden business and penetrate into new geographical areas; and intensifying stakeholder value. The strategy of M&As are not new in the Indian economy. In past, companies had also used M&As as a tool of corporate restructuring to grow and develop their business and now, companies use it for other reasons such as integration of of core competence, rapid expansion of market share in geographical area, cost advantage, global competitiveness, technological development and consolidation of business etc. The reforms and globalization initiative started by Government since 1991, has added the fuel on functioning and governance of Indian corporate firm, which has adopted diverse growth and innovative expansion strategies available to them. The statute has also recognized such innovative strategies from time to time by changing applicable laws and guidelines of the nation. Mergers and Acquisitions (M&As) are the overriding corporate strategies followed by business looking for greater value creation.

Formerly, merger or consolidation of one bank with other was regulated by RBI, Banking Regulator was aimed at protecting the concern of smaller investors of sick banks. The main intention of merging of sick bank with strong bank as per the guideline of RBI is mainly to safeguard the interests of depositors and other stakeholders. The marriage of sick bank with strong bank may be classified as forced mergers. Force mergers is not a natural process and it is only happened with intervention of the Reserve Bank of India (RBI). RBI, under force merger process, imposes moratorium under Section 45(1) of Banking Regulation Act, 1949 for define period on the operations of the sick bank, when the said bank shows various indications of sickness such as huge Non-Performing Assets (NPAs), huge losses lead to erosion in capital employed and significant reduction in capital adequacy ratio (CAR). During the moratorium period, RBI finds a strong bank and asks them to arrange a scheme of merger. Presently, market led consolidation has got momentum. M&As (Mergers and Acquisitions) activity has gained significance caused by intensifying competition, liberalization, globalization, and integration of domestic and foreign markets. One of the techniques to confront the strong competition in the market could motivate banking and financial sector organization, to consolidate its operations and better prospects of survival through the progression of M&As (mergers and acquisitions). India is sluggishly but slowly moving from its traditional concept of ‘large number of small banks' to new dynamic concept of 'small number of large banks'. The advantage of ‘small number of larger bank is to create its higher competitiveness in the national and global market, provide better quality of products at low cost, strong liquidity to provide loan and advances to customers, ability to use of latest technology and well forecasts of survival’ seems to be the tune for success.

Most of the consolidation in banking segment has so far taken place to restructure financially fragile banks with strong banks. However, this may have unfavorable impact on asset superiority of the stronger banks. It is, expected that the strong banks would be consolidated with stronger banks to create its competitiveness among the foreign banks as well as to penetrate in the global financial market.

The county's economic sector has witnessed a drastic alteration during the nineties with the opening up of the economic sector in 1990 followed by RBI's reform curriculum. It targeted at forming a competitive and efficient banking system in the country with the entry of many private banks both Indian as well as foreign banks and increased competition among the banks in India. Furthermore, the government have adopted policies and procedures, which have drafted by policy makers, think tanks and civil society experts. Among the policies and procedures, the consolidation of banks through M&As (merger and amalgamations) is one of the greatest preferable strategy for banks. Earlier M&As (merger and acquisitions) of two banks, either two fragile banks or one strong bank with another feeble bank or two strong banks, are the most commonly adopted form of consolidation. Recently, the consolidation of two strong banks is called a natural market driven merger. The key motives behind the merger and acquisitions (M&As) in the banking industry is to achieve significant gain of synergies and scope. The sizes of bank rises efficiency in the financial sector, which helps in the diversifications of the products and assists in decreasing the risk as well.

The Government started policy initiatives after post liberation period and onwards allowed RBI to issue license for Indian private sector bank and foreign bank to establish their branch in India. The market share of private sector banks have increased more than

30% from the date of allowing the license to till today. On the other side, the market share of public sector banks (PSBs) have decreased to that extend because of intense completion with private sector banks primarily in terms of better quality of services, innovative product with low cost, adopting new technology for digital banking or virtual banking, artificial intelligent (AI) and block chain etc. The licensing policy to private sector banks and foreign bank after post liberation period encourages banks to adopt more the technique of merger and acquisitions (M&As) strategies with a view to increasing the customer base, size of banks in terms of assets, profitability, and economic strength of Indian Banks thereby augmenting their ability to compete globally. The synergies gain or inorganic growth with a short span of time through the merger & amalgamation (M&As) regulations fostered an increase in the number of merger deals among Indian banks. The economic reforms initiated in 1991 brought about a widespread change in the competitive landscape of the Indian Banking system, which aims several banks to take mergers and acquisitions (M&As) strategy with the objective of restructuring themselves in order to enhance their performance, efficiency, growth & development and competitive strength. The globalization and liberalization process initiated by government has strongly influenced the Indian banking sector from 1992 onwards to ensure the security and trustworthiness of financial institutions and at the same time making them operationally efficient, functionally diverse and competitiveness in the market. Financial sector reforms provided banks and financial institutions with operational flexibility, functional autonomy and provide well structure regulatory environment for synergetic growth and development. As stated earlier, the greater efficiency and competition in the financial sector because of after entering into the new

