Analysis of Merger and Acquisition trends of Banking Sectors in India and its legal consequences

June 9, 2021

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Various Acts defining Merger of Banks

MERGERS AND BANKING REGULATION ACT, 1949

Section 44A of the Banking Regulation Act of 1949 states that no banking companies shall amalgamate unless a scheme of such amalgamation is approved by a two-third majority of shareholders of each amalgamating company. **Subsequently it is sent to RBI for its sanction**.

MERGERS UNDER BANKING COMPANIES (ACQUISITION AND TRANSFER OF UNDERTAKINGS) ACT, 1970/ 1980

The Central Government may, in exercise of the powers conferred by Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/ 1980 and after consultation with the Reserve Bank of India, notify the Scheme Amalgamation of Banks mentioned in Schedule I of the aforesaid Acts.

MERGER AND COMPETITION ACT, 2002

The Competition Act 2002 (Competition Act) is the principal legislation that regulates Combinations (mergers and acquisitions) in India. Sections 5 and 6 of the Act, deal with the regulation of mergers and acquisitions.

The main objective behind introducing the Competition Act of 2002 was to eliminate practices having appreciable adverse effect on competition (AAEC), promote and sustain competition, protect customer's interests and ensure freedom of trade carried on by other participants in the market, to prohibit anti-competitive agreements and abuse of dominate position, provide for regulation of combinations i.e., mergers, amalgamations, acquisitions, etc. and to enjoin competition advocacy. Any combination which is likely to cause any AAEC is void. Any bank pursuant to any loan or investment agreement enjoys exemption from the rigors of combination provision; however, the disclosure of such combination is required to make before the CCI within 7 days.

In 2017, the Government has exempted mergers of nationalized banks from seeking fair trade watchdog CCIs approval. The aim was paving way for fast-tracking consolidation in PSU banking space. This exemption will be applicable for ten years and comes at a time when several experts and even policymakers have been talking about the need for consolidation in the banking sector, especially among the state-run banks.

What is the Need for Merger?

- In 2018-19, according to Reserve Bank of India, frauds reported by Public Sector Banks (PSBs), during the period from April 1, 2019 to September 30, 2019 is 5,743 involving a total amount of INR 95,760.49 crores.

- PSBs have a disproportionate share of 85% in the Indian banking scenario, significantly exceeding their relative business share. Prima facie, an initial investigation in these cases has revealed involvement of not only mid-level employees, but also of the senior most management and also political interference and the ‘pro-corporate’ approach of decision makers.

- The banking system is plagued with high levels of NPAs and it is a cause of worry. It reflects financial distress of borrower clients such as Vijay Malaya, Nirav Modi, Dewan Housing etc, and inefficiencies in transmission mechanisms.

- In 2018, according to reports, India became one of the 10^{th} largest economies in the world, with the highest bad loan ratio after Italy. This is because government-controlled lenders are estimated to be holding approximately 90 percent of such non-performing assets.

- The losses incurred by the four PSBs including Bank of Baroda, IDBI Bank Ltd, Oriental Bank of Commerce and Central Bank of India were INR. 21,646.38 crores in the year ending March 31, 2018, after which the government planned these merger.

- These catastrophic situations resulted in Centre’s advised (forced) Bank mergers.

Mergers & Acquisitions: Banking Sector

- In India, the banking system has undoubtedly earned numerous outstanding achievements, in a comparatively short time, for the World's largest and the most diverse democracy.

- The reform process of the banking sector or industry is part and parcel of the government's strategic agenda aimed at repositioning and integrating the Indian banking sector into the global financial system.

- There have been several reforms in the Indian banking sector, as well as quite a few successful mergers and acquisitions, which have helped it grow manifold.

- Mergers and acquisitions are most widely used strategy used by the banks (or any body corporate) to strengthen and maintain their position in the marketplace.

- M&As are considered as a relatively fast and efficient way to expand into new markets and incorporate new technologies.

- For instance, in 1993, Punjab National Bank acquired New Bank of India.

