



# In the Indian Banking Sector, Strategic Issues and Implications of Mergers and Acquisitions (M & A)

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**Abstract:** Indian banking mergers and acquisitions have taken centre stage in recent years, as a result of economic reforms designed to stabilize the industry. For many firms, today's fast-paced economy has prompted them to examine the impact of corporate restructuring and change programmes on their organizational performance. Because of this, a large number of M&A studies have been conducted in India and throughout the world. There is a shortage of empirical research in India on the long-term and short-term effects of mergers and acquisitions on the banking industry by employing event study technique. The view of the workforce on any organizational project is critical since people are now more than ever seen as a company's greatest asset. To put it another way, M&A activity might lead employees to feel as if they're being psychologically ripped apart, which can have a negative impact on the reputation of a company among its personnel. The mergers and acquisitions (M&A) agreements are becoming more prevalent in both developed and developing countries. Prior to liberalization in India, the phenomena saw an increase as a consequence of a reduction in government rules and constraints that allowed business houses to expand, diversify, and modernize their operations through mergers and acquisitions.

**Keywords:** mergers and acquisitions (M&A), strategic issues, implications, Indian banking sector

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## INTRODUCTION

Mergers and Acquisitions in the Indian banking industry have taken centre stage in the minds of bank employees and policymakers. In recent years, the Indian banking system has seen several high-profile mergers, particularly in the industrial and service sectors as a result of globalization, such as ICICI Ltd.'s merger with its banking arm ICICI Banks Ltd., Global Trust Bank's merger with Oriental Bank of Commerce and IDBI's merger with its banking arm IDBI Bank Ltd. Mergers and acquisitions (M & A) are becoming increasingly accepted in the Indian economy as a business strategy instrument. Mergers and Acquisitions (M & A) is becoming increasingly popular in India as well. Mergers and Acquisitions (M & A) in the industrial and service sector has given a fresh lease of life to the way businesses are conducted in today's globe.<sup>1</sup>

The banking industry has been converted from a highly regulated and protected system to a more competitive and deregulated segment across the globe. The world has become smaller as a result of globalization and technological advancements. Customers around the world have access to financial services and products. Institutional performance relied heavily on new ideas and innovations. As recently as the 1980s size, which had lost its luster, was once again a factor in banking. Changes in globalization and deregulation, hallmarks of the international banking and finance policy framework, are redrawing the contours of banking structures around the world. As a result of the Southeast Asian financial crisis and

other economic instability in developing countries, it is clear that solid banking institutions are essential for sustainable economic progress. Consolidation is the only way to improve the competitiveness and quality of the banking sector, which is why it is being pursued in India, too. It doesn't matter if you're talking about Mergers and Acquisitions in the free market or worldwide market consolidation. As technology, competition, and new markets and products become more prevalent in today's operational environment, the current structure cannot keep up. Because of the need for increased capital, risk management, financing development projects, technological up gradation and improvement in customer service, and a global reach with a variety of financial product and services, such as agency functions, dealings in foreign exchange, insurance, mutual fund, venture capital and merchant banking, as well as factoring and leasing among many other things.

## **SCENARIO OF INDIAN BANKING SYSTEM**

India's banking system had previously seen a number of crises and failures prior to independence. As a result, it grew very slowly. The Indian banking industry, on the other hand, has seen remarkable growth since independence. The Reserve Bank of India's control and guidance of the Reserve Bank of India's planned economic growth, increase in money supply, and growth of banking habits were all factors in this. The function of public sector banks in economic development and resource mobilisation, particularly in rural and poorer areas of the economy, was originally played by the public sector banks. However, the lack of competition was caused by a system of regulated prices, tailored banking products, and only a few participants. Ownership by the state resulted in political intervention in its operations, which stifled new ideas.<sup>2</sup> The combination of the foregoing reasons, as well as an insatiable need to develop, led to a major banking crisis.

