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Mergers and acquisitions of public and private sector banks in India: A review

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Abstract
Banking is important to all economies and is one of India's fastest-growing sectors. The competition is fierce. Despite the threat posed by multinational players, domestic banks - both public and private - are also seen as being rigorous in pursuing a competitive edge through acquisitions or mergers with potential opportunities. There have been various mergers in the banking sector since the start of economic and banking reforms in 1990. Severe competition among companies in the same sector, which focuses on economies of scale, cost-efficiency, and profitability, is a major driving force for mergers. The belief that a bank is "too big to fail" is another factor behind mergers. The effect of mergers on post-merger banking performance is investigated in this paper.

Keywords: merger & acquisition, commercial banks, non-commercial banks, liberalization, globalization

Introduction

The banking sector catalyzes a country's socio-economic growth. The Indian banking sector is known as the "backbone" of the Indian economy, and it plays a significant role in a developing country like India. There have been 22 mergers in the banking sector since the start of economic and banking reforms in 1990. Before 1999, most of these mergers were prompted by the target bank's weak financial and operational efficiency, while after 1999, mergers were mainly driven by market and commercial implications.

Times Bank merged with HDFC Bank, and Bank of Madura merged with ICICI Bank, among other notable mergers and acquisitions during the post-reform period. These bank acquisitions were a clear indication that the banking industry was on the verge of restructuring, with private and public sector banks exploring suitable target banks. Few public sector banks, such as the SBI, have announced plans to merge with their peers to combine their resources and reap the benefits of economies of scale and scope and lower costs. Liberalization, privatization, and globalization were the forces that ushered in a revolution in the financial sector, especially among Indian banks. A paradigm shift has occurred from a regulated to a deregulated economy and in bank business practices. Mergers and acquisitions have become a useful approach for corporate restructuring worldwide, and merger waves in the financial services sector have resulted in the emergence of big banks and financial institutions.

Many measures have been taken by the financial regulatory authorities and the RBI to stabilize the Indian banking sector in the post-liberalization phase of the Indian economy. These initiatives are focused on the fundamental belief that increased business credibility and synergies for Indian banks would benefit from economies of scale, scope, and size. According to a study, evaluating a bank's efficiency is significant in both a macroeconomic and microeconomic context. From a macroeconomic perspective, it discusses the steps taken by financial authorities, especially the RBI, to structure and liberalize the Indian banking system. While from a microeconomic perspective, it discusses each bank's efficiency and benefits and their effect on the cost structure and financial market stability.

Event studies to determine mergers' effect on post-merger banking performance include technical information and share price data, which are only easily accessible for listed banks whose shares are publicly traded. However, the accounting-based report, linked to accounting data, is widely available in the banks' financial states. Recent research, which is focused on an accounting approach, helps to provide actual evidence of "Pre-Merger versus

Post-Merger performance assessment of Public Sector Banks vs. Private Sector Banks in India that merged during 1993-1994 and 2004-2005."

Literature Review

The Indian banking sector is the country's economic key. A study emphasized the importance of systemic growth of the Indian economy. The study also presented financial concerns, emphasizing mergers and acquisitions in the Indian banking sector to improve financial efficiency. From the beginning of India's financial services sector, the banking sector, in particular, had seen many mergers and acquisitions stated that the existing economic and banking environment was drastically different from that of four decades ago when the merger process was at its peak. When the weaker banks were on the verge of going out of business, it helped strengthen the foundation.

From the perspective of strategy and finance, the issue of mergers and acquisitions is essential. Over the past few decades, it has been extensively researched globally, particularly in the USA and U.K. markets. The critical question is whether mergers and acquisitions have achieved the intended goal and synergy. It has been a fascinating question that's spurred researchers' interest all over the world (Grant Thornton, International Business Report 2008). According to studies undertaken in the United States and the United Kingdom, there are three approaches to the study to see whether mergers and acquisitions produce the synergies intended.

- Event-based analyses, which look at how the company's value changed after the announcement was made.
- Accounting-based framework examines how certain accounting relationships, such as operating cash flows, earnings, and assets, have changed over time (usually 3 to 5 years).
- The clinical process, which is based on a case study. Each of these approaches has advantages and disadvantages.

An event study is beneficial because it employs a significant value creation indicator: stock prices represent expected future cash flows.

