Emerging Issues in Banking Industry of India

MOHIT BINDLISH

Asst. Prof., RKSD PG College, Kaithal, Haryana, India

Abstract: The world of competition is like a jungle where monsters gobble smaller ones therefore one has to be competent enough to win the rivalry. There are evidences that large enterprises have merged smaller competitors in themselves. This review article on mergers in banking industry has been ignited from the case of the Bank of Rajasthan Ltd. and ICICI Bank Ltd. The aim of this paper is to probe the motives of banks for mergers and acquisition with special reference to Indian Banking Industry. For this purpose sample of 17 mergers (post liberalization) of Banks is taken. This study is conducted on the basis of number of branches, geographical penetration in the market and benefits from the merger. Apart from their financial aspects, this article also raises certain questions from the point of view of Human Resources Management and Organization Behaviour for scholars and researchers. This article leaves footprints on the way of further studies on mergers and acquisitions from a different outlook.

Key Words: Mergers and Acquisitions, Indian Banking Industry, Motives

-------------------------♦-------------------------

OVERVIEW OF INDIAN BANKING INDUSTRY

The history of Indian Banking shows that seeds of banking in India were sown back in the 18^{th} century when efforts were made to establish the General Bank of India and Bank of Hindustan in 1786 and 1790 respectively. Later some more banks like Bank of Bengal, Bank of Bombay and the Bank of Madras were established under the charter of British East India Company. These three banks were merged in 1921 and it formed the Imperial Bank of India, which later became the State Bank of India. The period between 1906 and 1911 witnessed the establishment of banks such as Bank of India, Bank of Baroda, Canara Bank, Corporation Bank, Indian Bank and Central Bank of India; these banks have survived to the present.

The banking sector in India can be divided into two era i.e. pre-liberalization era and post- liberalization era since 1991. In the pre-liberalization era, the Government of India nationalized the 14 largest commercial banks in 1969. A second dose of nationalization of six more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. Later, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was only the merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19.

The banking sector has seen a tremendous amount of change in the post liberalization era i.e. in the early 1991; the then Narasimha Rao government embarked the policy of liberalization. Licences were given to small number of private banks like Global Trust Bank, which later amalgamated with Oriental Bank of Commerce, Axis Bank (earlier UTI Bank), ICICI Bank and HDFC Bank. This move had augmented the growth in Indian Banking. Along with the rapid growth in the economy of India, followed by the growth with strong contribution from all the three sectors of banks, viz. government banks, private banks and foreign banks.

The impact of globalization on Indian Banking has caused many changes in terms of regulations and structural. With the changing environment, many different strategies have been adopted by this sector to remain efficient and to surge at the forefront in the global arena. One such strategy is in the course of consolidation is merger and acquisition.

CONCEPTUAL FRAMEWORK

In the wake of economic reforms, Indian industries have started restructuring their operations around their core business activities through merger, acquisition, and takeovers because of their increasing exposure to competition both domestically and internationally. According to Accounting Standard (AS) 14, ‘Accounting for Amalgamations’, issued by the Council of the Institute of Chartered Accountants of India, amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not only of the assets and of liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category, those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase.

NEED OF MERGERS AND ACQUISITIONS IN BANKING INDUSTRY OF INDIA

It is observed in literature that most of the work done on mergers and acquisition is based on financial & accounting aspect like performance of banking institutions based on. Devos, Kadapakkam & Krishnamurthy (2008) studied M&A as value creation, efficiency improvements as explanations for synergies and produced evidence that suggests mergers generate gains by improving resource allocation rather than by reducing tax payments of increasing the market power of the combined firm. Kemal (2011) has used accounting ratios to compare the post-merger profitability of two banks i.e. RBS and ABN AMRO. DeLong (2003) studied sample of 54 bank mergers announced between 1991 and 1995, tests several facets of focus and diversification. The study found that upon announcement, the market rewards the merger of partners that focus their geography and activities and earning stream. Only of these facets, focusing earning streams enhances long-term performance. Shanmugam & Nair (2004) identified factors in their study on mergers and acquisitions of banks in Malaysia like globalization, liberalization and information technology developments have contributed to the need for a more competitive, resilient and robust financial systems.