private sector bank in this sector, increased operational autonomy to public sector banks and continuous reforms in the financial sector and used of latest aadhar enable portable Micro ATM, artificial intelligence and block chain etc. were also aimed at increasing financial inclusion in rural India, funding of economic growth and better customer services to the rural and urban people. In February 2005, Reserve Bank of India (RBI), keeping in mind augmenting the efficiency and strength of the financial service sector had adopted two ways approaches. First was the consolidation of the domestic banks in both the public and private sectors. The second was the boost of the existence of foreign banks in a gradual manner.

There have been several bank mergers in India in the pre and post-reform period. In post-reform period (1991 to 2015), there have been 23 (as per table 1.3 as below) major merger & acquisitions (M&As) happened in India. 8 M&As ( out of 23) has occurred during the period of 1991 to 2000 and 15 M&As have happened during the period of 2000 to 2015, which is our study period. The various combination of M&As took place such as Public bank to Public sector banks, Private sector to Public sector banks and Private to Private sector banks. Of these mergers, 11 involved mergers of private sector banks with public sector banks, another 11 involved mergers of private sector banks with private sector banks, while in the remaining 1 cases, mergers involved public_sector-to-public_sector banks. The merger & acquisitions (M&As) of banks were primarily triggered by the weak financials of the bank being merged with strong bank (called forced merger), whereas there have also been mergers between healthy banks (called natural market driven merger), driven by the business and commercial considerations.

Consolidation through the route of merger and acquisitions (M&As) affords Indian banks the 'size advantage' that a good number of foreign banks have. Very recently, it has showed that there is a positive relationship with size of the banks and strengthening the power of confronts competition with other banks. There is no exception to the Indian banking industry. It has acknowledged that size matters in terms of assets play an important role when it confronts competition with other banks either in domestic or international market. Bigger size of the bank would carry economies of scale leading to bring down the transaction costs, efficient management of Non-performing-Assets (NPA), and increasing capability to face competition arising from domestic and overseas banks as well as strengthening them to expand business either in domestic and overseas markets. The fundamental principle of any kind of merger and acquisitions (M&As) can be questioned if the performances of the merged/acquiring firms do not confirm any improvement in the long run. There are numerous evidences where we can unearth that the triumph of merger is by no means assured.

The effect of merger and acquisition (M&As) on the performance of banks has been well documented in the literature. Most of the literature about the impact on performance of merged (acquiring) bank is found in developed nation such as UK, European countries and USA. In India, the literature about the performance of merged bank (acquiring bank) on pre or post-merger period is very rare or not well documented. Very little research and studies have been supported with the intention to observe the impact on performance of merged Indian commercial banks taking both primary data especially information gathered from financial executives who solemnize merger deal in India as well as with secondary data. The present study contributes additional fuel to the existing literature

especially on the performance of merged banks under the process of merger and acquisitions (M&As) in India. Most of the existing research and studies on the performance of Indian commercial banks under merger and acquisitions (M&As) process used a balanced panel. Keeping in mind of the above prelude, this dissertation is an objective analysis on outcome of merger of two Indian banks when those banks undertake inorganic way of expansion. However, the main intention is on finding the measuring the performance (using various financial parameters) of 5 sample banks merger selected cautiously and comparing their performance in term of financial parameters on all selected banks before and after merger, which have been substantiated by using various statistical tools. We restrict our research only on 5 Indian bank mergers on some appropriate logic presented in the study.

Extensive analytical study of opinion of executives who formalize mergers and acquisitions (M&As) in commercial banks in India as a measure of performance of merged banks in pre and post-merger period has received very little attention. Moreover, most of the research and studies on mergers and acquisitions (M&As) have used conventional methods which are basically statistical constructs based on officially published data.