- The only other nationalized bank merged with another except for State Bank of India with its associate banks was the merger of Bharatiya Mahila Bank with State Bank of India in 2017.

- In August, 2019 the government merged 27 public sector banks and reduced to it 12.

- The second largest bank PNB amalgamated with Oriental Bank of Commerce, United Bank of India and Bank of India.

Merger of Indian Banks

- In the present times, the banking sector is a rapidly growing industry in India.
- Merging of the Indian banking sector through mergers and acquisitions on commercial considerations and business strategies – is a vital pre-requisite.
- A comparatively new development in the Indian banking sector is enhanced through mergers and acquisitions. It permits banks to achieve a world class position and throw superior value to the stakeholders.
- The impact of merger on a company’s stock and the effect on the equity share of the shareholder’s capital is usually proportional.
- Performance of the bank pre and post-merger usually is in the green and improved.
- Most findings/ research state that to a certain extent M&A’s have been successful in Indian banking sector.
- In today’s fast-growing world, mergers and acquisitions is an approach used by corporations for their growth, extending their business to other dominions and to overcome financial struggle.
- It can be observed that there are various recognized laws accessible in India on numerous modes of corporate restructuring namely the Companies Act, 2013, the Securities Contract Regulation Act, 1956, the SEBI Act, 1992, Insolvency and Bankruptcy Code, 2016, State Bank of India Act, 1955 and the Banking Regulation Act, 1949.

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- Abolition of competition between the banks is another aspect for bank mergers. By doing this considerable amount of funds used for supporting competition can be used for the growth banking business. Sometimes, a bank with a big bad debt portfolio and poor revenue will merge itself with another bank to seek backing for survival.

- Merger in India between unviable banks is growing quickly so that the weak banks can be reformed providing continuity of employment with the working force, operation of the assets blocked up in the unviable banks and adding beneficially to the prosperity of the nation through increased flow of funds.

- In the banking sector, important mergers and acquisitions in India in recent years include the merger between IDBI (Industrial Development bank of India) and its own subsidiary IDBI Bank in 2004. The deal was worth USD 174.6 million (INR 7.6 billion in Indian currency).

- Another important merger was that between Centurion Bank and Bank of Punjab in 2005, worth USD 82.1 million (INR 3.6 billion in Indian currency), this merger led to the creation of the Centurion Bank of Punjab with 235 branches in different regions of India,

- The economic environment is full of problem for the small and medium sized banks, due to superseded technology, insufficiencies of resources, faltering marketing efforts and weak financial structure. Their existence becomes a question of doubt without new techniques and innovations and they have a threat from the larger banks. Their restructuring through merger could offer a relief and help them to revive.

- So far bank mergers have provided a protection to weak banks from closing down and failure. Smaller banks fearing aggressive acquisition by a large bank sometimes enter into a merger to increase their market share and protect themselves from the possible acquisition. Even RBI has taken initiative for the same and the primary objective behind this move is to attain growth at the strategic level in terms of size and customer base.

- This, in turn, upsurges the credit-creation capacity of the merged bank tremendously. Bank mergers make the bank vigorous to survive in the changing business environment. Through mergers the weaker banks find it easier to adapt themselves quickly and grow in the domestic and international financial markets.

Reasons for Mergers & Acquisitions in Banks

Mergers and acquisitions have moulded the Indian Banking sector in a perfect manner. Though there seem to be diverse opinions on this particular material, yet there is always hope for an improvement in the current condition after bank mergers:

The following are the reasons for the mergers to take place in banks.

- **Merger of weaker banks:** The exercise of merger of weaker banks with stronger banks was encouraged in order to provide stability to weak banks but Narasimhan committee conflicted with this practice. They said that mergers can diversify risk management.

- **Rise in market competition:** Invention of new financial products and merging of regional financial system are the reasons for merger. Markets industrialized and became more competitive and because of this, market share of all individual firm condensed and hence, mergers and acquisition started.

- **Economies of scale:** Ability of producing economies of scale when firms are merged.