There are few efforts have been made to measure the impact of bank's M&A on their employees and staff. However, apart from this some efforts have been made to study the state of customers in the course of M&A.

Acquisitions often have a negative impact on employee behaviour resulting in counterproductive practices, absenteeism, low morale, and job dissatisfaction. It appears that an important factor affecting the successful outcome of acquisitions is top management's ability to gain employee trust.

Panwar (2011) studied ongoing merger trends in Indian banking from the viewpoint of two important stakeholders of a banking firm- stockholders and managers. The findings shows that the trend of consolidation in Indian banking industry has so far been limited mainly to restructuring of weak banks and harmonization of banks and financial institutions. Voluntary mergers demonstrating market dynamics are very few. She concluded that Indian financial system requires very large banks to absorb various risks emanating from operating in domestic and global environments.

RATIONALE BEHIND MERGERS OF BANKS

It is evident from large number of studies conducted on Mergers & Acquisition that it is most widely used strategic option adopted by organizations for growth purpose. Rhoades (1998) summarized nine case studies, by nine authors, on the efficiency effects of bank mergers. The mergers selected for study were ones that seemed relatively likely to yield efficiency gains. That is, they involved relatively large banks generally with substantial market overlap, and most occurred during the early 1990s when efficiency was getting a lot of attention in banking. All nine of the mergers resulted in significant cost cutting in line with pre-merger projections. Four of the nine mergers were clearly successful in improving cost efficiency but five were not.

It was found in the studies of Humphrey, Willeson, Bergendahl & Lindblom (2006) that industry consolidation occurred primarily because of financial and technological innovation that altered the optimal production functions of financial firms. The enabling force was a wave of financial deregulation that was necessary for banks and other financial services to take full advantage of the new production processes and technological advances revolutionized back-office processing, front-office delivery systems, and payments systems.

Sergio & Olalla (2008) finds that financial deregulation and technological progress has an important role in the process of mergers and acquisitions in the banking sector during the period 1995-2001. They used Multinomial logit analysis to conclude the characteristics of continental European financial institutions and observed that size is an important factor in mergers and acquisitions.

DeYoung, Evanoff & Molyneux (2009) have found in their study that the changes in deregulation, allowed commercial banks and other financial services firms to expand through mergers and acquisition into geographic markets and product markets.

Calipha, Tarba & Brock (2011) have reviewed M&A motives and success factors in their article such as entering a new market, gaining new scarce resources, achieving synergies and other managerial and organizational factors that are associated with M&A i.e. relative size of M&A partner, managerial involvement, culture and organizational structural issues etc. On the basis of our studies of 17 bank mergers in India, we can identify following motives and rationale for mergers.

1. Market Leadership

The merger can enhance value for shareholders of both companies through the amalgamated entity's access to greater number of market resources. With addition to market share a company can afford to control the price in better manner with a consequent increase in profitability.

2. Growth and Diversification

Companies that desire rapid growth in size or market share or diversification in the range of their products may find that a merger can be used to fulfill the objective instead of going through the volume consuming process of internal growth or diversification. The firm may achieve the same objective in a short period by merging with an existing firm. In addition, such a strategy is often less costly than the alternative of developing the necessary production capability and capacity.

3. Synergy

Implies a situation where the combined firm is more valuable than the sum of the individual combining firms. It refers to benefits other than those related to economies of scale. Operating economies are one form of synergy benefits.

4. Risk

Managing Bankruptcy and organizational risks, recent studies have established that if merger and acquisitions in banks if allowed in a controlled manner would significantly reduce the bankruptcy risk of the merged entity. Obviously, mergers would also provide these benefits to banks in India reducing their bankruptcy concerns.