On the other hand, the approach has the drawback of inefficient and imperfect markets, where share prices could not accurately represent their worth. Furthermore, other macroeconomic factors such as taxes, foreign exchange rates, interest rates, and various other macroeconomic variables can affect share prices. Reviewed post-merger accounting data for the 50 largest U.S. mergers between 1979 and mid-1984 and concluded that announcement returns based on merging firms' stock price changes are substantially correlated with post-merger operating results, suggesting that expected merger benefits drive the share price on the announcement.

Several studies conclude that no discernible effect on shareholder wealth examined 304 mergers and 155 acquisitions between 1965 and 1986. The findings indicated that mergers generated a negative but statistically insignificant abnormal return over the subsequent five years, while acquisitions generated a positive but statistically insignificant abnormal return over the same period. Similar studies indicate that merger announcements positively affect the stock prices of target banks and negatively affect the stock prices of bidding banks. Who examined the performance of 45 mergers and acquisitions that occurred in various sectors of Pakistan between 2004 and 2010. The study concluded that neither target nor acquirer firms created or destroyed shareholders' value during the eleven-day window period. Additionally, studies have discovered that the cumulative abnormal return to the target bank is significant. In contrast, the acquirer's abnormal return is transient and tends to zero at the end of the event window.

Research Methodology

Research is a practice of methodically finding perfect answers to necessary and appropriate questions using a systematic method of collecting and interpreting information. The present study is empirical and particularizes the merger of public and private sector banks in India. Also, this study includes the determination of several challenges faced by the banking sector. Secondary data has been used and collected from various sources. The key objectives of this paper are as follow:

1. To know the present structure of the Indian banking sector.
2. To study the restructuring of financially weak banks.
3. To study the private and public banks mergers and acquisitions

Present Structure of the Indian Banking Sector

Based on its organized status, business, and products, the current structure of the Indian banking industry has been analyzed. In terms of status, business, and products, this industry has a complicated structure. The organized banking system is divided into two types: scheduled and non-scheduled banks. Most of this section's scheduled banks account with unscheduled banks contributing for just a tiny percentage.

Since 1935, the RBI has been responsible for Indian banking. SCB,s are commercial banks that come under the second schedule of the RBI Act 1934. They are categorized into five groups based on the nature of their operations and ownership.

1. Nationalized Banks
2. SBI and its Associates
3. Private Sector Banks
4. Foreign Banks
5. Regional Rural Banks (RRBs)

Before the reforms, the PSBs were wholly owned by the Indian government and were the primary protagonist in the Indian banking system-

Table 1: Types of Bank and share of Bank India

Types of Banks	Banks in India	Branches	Share of Branches in percentage	Assets Market Share in Percentage
Public Sector Banks	26	67, 466	83. 0	72. 8
Private Sector Banks	20	13, 452	16. 6	20. 2
Foreign Banks	41	323	0. 4	7. 0
Total	87	81, 241	100.0	100.0

Source: Report on ABC, Mumbai, 13 August 2013.

Categorization of Banks and its Spread

Scheduled Banks (SB)

A scheduled bank is included in the RBI Act of 1934's second schedule. In order to be classified as a scheduled bank, all scheduled banks must meet specific requirements. These terms and conditions apply to paid-up capital as well as reserves. Aside from that, they must try to persuade the RBI that their banking operations do not impede the depositors' and customers' interests.

Commercial and cooperative banks are the two main types of scheduled banks. The primary distinction between scheduled commercial and scheduled cooperative banks is in their holding pattern. Cooperative credit institutions that the Cooperative Societies Act has approved are known as scheduled cooperative banks. These banks operate based on mutual assistance and cooperation.

Scheduled Commercial Banks (SCBs)

SCBs are in charge of the scheduled banks' business. Scheduled Commercial Banks in India can be divided into four classes based on their ownership and operating style. As of August 2013, these included Public Sector Banks (26), Private Banks (20), Foreign Banks (41), and Regional Rural Banks. They are listed as SCB,s by the RBI. Public sector banks, wholly state-owned before reforms, consist of nationalized banks and SBI and its associates. The Government of India owns a majority stake in the former, while the RBI's owns a majority stake. Old private sector banks and new generation private sector banks were founded in 1993, following the RBI's revised guidelines for private sector bank entry. There were 14 old generation private sector banks and seven new generation private sector banks in India as of the end of March 2013. Since they are regulated by different laws (SBI Act, 1955 and SBI Subsidiary Banks Act, 1959), the SBI and its five associates are considered a separate category of SCBs.