India's government opened the banking market to new private sector banks two decades after nationalizing banks. Since their nationalization, the banks have undergone a radical transformation. The near monopoly of the public sector banks began to be undermined by the more customer-focused private sector entrants in the mid-nineties. Older banks were forced to modernize their operations as a result of competition. Consumerism and rising income levels necessitated the banking industry to become a centre for a variety of financial services following the deregulation process. Financial institutions saw an increase in their profits and a slew of new chances to provide services to the general public. There is a gradual shift in the public sector banks toward automation in order to recoup the ground they've lost. They spend a lot of money to keep up with the latest technologies. These banks need to shift gears and accelerate their advances in the right direction by automating their branches and offering internet banking services. To make matters worse, the Reserve Bank of India instituted a framework in which interest rates were more closely tied to market forces, allowing banks to charge borrowers at a variable rate based on their risk perception. Customers gain from less regulation in the banking industry. Using virtual networks and upgrading backroom operations in banks, the adoption of new technology enables banks to reach out to clients more effectively.<sup>3</sup> Since 1990, banks have encountered a number of key problems and implemented a number of new operational initiatives.

- Non- Performing Assets

- Competition
- Asset Size
- Capital Base
- Universal Banking
- Customer Service g. Branch Banking
- Technology
- Basel II Implementation
- Implementation of New Accounting Standards
- Transparency and Disclosures
- Financial Conglomerates
- Know Your Customer (KYC) Guidelines -Anti Money Laundering Standards Corporate Governance

## IMPORTANCE OF BANKING

In today's global economy, banking is an essential component for the growth of every country's economy. In actuality, any country's financial system is controlled by the country's banking system, which in turn ensures the nation's progress. It is widely agreed that a healthy financial system is essential for both the economy and society. Thus, it may be concluded that banks play an important role in the nation's socioeconomic well-being. In the next section, we'll go through some of the bank's advantages.

- **Stimulate Saving Behaviors:** The function of the bank in influencing people's saving habits is significant. Depositors are attracted to banks by many techniques, such as a higher interest rate on fixed deposits. As a result, consumers are more likely to deposit money in a bank since they know that their money is safe and will grow at a quicker rate than if they use any other method.
- **Assistance to Businesses and Industry:** The banks are providing businesses with the capital they need to run and develop their activities. People are encouraged to deposit money in banks, which is then loaned out to enterprises as capital. Without the assistance of banks, no company or industry can even consider expanding.
- **Support in Commercial transactions:** We all have to deal with money on a daily basis, either as individuals or as organisations. In particular, when we need to transmit money to remote locations, banks are the only option. A well-developed banking system offers a wide range of services, including online banking, mobile account management, and credit cards. Using these kinds of administrators improves the speed and efficiency of bank operations.
- **Employment Generation:** As a result, the banking industry employs millions of people and contributes to the economy by providing services to its consumers.

- **Assisting Farming and agricultural output:** India's economy is heavily reliant on the agriculture industry. Farmers typically require loans to produce agricultural goods in this industry, which is dependent on the monsoon rains. This is where the banks play a big role since they provide lower interest loans.
- **Monitory Policy:** The country's financial policy is implemented mostly through banks. The primary goal of monetary policy is to reduce inflation, which may be readily accomplished through banking system rules.

## MERGERS

When two or more businesses come together to form a single business, it is a merger. An current business entity or a new one can be formed through the merger of the one or more business firms. When two or more companies combine, their assets and liabilities as well as their owners' interests and businesses are entwined. In other words, in a merger arrangement, the good-performing business will acquire all of the bad-performing firm's assets and liabilities. Statement of Accounting Standards (AS-14) - Accounting for Amalgamations- Laws in India utilise the terms "mergers" and "amalgamation" interchangeably, according to the Institute of Chartered Accountant of India (ICAI).<sup>4</sup>

## TYPES OF MERGER

The phrase merger and acquisition is used to cover a wide range of combination activities, from the merging of 100 or more companies to the purchase of one company by another in the same core industry or in wholly unrelated fields of operation. There are two general classifications for mergers: one relates to the form of the merger (i.e., whether it is a consolidation of firm or an acquisition of one firm by another), and the other relates to the type of merger, which depends on the industrial or commercial relationship of the firm involved in the merger.. An combination of two or more businesses into a single company is called a merger or consolidation. It is possible to think of mergers and acquisitions as the one-at-a-time variant of the merger; with mergers, a larger or stronger company takes over a smaller one. Companies that combine keep their own identities and complete the purchase by extending their own capital or by using cash reserves, if any are available.