5. Economies of Scale

With the help of mergers and acquisitions in the banking sector, the banks can achieve significant growth in their operations and minimize their expenses to a considerable extent. Another important advantage behind this kind of merger is that in this process, competition is reduced because merger eliminates competitors from the banking industry.

6. Economies of Scope

An ability to grow products and segments and an opportunity to cross sell would enhance revenue. This could also result in more geographic growth.

7. Strategic Integration

Considering the complementary nature of the businesses of the concerned companies, in terms of their commercial strengths, geographic profiles and site integration, the amalgamated entity may be able to conduct operations in the most cost efficient manner. The merger an also enable maximum utilization of various infrastructural and manufacturing assets, including utilities and other site facilities.

MERGERS OF INDIAN BANKS

The following table clears the picture of mergers in Indian Banking Industry.

S.NO.	TARGET BANK	ACQUIRER BANK	YEAR
1	BAREILLY CORPORATION BANK LTD.	BANK OF BARODA	07.06.1998
2	SIKKIM BANK	UNION BANK OF INDIA	25.05.1999
3	TIMES BANK LTD	HDFC BANK LIMITED	26.02.2000
4	ANZ GRINDLAYS BANK	STANDARD CHARTERED	27/04/2000
5	BANK OF MADURA LIMITED	ICICI BANK LTD	14.03.2001
6	BENARES STATE BANK LTD	BANK OF BARODA	21.06.2002
7	ICICI & ITS RETAIL FINANCE	ICICI BANK LTD	January,
8	SOUTH GUJARAT LOCAL AREA BANK	BANK OF BARODA	25.06.2004
9	GLOBAL TRUST BANK	ORIENTAL BANK OF COMMERCE	27.08.2004
10	UNITED WESTERN BANK (UWB)	IDBI BANK	03.01.2006
11	GANESH BANK OF KURUNDWAD LTD	FEDERAL BANK LTD	25.01.2006
12	THE GANESH BANK OF KURUNDWAD	THE FEDERAL BANK LTD	02.09.2006
13	BANK OF PUNJAB LIMITED	CENTURION BANK OF PUNJAB	19.04.2007
14	LORD KRISHNA BANK LTD	CENTURION BANK OF PUNJAB	29.08.2007
15	SANGLI BANK LTD	ICICI BANK LTD	31.10.2007
16	CENTURION BANK OF PUNJAB LTD	HDFC BANK LIMITED	23.05.2008
17	THE BANK OF RAJASTHAN LTD.	ICICI BANK LTD	13.08.2010

Source: History of Banks.

BENEFITS OF MERGER TO INDIAN BANKS

After clearly understanding the motives and rationale for merger, we studied the mergers of 17 banks in India. In this analysis, we can identify following benefits of mergers to the all participants.

- Sick banks survived after merger.
- Enhanced branch network geographically.
- Larger customer base (rural reach).
- Increased market share.
- Attainment of infrastructure.

EMERGING ISSUES IN M&AS

Growth is an ongoing process that reflects various issues pertaining to the various dimensions of business. Mergers in any industry are prerequisite for growth but it surely affects the customers, employees, shareholders and all concerned departments. There are studies, which reveal significant relationships between mergers and constituents of business. In our study, we find following emerging issues that are required more attention by researchers in order to successfully implement merger.

1. Employees' Perception

There is an evidence of employees' agitation and strike resultant of merger of the Bank of Rajasthan Ltd. into ICICI Bank Ltd. Empirical studies are conducted to know the perception of banking services in the wake of bank mergers. George & Hegde (2004) reported a case for the delicate aspect of employees' attitudes, their satisfaction and motivation, which are posited as prerequisites for customer satisfaction, which is, again necessary for the competitive sustenance of the organization.