Foreign banks have a complete branch/subsidiary presence or have representative offices in the region. In September 1975, RRBs were founded to provide banking services to the rural economy and help it to grow. There were 82 RRBs in the country as of 31st March 2013.

Table 2: Statistics of Commercial Banks

Indicators	March-2005	March-2006	March 2007	March-2008	March-2009	March-2010	March-2011	March-2012	March-2013
Commercial Banks	291	288	222	182	173	170	167	167	173
a) Scheduled Commercial banks	286	284	218	178	169	166	163	163	169
Regional Rural Bank (RRB)	196	196	133	96	90	86	82	82	82
b) Non-Scheduled Commercial Banks	5	4	4	4	4	4	4	4	4

Source: Dept. of Statistics and information Management, RBI.

Scheduled Cooperative Banks

The cooperative banking sector in India is the country's oldest banking system. It is a significant instrument of large-scale financial inclusion due to its vast geographical reach. State governments register and operate cooperative banks, which are regulated by their respective cooperative society's acts. They are also regulated by the Banking Regulation Act of 1949 and are monitored by the Reserve Bank of India. Though state governments are in charge of these banks' administrative aspects, such as registration, management, organization, recruitment, amalgamation, and liquidation, RBI directives regulate banking matters.

Since it wanted to promote the idea of financial inclusion, both the RBI and the National Agricultural Board of Rural Development Bank (NABRDB) have taken stringent measures to strengthen these banks' financial stability. There are presently 26 scheduled cooperative banks operating in the country.

Non-Scheduled Banks

In India's banking system, there are several non-scheduled banks known as Local Area Banks. There were four such banks in India as of the end of 31st March 2012. Local area banks are banks established under India's 1996 scheme to establish new private banks with a local character and jurisdiction over no more than three contiguous districts. They help the rural and semi-urban districts to mobilize funds. Six such licenses were initially issued, but one of them was revoked due to operational irregularities. The other was merged with Bank of Baroda in 2004 due to its poor financial condition. Through their branches, both of these banks have a vast network.

Banking Mergers and Acquisitions in India

Because of intense competition, globalization, and technological changes, corporate restructuring has become extremely important worldwide. The structural reforms that began in the early 1990s forced Indian industries to follow some strategies, such as restoring their existing structure by dropping non-core operations on the one side and pursuing mergers and acquisitions on the other side. Banking companies are no exception to this.

This process has gained traction by opening the Indian economy and the FDI flow through various routes. In the Indian banking sector, this inorganic restructuring method is still in its infant stage; however, it has gained momentum in western countries. The banking sector in India is essential to the national economy. The banking sector reforms of the early 1990s and the amendments made to these reforms are evidence of the broader economic reform to enhance the banking system's competitiveness and effectiveness. These reforms have sought to protect and strengthen the banking system. These reforms have ensured that Indian banks' capital adequacy is in line with international standards. Another remarkable achievement is that the level of nonperforming assets (NPAs) has been reached under control. Despite these advancements, Indian banks still face challenges such as complying with Basel Norms and competing with foreign banks. Before 1999, it is also evident that acquisitions were driven primarily by poor financial performance and non-compliance with industry norms. These conditions changed after 1999 when acquisitions were driven more by business and commercial factors. A series of notable mergers and acquisitions took place in the post-reform era.

The development of commercial banks' structural, operational, and financial efficiency has long been discussed in the Indian policy milieu, with India's (GOI) consulting with the RBI on the issue. The regulators have emphasized restructuring the Indian banking system, focusing on consolidation, with three to four significant banks operating across the country and the rest operating at the regional level. To initiate the consolidation process, regulators facilitated mergers between solid banks in the public and private sectors and between financial institutions and non-banking financial institutions.