There are several ways to enhance the benefits of mergers In order to be classified as a merger, the relationship between the companies involved must be defined. A horizontal merger occurs when two or more companies in the same industry unite to form a single conglomerate. An example of this would be the merger of two cement companies. Horizontal mergers can also result in geographical diversity, which occurs when companies that make the same items are situated in various market areas and offer those products. A vertical merger can be either pursued (such as an automotive manufacturer purchasing a tyre maker) or it can be used to offer facilities to process or distribute commodities at different stages in the distribution process. (such a shoe manufacturer buying a chain of retail shoe stores). Products or services that are distinct from one other but are distributed via the same channels are part of a "expansion" merger, which is a sort of circular merger. This is similar to a laptop manufacturer acquiring a CD-manufacturing company, with both products being sold in the same retail locations. In the context of a conglomerate merger, two or more companies that have no obvious connection to each other's production or marketing operations are combined (such as mining company buying an ice cream producer).<sup>5</sup>

## ACQUISITION

A purchase of a smaller company by a larger one is known as an acquisition. The purchase of one firm by another, often known as a takeover or a buyout, is known as acquisition. Between the bidders and the target firm, acquisitions or takeovers take place. It's possible that aggressive or amicable takeovers will occur. In a broad sense, acquisition refers to obtaining property ownership. An acquisition is the purchase by one firm of a controlling stake in the share capital of another existing company in the context of a business combination.<sup>6</sup>

## TYPES OF ACQUISITION

There are different types of Acquisitions/takeover:-

1. **Friendly takeovers:** Before making an offer for another firm, a bidder normally tells the board of directors of that company. If the board believes that accepting the offer is better for shareholders than rejecting it, it recommends that the offer be accepted. Because the shareholders and the board of directors are frequently the same individuals or have a strong relationship, private purchases are usually pleasant. If the shareholders agree to sell the firm, the board of directors is typically of the same mind or sufficiently bound by the shareholders' orders to work with the bidder.
2. **Hostile takeovers :** A hostile takeover allows a suitor to get over a target company's unwillingness to consent to a merger or takeover. If the target company's board of directors rejects the offer, but the bidder persists in pursuing it, or if the bidder makes the offer without alerting the target company's board of directors beforehand, the takeover is called "hostile." A hostile takeover might be carried out in a variety of ways. The purchasing business can make a tender offer, which is a public offer at a set price above the current market price. The Williams Act governs tender offers in the United States.
3. **Reverse takeovers:** A reverse takeover occurs when a private firm purchases a publicly traded corporation. This is typically done at the request of a bigger, private firm, with the goal of allowing the smaller company to effectively float itself while avoiding some of the costs and time associated with a traditional IPO. A reverse takeover, on the other hand, is defined as an acquisition or acquisitions in a 12-month period that for an AIM company would: exceed 100% in any of the class tests; or result in a fundamental change in its business, board, or voting control; or, in the case of an investing company, depart substantially from the investing strategy stated in its admission document or, where no admission document was produced on admission, depart substantially from the inv strategy..

## DIFFERENCE BETWEEN MERGER AND ACQUISITION (M&A)

Even though they're commonly used interchangeably, the terms merger and acquisition (M&A) have different meanings. An acquisition occurs when one firm buys another and immediately positions itself as the new debtor. The target company ceases to exist from a legal perspective, but the buyer acquires the business and the buyer's stock continues to be traded after the transaction is completed. Whereas in the strictest sense, a merger occurs when two businesses, frequently of comparable size and scope, decide to combine rather than continue as independent entities. A merger essentially signifies:

M- Mixing

E-Entities

R-Resources

G-Growth

E-Enrichment and

R-Renovation

## **REGULATORY ISSUES OF MERGER AND ACQUISITION (M&A)**

Regulators of relative Market dynamics and how they influence the interests of many stakeholders are constantly a source of concern. In general, regulators want to make sure that the playing field is as equal as possible for all participants. There are many significant institutional and non-institutional shareholders, but there are also a large number of people who invest their hard-earned money in bank shares, even though they may not be as intelligent or informed as they should be. Regulators must also protect the interests of these bank customers, who engage in a wide range of transactions with banks, and whose interests may be adversely affected, by the various day-to-day actions of the bank managements, may be, more pronouncedly, following large-scale voluntary mergers of banks. Antitrust laws in the United States are against such mergers.<sup>7</sup>