Schneider, Parkington and Buxton (1980) conducted research on some boundary-spanning theory and on some practical realities. Assumptions underlying the use of perception-based diagnoses were also explained. Results revealed some strong relationships between employee perceptions of branch practices and procedures in relation to service and customer perceptions of service practices and quality. Schneider and Bowen (1985) found a significant relationship between branch employees' perceptions of organizational human resources practices and branch customers' attitudes about service.

Mylonakis (2006b) has examined in his article that how bank employees perceive bank' M&As and how it is expected to affect their personal and professional career. The result showed that bank employees feel personally threatened by mergers and acquisitions, which are not considered to be justified and necessary entrepreneurial activities conducive to enhanced, quality banking services.

Wickramasinghe & Chandana (2009) took views of 109 employees of two banks of Sri Lanka, which had undergone an extension merger and a collaborative merger and reported that the type of the merger affects employee perceptions and employees are less satisfied in the collaborative merger than in the extension merger. Further findings revealed that age, gender, and marital status influence the perceptions of the respondents and among those, age is the most influential.

2. Branch Size

According to Mylonakis (2006a), an important parameter in the relationship between the number of branches and employment is branch size. He has used most well-known indicators for the evaluation of staff efficiency in banking sector i.e. operating revenue per employee, personnel expenses per employee and pre-tax profits to personnel expenses. He observed that operating revenue either fall or remains stable, administrative expenses per employee increase for every examined bank and pre-tax profits to personnel expenses indicator showed how many euros are gained by the bank for every euro spent in staff payroll.

3. Customer Perception

Sureshchandar, Rajendran, & Anantharaman (2002) have used factor analysis approach to determine customer-perceived service quality in banking industry. They have brought to light some of the critical determinants of service quality that have been overlooked in the literature & proposed a comprehensive model & an instrument framework for measuring customer perceived service quality.

Hossain & Leo (2009) conducted an analytical study to measure customer perception on service quality in retail banking in Qatar and covered 18 parameters with sample size of 120, chosen on a convenient basis from 4 banks. They have used five-point Likert scale to conclude the results that customer's perception is hightest in the tangibles area and lowest in the competence area.

4. Communication

Nikandrou, Papalexandris and Bourantas (2000) explored a number of variables that bear an impact on managerial trustworthiness, for example frequent communication before and after acquisition, and the already existing qualities of employee relations seem to play the most important role. Therefore, a carefully planned, employee-centered communication programme, together with a good level of employee relations, seem to form the basis for a successful outcome as far as employee relations in the face of mergers and acquisitions is concerned. Literature shows that communication also plays vital role in the success of a merger. Appelbaum, Gandell, Yortis, Proper & Jobin (2000) concludes that communications throughout the M&A process plays a crucial role in its eventual success. Providing clear, consistent, factual sympathetic and up-to-date information in various ways will increase the cooping abilities of employees, which will in turn increase their productivity. This increased productivity will positively affect firm's performance and create sustained competitive advantage by achieving the projected strategic fit and synergies.

5. Change Management Strategies

Kavanagh (2006) conducted longitudinal study that examined mergers between three large multi-site public-sector organizations. Both qualitative and quantitative methods of analysis were used to examine the effect of leadership and change management strategies on acceptance of cultural change by individuals occurred due to merger. Findings indicate that in many cases the change that occurs as a result of a merger is imposed on the leaders themselves. In this respect, the success of a merger depends on individual's perceptions about the manner in which the process is handled and the direction in which the culture is moved.

6. Human Resource Management

Researchers in some articles also raise issues related to human resource management. Bryson, (2003) reviewed the literature around managing HRM risk in a merger. He found that poor merger results are often attributed to HRM and organizational problems, and that several factors related to maintaining workforce stability are identified as important in managing HRM risk. Schraeder and Self (2003) found that organizational culture is one factor as a potential catalyst to M&A success.

