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"Merger and Acquisition: Banking Sector"

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Introduction

Historically India's banking sector was subject to several operational experiments in search of appropriate model suitable for India's mixed economy. [1] Apposite economic policy for such type of economy has always been a myth. Banking sector can be considered as an instrument to outfit the need of the economic which was well explained in the Report of Reserve Bank of India 2013-2014. It was stated that "*It is important to review the banking sector of India to cater the needs of a growing and globalizing economy as well as furthering financial needs.*" [2]*Moreover, Dr. Desai has called banking system as heart of financial structure.*[3]

Indian commercial banks are eye witnessing all-encompassing modification in the regulatory environment, great progress instrument to manage balance sheet growth management, inclusion of e commerce and online transaction etc. These changes have lead banking sectors to be more competitive. Merger is basically referred as a tool for gaining synergies for all the participants taking part in such merger.[4]

Merger can be classified as a source of confederacy of two entities into an entity.It is more of a process of common ownership. A merger occurs when an independent bank loses its charter and becomes a part of an existing bank with one headquarter and a unified branch network. Banks today face operational risks such as competition risk, technological risk, casualty risk, interest rate risk, market risk etc. While the 1988 Basel I rules did not take these risks into account, Basel II stipulates that banks set aside 15% of their net income towards coverage for operational risks. Mergers among banks have not taken off on a large scale in India, in spite of the imperatives of Basel II compliance, the imminent threat of competition from foreign banks looming up and the

[1] T.R BISHNOI AND S. DEVI, BANKING REFORMS IN INDIA: CONSOLIDATION, RESTRUCTURING AND PERFORMANCE 2 (2011).
[2] RESERVE BANK OF INDIA ANNUAL REPORT 2013-14.
https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/RBIARE210814_FULL.pdf
[3] DR. (CA) MAHESH BHIWANDIKAR, MERGERS & ACQUISITIONS OF URBAN CO-OPERATIVE BANKS 2(2015).
[4] Dr. (Mrs.) Prashanta Athma, *Bhavani, Mergers in Banking Sector in India: An Analysis of Pre & Post Merger Performance of SBI & HDFC Bank* , IOSR JOURNAL OF BUSINESS AND MANAGEMENT (IOSR-JBM).

successive merger waves in the global banking sector. This will mean a more efficient use of capital, on one hand, but on other hand it would demand higher capital adequacy level from the more aggressive lenders.[5]

History

The history of banking in India is as old as trade[6]. The banking system of India was started in 1770 and the first bank was the Indian bank knows as the bank of Hindustan. After that Charter of British east India Company established banks like the bank of Bombay 1840, the bank of Madras 1843 and the bank of Calcutta 1840.Later, these were merged to form Imperial bank of India and then in the year 1955, it was partially nationalized. [7]. Development of operational and distribution efficiency of commercial banks has always been subject for conversation in the Indian guiding principle and Government of India along with suggestion from RBI. [8]

Committees

A quantity of important committees among these are the ***banking commission-1972 and 1976, and committee for functioning of public sector banks-1978***.[9]The shove on strengthening has evolved with the *Narasimham committee (1991)* emphasizing on convergence and consolidation to make the size of Indian commercial banks comparable with those of globally active banks.[10] Further, the *second Narasimham committee (1998)* had suggested mergers among strong banks or financial institutions, which would make for greater economic and commercial sense.

Legal Framework

"Consolidation will help by marrying two banks that have similar structures and are chasing the same goal. The banks will be able to better channelize the resources and function more smoothly if they are being controlled by one strong management team."[11]

Indian legal system witnesses good number of laws to regulate this process of merger and acquisition. Merger and Amalgamation of banks under BR (Banking Regulation) Act, 1949 has been broadly categorized into voluntary merger and compulsory merger.

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[5]Madan Mohan Dutta & Dr. Suman Kumar Dawn, *Mergers And Acquisitions In Indian Banks After Liberalisation: An Analysis* INDIAN JOURNAL OF COMMERCE & MANAGEMENT STUDIES 108 (2012). http://www.scholarshub.net/ijcms/vol3/issue1/Paper_16.pdf

[6] D. MURALEEDHARAN, MODERN BANKING: THEORY AND PRACTICE 3 (2014).

[7] CHRISTIAN ROLAND, BANKING SECTOR LIBERALIZATION IN INDIA: EVALUATION OF REFORMS 17 (2007).

[8] JAYSHREE BOSE, BANK MERGERS: THE INDIAN SCENARIO 4 (2007).

9 V. K. RAMACHANDRAN, MADHURA SWAMINATHAN, **FINANCIAL LIBERALIZATION AND RURAL CREDIT IN INDIA 54(2005).**

[10] T R BISHNOI, SOFIA DEVI, BANKING REFORMS IN INDIA: CONSOLIDATION, RESTRUCTURING AND PERFORMANCE 10 (2017).