We have selected five sample banks merger cases- namely **Nedungadi bank with Punjab National Bank (PNB)**, **Global Trust Bank (GTB) with Oriental Bank of Commerce (OBC)**, **Centurion Bank of Punjab (CBOP) with HDFC Bank**, **United Western Bank Ltd. (UWB) with IDBI Bank**, **Bank of Rajasthan (BOR) with ICICI bank** -out of total 15 banks mergers and acquisitions happened during the study period between FY 2000-01 to 2014-15. The selected banks is representing the

forced/compulsory M&A and voluntary/natural market driven M&A. We have selected such combination of public–private merger and private–private mergers of banks under our study to make a meaningful comparison of the effect on performance of merger of several types of banks. Having studied the background of Indian banking sector, the study involves a detailed impact analysis of five mergers and amalgamations, which have taken place in India taking into account primary and secondary data. The effect of M&As (mergers and amalgamations) on the performance of selected Indian commercial banks both pre and post-merger era has been found out.

In order to bridge the gaps mentioned below, the present research is classified into seven chapters where each chapter concentrates on a specific issues related to the main theme.

Chapter 1 portrays brief introduction of the financial services and its effect on Indian economics along with glimpse of M&As (merger and acquisitions) of Indian banks.

Chapter 2 critically analyzes brief profile of target bank and acquiring bank of five cases of M&As (merger and acquisitions) and background behind merging with each other.

Chapter 3, a through careful and up- to-date investigation has been made into the existing literature and to find out whether there exists any research gap prevalent in the context of M&As of some selected commercial banks in India, which are under our research consideration.

Chapter 4 highlights the objectives and tentative hypotheses of the study.

Chapter 5, an effort has been made to portrait the methodology that consists of study period, description of data and variables and econometric models regarding assessment of performance of merger, and impact of merger thereon.

Chapter 6 seeks to analyze trend in performance of target bank and acquiring bank during pre-merger period and trend in performance of buying bank during post-merger period, dividing the entire time span into before and after merger period.

Chapter 7 presents summary findings & conclusion, where an effort has been put to evaluate the trend in economic performance of merged entity and to judge the effect of merger in those merged entity whether these sectors have led to enhancement in performance of buying banks or has deteriorated the performance after the merger period and also to show the variance of economic performance between before and after merger from analytical perspective.

**Merger and Acquisition in Indian Banking Sector:**

In 1770, the concept of banking services in India was introduced and the first bank in India (known as the Bank of Hindustan) was established in 1870. Afterward, some more banks such as the Bank of Bombay, the Bank of Madras and the Bank of Calcutta were set up under the Presidency Bank's Act 1876. These banks were combined in 1921 and captured the shape of the Imperial Bank of India, nationalized on 1 July 1995, and named as the State Bank of India (SBI) along with its 8 associate banks. Recently, SBI and its associate's banks have merged with direction of the Government of India with the supervision of various Authorities & Regulators. After the merger of its associates, the number of associate banks of SBI stands nil as of now. Reserve of India (RBI) under Banking Regulations Act, 1949 got power for supervision and control of all banks.

The financial service sector in India is the back born of Indian economic development. The journey of Indian banking sector is divided in two ways such as the pre liberalization journey and the post liberalization journey. In the first journey, Government nationalized 20 banks, which was included 14 banks in 1969 based on deposit limit of Rs.50 Cr & above and 6 banks in 1980 based on deposit limit of Rs.200 & above. The nationalization of banks laid down the foundation of economic growth through the control of credit delivery. In the second journey, the Government stated with the policy of liberalization and licensing of private section banks and foreign banks. In 1993, the only merger between two nationalization banks was happened between the New Bank of India and the Punjab National Bank, resulted the number of nationalized Banks reduced from 20 to 19. In post-liberalization regime, government had opened the door to the private sector banks as well as foreign banks, which lead to create strong competition, financial inclusion and making the financial sector more vibrant & strong. Licenses were allowed to number of private banks like Global Trust Bank, Axis Bank (earlier UTI Bank), ICICI Bank, HDFC Bank, IndusInd Bank, Kotak Mahindra Bank, Yes Bank, IDFC Bank and Bandhan Bank. This initiative for allowing private sector banks, foreign banks along with public sector bank & cooperative credit institutions (such as Regional Rural banks, Urban Co-operative and Rural Co-operative banks) had created the foundation of modern banks for growth in Indian Banking sector along with the next phase of economic growth for the country. The Narasimhan Committee (1998) had suggested wide range of reforms including the merger among strong banks, both in public and private sectors. The summary of mergers in Indian Banking sector is follows:

**Table 1.1: M&A in the Indian Banking Sector**

| Period | Number of M&A |
|---|---|
| Pre-nationalization: 1961-1968 | 204 |
| Pre-liberalization :1968-1991 | 15 |
| Post –liberalization: | |
| Phase I: [1992-2000] | 08 |
| Phase II: [2001-2015] | 15 |
| Total | 242 |

Source: Report on Reserve Bank of India (RBI)

The foundation of Indian Banking Industry always remain very strong in spite of up and down in the economy of the country. In spite of global slowdown in 2008-09, the Indian banking industry has achieved a great height in various parameters in terms of improvement in performance because of continuous close supervision and inspection of RBI, continuous reforms process to strengthen the financial system, various monetary policy initiatives taken by RBI and technology revolution on the working style of banks etc.

**Table 1.2: Major Banks merged in India Pre-Liberalization**

| SR. NO. | TARGET BANK | ACQUIRER BANK | Date of Merger |
|---|---|---|---|
| 1. | Bank of Bihar Ltd | State Bank of India | November 8, 1969 |
| 2. | National Bank of Lahore Ltd. | State Bank of India | February 20, 1970 |
| 3. | Miraj State Bank Ltd. | Union Bank of India | July 29, 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, 1986 |
| 7. | Traders 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 | February 20, 1990 |
| 10. | Bank of Thanjavur Ltd. | Indian Bank | February 20, 1990 |
| 11. | Parur Central Bank Ltd. | Bank of India | February 20, 1990 |
| 12. | Purbanchal Bank Ltd. | Central Bank of India | August 29, 1990 |

**Table 1.3: Major Banks Merged in India Post –Liberalization**

| S.NO. | TARGET BANK | ACQUIRER BANK | Date of Merger |
|---|---|---|---|
| 01. | New Bank of India | Punjab National Bank | September 4, 1993 |
| 02. | Bank of Karad Ltd | Bank of India | 1993-1994 |
| 03. | Kashi Nath Seth Bank Ltd. | State Bank of India | January 1, 1996 |
| 04. | Bari Doab Bank Ltd | Oriental Bank of Commerce | April 8, 1997 |
| 05. | Punjab Co-operative Bank Ltd. | Oriental Bank of Commerce | April 8, 1997 |
| 06. | Bareilly Corporation Bank Ltd | Bank of Baroda | June 3, 1999 |
| 07. | Sikkim Bank Ltd | Union Bank of India | December 22, 1999 |
| 08. | Times Bank Ltd. | HDFC Bank Ltd | February 26, 2000 |
| 09. | Bank of Madura Ltd. | ICICI Bank Ltd. | March 10, 2001 |
| 10. | ICICI Ltd | ICICI Bank Ltd | May 3, 2002 |
| 11. | Benares State Bank Ltd | Bank of Baroda | June 20, 2002 |
| 12. | Nedungadi Bank Ltd. | Punjab National Bank | February 1, 2003 |
| 13. | South Gujarat Local Area Bank Ltd. | Bank of Baroda | June 25, 2004 |
| 14. | Global Trust Bank Ltd. | Oriental Bank of Commerce | August 14, 2004 |
| 15. | IDBI Bank Ltd. | IDBI Ltd | April 2, 2005 |
| 16. | Bank of Punjab Ltd. | Centurion Bank Ltd | October 1, 2005 |
| 17. | Ganesh Bank of Kurundwad Ltd | Federal Bank Ltd | September 2, 2006 |
| 18. | United Western Bank Ltd. | IDBI Ltd | October 3, 2006 |
| 19. | Bharat Overseas Bank Ltd | Indian Overseas Bank | March 31, 2007 |
| 20. | Sangli Bank Ltd. | ICICI Bank Ltd | April 19, 2007 |
| 21. | Lord Krishna Bank Ltd. | Centurion Bank of Punjab Ltd. | August 29, 2007 |
| 22. | Centurion Bank of Punjab Ltd. | HDFC Bank Ltd | May 23, 2008 |
| 23. | The Bank of Rajasthan | ICICI Bank Ltd | August 13, 2010 |

Source: Reserve Bank of India (RBI)