Chew and Sharma (2005) examined the effectiveness of human resource management (HRM) and organizational culture on financial performance of Singapore-based companies involved in mergers and acquisition activities. They used the method of content analysis to collect information on cultural values and HRM effectiveness, using Kabanoff's content analysis. Culture profiles were then assigned to organizations in the sample following the results from cluster analysis. Various financial ratios were used to measure organizational performance. Finally, regression analysis was performed to test various hypotheses. The key finding of the study suggests that organizations with elite and potential leader, when complemented by human resource effectiveness, had a better financial performance as compared to other organizations. At the end, it was concluded that to achieve better financial results by undertaking merger and acquisition activities organizations need to have elite or leadership value profile.

7. Other Issues

There are evidences in literature that media plays an important role in shaping the social context for mergers and acquisition. Schneider and Dunbar (1992). Schweiger and DeNisi (1991) suggest that it is the uncertainty that creates stress for employees rather than the actual changes associated with the merger.

Communication and a transparent change process are important. Leaders need to be competent and trained in the process of transforming organizations to ensure that individuals within the organization accept the changes prompted by a merger.

SUMMARY AND CONCLUSION

Banking sector is one of the fastest growing areas in the developing economies like India. M&A is discussed as one of the most useful tool for growth, which has evoked the interest of researchers and scholars. Indian economy has witnessed fast pace of growth post liberalization era and banking is one of them. M&A in banking sector has provided evidences that it is the useful tool for survival of weak banks by merging into larger bank. It is found in our study that small and local banks face difficulty in bearing the impact of global economy therefore, they need support and it is one of the reasons for merger.

Some private banks used mergers as a strategic tool for expanding their horizons. There is huge potential in rural markets of India, which is not yet explored by the major banks. Therefore ICICI Bank Ltd. has used mergers as their expansion strategy in rural market. They are successful in making their presence in rural India. It strengthens their networks across geographical boundary, improves customer base and market share.

Any action of the object leads to the reactions on the other hand and that is what happened in the merger of the Bank of the Rajasthan and ICICI Bank Ltd. when employees of BOR got agitated when the news about the merger was released. Consequently, various emerging issues have been identified for further attention of researchers and scholars.

REFERENCES

Appelbaum, Steven H., Gandell, Joy, Yortis, Harry, Proper, Shay & Jobin, Francois (2000).

Anatomy of a Merger: Behavior of Organizational Factors and Processes Throughout the Pre-during-post Stages Part 1). Management Decision 38(9) p. 649-661.

Bryson, Jane (2003). Managing HRM risk in a merger. Employee Relations 25(1) p. 14-30.

Calipha, R., Tarba, S. & Brock, D (2011). Mergers and Acquisitions: A Review of Phases, Motives and Success Factors. In Cary L. Cooper & Sydney Finkelstein (eds.). Advances in Mergers and Acquisitions. 9. Emerald Group Publishing Limited. p. 1-24.

Chew, I.K.H., & Sharma, B. (2005). The Effects of Culture and HRM Practices on Firm Performance: Empirical Evidence from Singapore. International Journal of Manpower 26(6) p 560-581.

DeLong, G.L. (2003). Does Long Term Performance of Mergers Match Market Expectations? Evidence from the US Banking Industry. Financial Management, p. 5-25.

Devos, E., Kadapakkam, P.R., & Krishnamurthy, S. (2008). How Do Mergers Create Value? A Comparison of Taxes, Market Power, and Efficiency Improvements and Explanations for Synergies. The Review of Financial Studies 22(3), March 27, 2008, from Net Library Database at Mohanlal Sukhadia University, Udaipur.

DeYoung, R., Evanoff, D.D. & Molyneux P. (2009). Merger and Acquisitions of Financial Institutions: A Review of the Post-2000 Literature. J Financ Serv Res 36, p. 87-110.