[11] Sampad Patnaik, *India's Plan for Bank Mergers Ignores History and International Consensus* THE WIRE 3 SEPT 2017. https://thewire.in/banking/bank-mergers-risky-crisis-imf-india

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Voluntary Merger of Banks

The procedure for voluntary merger among banks has been laid down under Section 44A of the BR Act, 1949[12]. Under the provisions of this Act, a bank may be merged with another bank by approval of shareholders of each banking company by resolution passed by majority of 2/3 in value of the shareholders of each participating bank.[13] Although as per the recommendations of Joint Parliamentary Committee the role of RBI [14]is limited, the sanction of RBI is essential for the approval of any merger scheme. Generally, the scheme for merger among banks is encouraged by the RBI when it is confirmed that the scheme is in the interests of depositors of the amalgamating or merging banks

The provisions of Section 44A of the BR Act, 1949 provides that the approval of High Court is not an essential condition for the sanction of any merger scheme. RBI has also given the power to determine the market value of shares of the minority shareholders who have voted against the scheme of merger. Since nationalized banks, SBI and its associate banks are governed by a separate statute, the provisions of Section 44A of BR Act, 1949, are not applicable in the case of amalgamation or merger of two public sector.[15]

Compulsory Merger of Banks

Section 45(4) of the BR Act, 1949 provides provisions for the compulsory merger of banking company with other banking institutions[16]. Under sub-section (15) of section 45 "banking institution means any banking company and includes State Bank of India or a Subsidiary bank or a corresponding new bank." [17]A compulsory merger or amalgamation is pressed into action where the financial position of the bank has become weak and urgent measures are required to be taken to safeguard the depositors' interest.

Banking Regulation Act of 1949 (X of 1949) has laid down the procedure and schemes for amalgamation and reconstruction of banking companies. As provided in sub-section (15) of section 45, of BR Act, 1949 a bank is to be reconstructed or merged compulsory without the consent of its members. A banking company cannot be merged with a nationalized bank or other financial entity under voluntary merger whereas under compulsory merger RBI has the power to

[12] Banking Regulation Act 1949.
[13] T R Bishnoi, Sofia Devi, Banking Reforms In India: Consolidation, Restructuring And Performance 37(2017).
[14] https://www.rbi.org.in/scripts/AboutUsDisplay.aspx?pg=Preface.htm
15 Bharati V. Pathak, The Indian Financial System: Markets, Institutions And Services 443 (2011).
16 Kamal Ghosh Ray, Mergers And Acquisitions : Strategy, Valuation And Integration 692 (2010).
[17] Amit K. Kashyap, INDIAN BANKING: Contemporary Issues In Law And Challenges 212 (2014).

merge or amalgamate a banking company with another banking company, nationalized bank, SBI, subsidiary of SBI and other private and public sector banks. [18]

State Bank of India Act, 1955

Section 35 of SBI Act, 1955 provides the terms and conditions laid down by the Central Board of the SBI and the concerned banking institutions. [19]Further, it is suggested that these terms and conditions are required to be submitted by RBI to the Central Government for its sanction. Besides this, provision also made regarding the payment of consideration for the acquisition of the business and assets and liabilities of any banking institution, either in cash or by allotment of shares in the capital of the SBI.

Challenges/ Issues after merger and amalgamation: Current Instances

You have to be careful in any kind of merger that you don't get a big weak bank. You'd hope that the strong bank would clean up the weak bank's problems but there are very few banks without problems today in the public sector. So, the question you have to ask is are there any dangers in distracting the bankers once again with a new set of issues such as headache with mergers and so on, and not resolving the real problem which is cleaning up their balance sheets.

-Dr. Raghuram Rajan (Former RBI Governor).[20]

Merger of a weak bank with a strong bank may make combined entity weak if the merger process is not handled properly. The problems of capital shortages and higher non-performing assets may get transmitted to stronger bank due to unduly haste or a mechanical merger process.[21]

Challenges behind Bank of Baroda, Vijaya Bank & Dena Bank merger

When an experiment begins, the scientist hardly knows what the outcome will be. In a moment of adventure or necessity, the government put three menie., PS Jayakumar, RA Sankara Narayanan and Karnam Sekar in a boat and set them on sail into uncharted territory. These men who head Bank of Baroda (NSE 0.66 %), Vijaya Bank (NSE 1.16 %) and Dena Bank NSE (0.59 %) may face many a storm and choppy waters in a journey that could in a few years

[18] AMIT K. KASHYAP, INDIAN BANKING: CONTEMPORARY ISSUES IN LAW AND CHALLENGES 214 (2014).
[19] The State Bank of India Act, 1955 (23 of 1955) as asmended by The State Bank of India (Amendment) Act, 2010 (27 of 2010).
[20]RAGHUVIR SRINIVASAN, *Focus on cleaning bank books, rather than mergers: Raghuram Rajan* BUSINESS LINE September 06, 2017.
https://economictimes.indiatimes.com/industry/banking/finance/banking/raghuram-rajan-questions-governments-plan-to-merge-public-sector-banks/articleshow/60393070.cms
[21] Ibid.

make them either look like Christopher Columbus who found the Robinsone Cruse.[22] The mammoth task given to these heads is to bring the banks to equal financial footing.