Another group of individuals that pay a significant price in each merger/acquisition/amalgamation of banks is the personnel of the bank being taken over/merged with another. At least one bank's supply chain arrangements unexpectedly come to a standstill, affecting many suppliers and other service providers, which can cause legal and financial headaches for those affected. Now, the issue is who will foot the bill for this? As a result, any regulatory forbearance or tax or other concessions given to the rescuing bank inevitably come at a cost - social and/or financial cost - to the tax payers and society at general. We should, however, keep in mind that all these expenditures should be contrasted to what may have happened if the ill bank had been allowed to fail in the first place. Another question is why the bank in question got to this point in the first place/was allowed to get to this point. Preventative measures are definitely superior to any treatment.

## **RELEVANCE OF MERGERS & ACQUISITION (M & A) TO BANKING SECTOR**

Banking industry structures have been dramatically altered by the bank mergers over the past decade, particularly significant bank mergers. The majority of merger proposals are not rejected on the basis of competition. There is no reason to expect that future mergers of even the largest banking organisations will be significantly hindered by present antitrust laws. Consolidation of institutions, worldwide operations, development of new technology, and universal banking are the four themes that are radically changing the financial sector. Keeping track of the financial industry is becoming increasingly difficult due to the aforementioned tendencies. Only the banking collapses of the 1920s and 1930s and the pre-civil war free-banking legislation that allowed a large number of newly organised banks to enter were equivalent in magnitude to the merger-driven structural re-organization m envisaged. It is no longer uncommon for Bank



Economists to consider recent changes in banking regulations as a long-overdue rationalization that will enhance efficiency and increase Bank diversity and stability. In the long term, some forecasters believe that local markets will expand to the national level.<sup>8</sup> These people are confident and optimistic about how much competition there will be for customers like small borrowers, who are now reliant on their Local Banks for their financial needs. Consolidation of the banking industry is crucial for a number of reasons, including the following:

- (1) Need for higher Capital
- (2) Risk Management
- (3) Financing Development Projects
- (4) Technology upgradation
- (5) Improvement in Customer Service.

### **HISTORICAL PERSPECTIVE OF MERGER AND ACQUISITION (M&A)**

Before the contemporary banking system established in India, the Indian banking system passed through a number of stages. During the late 18th century, the East India Company's business and administration increased, and the early banking system was superseded by banks formed by the English agency firms. Because they merged banking and trade, practically all of them collapsed during the trading crisis of 1829-33. During the American Civil War in 1862-1865, the Indian cotton trade had a speculative boom, resulting in the establishment of several banks and corporations. Despite the fact that nearly all of them failed as soon as the Civil War ended and the boom fell. Government-created Presidency Banks also failed because of the inexperience and incapacity to execute foreign exchange transactions of their staff members. Indian banking's expansion was accelerated by the Swadeshi movement, and between 1900 and 1914, a considerable number of new banks were established. After the outbreak of World War I in 1914, the biggest over-banking crisis in India was exacerbated and followed by the post-war slump (1922-23), during which the rate of bank failures was extremely high. This was followed by the partition of India in 1924, which slowed the expansion of Indian banking. Until that point, it's likely that little effort was made to save these institutions, other than adequate supervision and surveillance, to prevent their demise.<sup>9</sup>

### **RBI GUIDELINES ON MERGER AND ACQUISITION (M & A)**

On May 11, 2005, the Reserve Bank of India released comprehensive rules for private sector bank mergers and amalgamations. These rules apply to merger proposals between two banks or a bank and a non-banking financial institution (NBFC). Subject to the relevant statutes, the principles underlying these rules would likewise apply to public sector institutions. As a result of these rules, the merger proposal procedure, swap ratio determination, transparency, the phases at which boards participate in the merger process, and standards for promoter buying/selling of shares before and during the merger process are all laid down. Banks must follow these rules when considering merger proposals between two banking institutions or between an institution and a non-banking financial institution. The following are the general outlines of the rules:

- There must be unanimous consent from two-thirds of each bank's board's entire strength to merge their respective firms' draught merger strategy.
- The Ganguly Group on Corporate Governance recommends that the members of the boards of directors who accept the proposed merger scheme sign the Deed of Covenants.
- The shareholders of each bank must approve the proposed merger by a two-thirds majority vote at a meeting scheduled for the purpose.
- This ratio should be assessed by independent valuers with the necessary expertise and experience; the Board should decide whether or not this swap ratio is fair and suitable.
- The RBI will evaluate the value of the shares owned by the dissenting shareholders and the compensation to be given by the appropriate banking entity to those shareholders.
- After the merger, the new banking company's board of directors must follow RBI rules for shareholding and composition.
- Section 391 to 394 of the Companies Act, 1956 mandates that the Reserve Bank must approve any proposed merger of an NBFC with a banking business.
- When an NBFC merges with a banking entity, it must meet certain conditions, such as whether or not the NBFC has violated or is likely to violate REI/SEBI regulations and ensure that these regulations are complied with before the scheme of amalgamation is approved; and (b) the NBFC has complied with the Know Your Customer (KYC) requirements for accounts which will become accounts for that banking entity.

## **PRESENT SCENARIO ABOUT M&A**

Even in a growing country like India, where progressive reforms over the past decade and a half have brought in a degree of professionalism, most PSBs, foreign banks, and new generation private sector banks are now being managed on safe, scientific lines. For commercial banks, it's perhaps one of the best-run financial systems on the planet. Some ancient private sector banks, however, nevertheless have many flaws and limitations. These banks are also unable to fulfil the Rs.300 crores minimum capital requirement from their profits or raise it from the capital market quickly. Their situation necessitates the merger with a strong bank. Under current policies, the Reserve Bank of India (RBI) is also allowing FDI in limited circumstances. However, this is not a one-way street. As our country is being heralded as the future economic superpower, huge foreign banks are looking to acquire Indian banks listed on stock markets that have previously been undervalued by the bourses. Large and medium-sized Indian banks' market capitalizations are dwarfed by the annual earnings of several of the foreign banks that operate in the country. Investment in financial services can't be blocked under GATT rules after 2009. All banks, especially the weak Indian banks, must take advantage of this critical period to improve or leave.

There is a need to prevent the whole Indian banking sector from being taken over by foreign investors in a few massive, whole sale transactions. International capital is not expected to respect national feelings or to



be particularly committed to nation-building projects.<sup>10</sup> How long and in what way the RBI can guarantee this is a significant concern. " As a result, the Indian government and the Reserve Bank of India have been rethinking the privatisation of the PSBs. Furthermore, despite the fact that the previous government had publicly put out the proverbial red-carpet to FDI, FII, and NRI investments in Indian banks, the RBI, has been less than enthusiastic in its actual execution, for obvious reasons. Due to the lack of activity, we don't expect this sector to be much of a focus until 2009. As far as commercial banks are concerned, we can claim that the Reserve Bank of India (RBI) has been carrying out its challenging regulatory task fairly efficiently. Mergers and acquisitions are allowed in the financial system only when a thorough due diligence procedure is completed. Just with Nedungadi Bank and GTB (and now UWB), these "blips" on the radar are just evidence of the fact that such forced marriages are more likely to be the result of 'regulated' disasters, rather than regulator over-indulgence. The RBI's regulatory policies are successfully tackling most of the current and relevant challenges in the context of mergers and acquisitions.

## CONCLUSION

This Paper reveals that private sector banks benefit from mergers, whereas public sector banks benefit from mergers, however the results are a little inconsistent. In the post-merger period, certain indicators suggest a positive improvement, while others show a decrease. The history of banking and mergers in particular reveals that mergers have a favourable influence on the banking industry. In both the Indian and international banking industries, mergers have been a boon to growth. As a result, mergers also assist to reduce competition, achieve the goal of development and expansion, and give numerous tax advantages. In the end, we may conclude that merger and acquisitions can be a positive source of development and expansion if the deal is undertaken with thorough investigation and consideration of the firm's long-term objectives. As a result of M&A, financial services can be more widely available and at a lower cost to consumers across the country. Ultimately, this will lead to financial inclusion, and the financial world will become more interconnected worldwide. As a result, M&A has a significant impact on both the country's economic and social growth. Any economy's foundation is built on the foundation of financial stability.

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