George, B.P. & Hegde, P. G. (2004). Employee Attitude towards Customers & Customer Care Challenges in Banks. International journal of Bank Marketing 22(6) p. 390-406. Hossain, M. & Leo, S (2009). Customer Perception on Service Quality in Retail Banking in Middle East: The Case of Qatar. International Journal of Islamic and Middle Eastern Finance and Management 2(4), p. 338-350.

Humphrey, D.B., Willesson, M., Bergendahl, G. & Lindblom, T. (2006). Benefits from a Changing Payment Technology in European banking, Journal of bank finance 30, p. 1631-1652.

Kavanagh, M.H. (2006). The Impact of Leadership and Change Management Strategy on Organizational Culture and Individual Acceptance of Change during a Merger. British Journal of Management 17(S1) p. 81-103.

Kemal, M.U. (2011). Post-Merger Profitability: A Case of Royal Bank of Scotland (RIBS). International Journal of Business and Social Science 2(5) p. 157-162.

Mylonakis, John (2006a). The Impact of Banks' Mergers & Acquisitions on their Staff Employment & Effectiveness. International Research Journal of Finance and Economics (3) p. 121-137.

Mylonakis, John (2006b). The Perception of Banks' Mergers and Acquisitions by Bank Employees. International Journal of Financial Services Management 1(2-3) p. 205-204.

Nikandrou, I., Papalexandris, N. & Bourantas, D. (2000). Gaining Employee Trust after Acquisition: Implications for Managerial Action. Employee Relations 22(4) p. 334-355.

Panwar, S. (2011). Mergers & Acquisitions in Banking Industry – The Need of Hour. International Journal of Contemporary Practices, 1(2), p. 75-82.

Rhoades, S.A. (1998). The Efficiency Effects of Bank Mergers: An Overview of Case Studies of Nine Mergers. Journal of Banking & Finance 22(3) p. 273-291
.

Schneider, B. and Bowen, D.E. (1985). Employee and Customer Perceptions of Service in Banks: Replication and Extension. Journal of Applied Psychology 70(3) p. 423-433.

Schneider, B., Parkington, J.J. & Buxton, V.M. (1980). Employee and Customer Perceptions of Service in Banks. Administrative Science Quarterly 25(2) p. 252-267.

Schneider, S.C., & Dunbar, R.L. (1992). A Psychoanalytic Reading on Hostile Takeover Events. Academy of Management 17(3) p. 537-559.

Schraeder, M., and Self, D.R. (2003). Enhancing the Success of Mergers and Acquisitions: An Organizational Culture Perspective. Management Decision 41(5) p. 511-522.

Schweiger, D. & DeNisi, A. (1991). The Effect of Communication with Employees Following a Merger: A Longitudinal Field Experiment. Academy of Management Journal 34(1) p. 110- 135

Sergio, S. & Olalla, M.G. (2008). Size, Target Performance and European Bank Mergers and Acquisitions. American Journal of Business 33(1) p. 53-64.
Shanmugam, B. & Nair, M. (2004). Mergers & Acquisitions of Banks in Malaysia. Managerial Finance (4) p. 1-18

Sureshchandar, G.S., Rajendran, C. & Anantharaman, R.N. (2002). Determinants of Customer-Perceived Service Quality: A Confirmatory Factor Analysis Approach. Journal of Services Marketing 16(1) p. 9-34.

Wickramasinghe, V. & Chandana, K. (2009). People Management in Mergers and Acquisitions in Sri Lanka: Employee Perceptions'. The International Journal of Human Resource Management 20(3) p. 694-715.

WEB SITES

http://www.anz.com/australia/aboutanz/corporateinformation/historyofanz/default.asp
http://www.icicibank.com/aboutus/history.html
http://www.icicigroupcompanies.com/history.html
http://www.banknetindia.com/banking/80142.htm
http://www.banknetindia.com/banking/70836.htm
http://www.indianexpress.com/fe/daily/19990526/fco26022.html