Challenges faced in this merger are:

I. While in the private sector, the easiest action for the management is to lay off people to derive cost savings, that option does not exist for the three CEOs. .
II. Replacement of cheque books will not be simple. RTGS, NEFT details and net banking interface will take time to change. The merged entity will have about 9,489 domestic branches which looks like a great leap forward, but of this nearly 10%, or 941, branch are in the same pin code, which needs to be reduced without much staff resentment.
III. For the moment, the three banks operate on three different technology platforms which appear to be easy to integrate but difficult to execute. “Technology integration in theory is easy to achieve but in practice it will require a lot of hard work like just getting a new account code for all customers and communicating that will not be a simple thing,” says Jayakumar. [23]

Recent Government Initiatives

Indradhanush **2.0**[24]

Government plans to come out with 'Indradhanush 2.0', a comprehensive plan for recapitalisation of public sector lenders, with a view to make sure they remain solvent and fully comply with the global capital adequacy norms, Basel-III.

'Indradhanush 2.0' will be finalised after completion of the Asset Quality Review (AQR) by the Reserve Bank.

Under Indradhanush roadmap announced in 2015, the government had announced to infuse Rs 70,000 crore in state-run banks over four years while they will have to raise a further Rs 1.1 lakh crore from the markets to meet their capital requirement in line with global risk norms, known as Basel-III. [25]

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[22] MC Govardhana Rangan, *The challenges behind Bank of Baroda, Vijaya Bank & Dena Bank merger* ECONOMICTIMES, Dec 5 2018.economictimes.indiatimes.com/articleshow/66946549.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

[23] Ibid.

[24] Dr. Sasikalapushpa is Member of Parliament (Rajya Sabha), *Banking Sector reforms: challenges and opportunities* **GOVERNMENT OF INDIA 13Dec 2018.** http://yojana.gov.in/public-account_Dec212017.asp

[25] *Govt plans 'Indradhanush 2.0' for recapitalisation of public sector banks* THE ECONOMICS TIMES 12 Feb 2017. //economictimes.indiatimes.com/articleshow/57108572.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

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Under the Indradhanush plan action related to
1. Appointments
2. Bank board bureau
3. Capitalization
4. De-stressing PSBs
5. Empowerment
6. Framework for accountability
7. Governance reforms have been initiated by the government.

Further under the plan the government proposed to make available 70,000 crores out of budgetary allocations for four years to PSBs[26].

Mega bank merger

Enthused by the success of India's largest bank State Bank of India's (SBINSE 1.31 %) merger, the government is reportedly mulling another mega bank merger. As per a report, the government is planning to merge Bank of Baroda NSE -1.37 %, IDBI Bank NSE 0.57 %, Oriental BankNSE -0.68 % and Central Bank. These four banks had reported a combined loss of Rs 21,646.38 crore in the year ended 31 March. [27]

Conclusion

Recent changes have resulted into certain noticeable improvements. The after effects of merger can be measured. This paper has illustrated about the laws which are applicable for merging two banks. Various committees' suggestions have also been mentioned. The effect of merger between banks has been analyzed by taking the recent example of **Bank of Baroda, Vijaya Bank and Dena Bank merger**. Moreover, government recent initiatives like **Indradhanush plan** and **Mega bank merger** has also been discussed in detail.

As a result of all the analysis, it could be concluded that this process of merger is more of an instrument to protect the financial crisis of bank. The bank in better position clears the books of account of the bank in financial crisis. But the fact to be taken into consideration is that whether such merger will adversely affect the other bank which was working well in the market? Merger should only be done after taking into consideration, the interest of both the banks.

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[26] Dr. Sasikalapushpa is Member of Parliament (Rajya Sabha), *Banking Sector reforms: challenges and opportunities* **GOVERNMENT OF INDIA 13Dec 2018.**
http://yojana.gov.in/public-account_Dec212017.asp

[27] *Modi government planning another SBI-like mega bank merger: Report* THE ECONOMICS TIMES Jun05 2018 https://economictimes.indiatimes.com/industry/banking/finance/banking/govt-planning-another-sbi-like-mega-bank-merger-report/articleshow/64448861.cms.