Restructuring of Financial Weak Indian Banks

The GOI has preferred mergers as a way of restructuring weak banks. This restructuring was intended to protect the weak banks' interests. Many small and weak banks have been merged with major banks, often to safeguard depositors' interests. These may be perceived as forced mergers. When a bank shows signs of financial distress, such as large NPAs, eroding net worth, or a significant drop in Capital Adequacy Ratio (CAR), the RBI imposes a moratorium on the bank's operations for a set period under Section 45 (1) of the Banking Regulation Act, 1949. During the moratorium, the RBI identified a substantial bank and suggested that they prepare a merger scheme. In a merger system, the acquiring bank usually takes over all of the weak bank's assets and liabilities and ensures that all depositors are paid to withdraw their claims. This category includes almost all pre-reform mergers. 13 of the 22 mergers took place since the reform was forced mergers; the primary reason for forced mergers was to protect depositors' interests and protect the weaker banks' interests.

Voluntary Mergers

Expansion, diversification, and overall growth are the key objectives of a few mergers in the Indian banking sector.

The acquisition of Times Bank by HDFC Bank, followed by the acquisition of Bank of Madura by ICICI Bank, was the first of its kind in the post-1993 era. In some of these cases, the target banks faced low profitability, high nonperforming assets, and a lack of other options for increasing capital adequacy. As a result, the merger was the only option; economies of scale and market power were also forcing these mergers, despite the lack of direct regulatory interference.

Table 3: Post Liberalization Mergers and Acquisitions in the Indian Banking Industry

Transferor Bank	Transferee Bank	Year
	Transferee Bank	Mergers/Amalgamations
New Bank of India	Punjab National Bank	March 1993
Bank of Karad Ltd	Bank of India	September 1993
Kashi Nath Seth Bank Ltd.	State Bank of India	January 1996
Bari Doab Bank Ltd	Oriental Bank of Commerce	April 1997
Punjab Co-operative Bank Ltd.	Oriental Bank of Commerce	April 1997
Bareilly Corporation Bank Ltd	Bank of Baroda	June 1999
Sikkim Bank Ltd	Union Bank of India	December 1999
Times Bank Ltd.	HDFC Bank Ltd	February 2000
Bank of Madura Ltd.	ICICI Bank Ltd.	March 2001
ICICI Ltd	ICICI Bank Ltd	May 2002
Benares State Bank Ltd	Bank of Baroda	June 2002
Nedungadi Bank Ltd.	Punjab National Bank	February 2003
South Gujarat Local Area Bank Ltd.	Bank of Baroda	June 2004
Global Trust Bank Ltd.	Oriental Bank of Commerce	August 2004
IDBI Bank Ltd.	IDBI Ltd	April 2005
Bank of Punjab Ltd.	Centurion Bank Ltd	October 2005
Ganesh Bank of Kurundwad Ltd	Federal Bank Ltd	September 2006
United Western Bank Ltd.	IDBI Ltd.	October 2006
Bharat Overseas Bank Ltd.	Indian Overseas Bank	March 2007
Sangli Bank Ltd.	ICICI Bank Ltd.	April 2007
Lord Krishna Bank Ltd.	Centurion Bank of Punjab	August 2007
Centurion Bank of Punjab Ltd.	HDFC Bank Ltd	May 2008
The Bank of Rajasthan	ICICI Bank Ltd	August 2010

Source: RBI, Various Issues, VIII competition and consolidation**,** 04 Sep. 2008

The acquisitions of Benares State Bank Ltd. by Bank of Baroda, Global Trust Bank Ltd. by Oriental Bank of Commerce, Times Bank by HDFC, and the reverse mergers of ICICI and ICICI Bank were among the highlights. The Indian banking sector is braced for restructuring, with Indian commercial banks vying for international bank acquisitions and global expansion.

The Indian banking sector is undergoing restructuring by mergers and acquisitions. Why do banks merge and acquire each other? These arguments help to justify the importance of mergers and acquisitions in the banking industry.

Conclusion

Despite all of the factors taken into account and analyzed, mergers and acquisitions are a boon to the industry. However, the journey to "international banks" is still a long way off, as while there have been a few mergers in the Indian banking sector, they have occurred as a result of "exigencies" and were more like "forced consolidation." During the post-merger era, some financial parameters have shown significant improvement, but the majority did not. As a result of the study, it can be inferred that the beneficial effects of mergers will accrue in later years, i.e., in the long

run, as the present study is limited to the period before and after the merger.

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