- **Skill & Talent:** Allocation of skill takes place between two organization which helps them to progress and become more competitive.

- **Technology and Products:** Introduction of e- banking and some monetary instruments/ derivatives. Removal of admission barrier opened the gates for new banks with high technology and old banks can't compete with them and hence they decide to merge.

- **Positive Synergies:** When two companies merge their sole motive is to create a positive result which is higher than the shared effect of two individual companies working alone. Two features of it are cost synergy and revenue synergy. Ill performing banks survived after merger and enhanced branch network geologically.

- **Larger Customer Base:** i.e., through rural reach and increased market share. Achievement of infrastructure & restrict competition and prevent congestion of banks & utilize underutilized resources so that the banks can contest with the foreign banks in a global era.

Government Objective?

Objectives of Amalgamation

The announcement of amalgamation are usually (in recent government’s tenure) was made with the following objectives:

1. Unlocking potential through consolidation - creation of Next Gen Banks.
2. Repositioning PSBs with scale for building of USD 5 Trillion Economy.
3. Big banks with Enhanced capacity to increase credit.
4. Creation of Banks with a strong national presence and international reach.
5. Operational efficiency gains to reduce cost of lending.
6. Enhanced risk appetite.
7. Wider offerings with enhanced customization.

Merger of Several Public Banks

- The merger of public sector banks (PSBs) involves integration of six weaker PSBs with four better performing ‘anchor’ banks.
- Andhra Bank and Corporation Bank were merged with Union Bank while Oriental Bank of Commerce and United Bank were merged with Punjab National Bank.
- Syndicate Bank has been merged with Canara Bank, while Allahabad Bank with Indian Bank.
- The mergers took effect from 1.4.2020.
- Dena bank and Vijaya bank were merged with Bank of Baroda in 2019.
- Punjab National Bank (PNB) has become the country second-largest bank, with business size of INR17.94 lakh crore, after SBI which has the business of over INR 52 lakh crore.
- Canara Bank has become the fourth-largest public sector bank of the country. After the merger, the combined business is INR 15.20 lakh crore and a lower gross NPA ratio of 8.77%.
- Union Bank of India post-merger has become 5th largest PSB. The combined business base of the merged bank is INR 14.59 lakh crore. Union Bank has a high Net NPA ratio of 6.85%.
- Indian Bank has assets of INR 8.07 lakh crore post-merger becoming 7th largest PSB. Indian Bank had a net NPA ratio of 3.75%.

Amalgamation of Andhra Bank & Corporation Bank into Union Bank of India

- The Central Government in exercise of the powers conferred by Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/ 1980 after consultation with the Reserve Bank of India notified the Amalgamation of Andhra Bank and Corporation Bank into Union Bank of India Scheme, 2020 ("Amalgamation Scheme") vide gazette notification dated March 4, 2020.

- Union Bank once stated that it has become the country's fifth largest public sector lender after amalgamating Andhra Bank and Corporation Bank into itself. The merger, effective from Wednesday, will harness rich individual legacies and forge a dynamic shared future.

- As of now, all employees, customers and branches of Andhra Bank and Corporation Bank will become part of the Union Bank of India

- The amalgamation is also expected to generate cost and revenue synergies to the tune of INR 2,500 crores over the next three years.

- Customers get much wider access to branches, ATM, digital services and credit facilities and are now in a much stronger position as a bank. The bank offers a wide array of products and services to more than 120 million customers across its over 9,500 branches and more than 13,500 ATM's.

- Combined, they are India's fourth largest banking network and fifth largest public sector bank.

- It further said in order to minimize disruption, the account numbers, IFSC codes, debit/credit cards and internet/mobile banking portals and login credentials will remain the same.

Amalgamation of Syndicate Bank with Canara Bank

- Syndicate Bank was one of the oldest and major commercial banks of India.
- At the time of its establishment, the bank was known as Canara Industrial and Banking Syndicate Limited.
- The bank, along with 13 major commercial banks of India, was nationalised on 19 July 1969, by the Government of India. The Bank was headquartered in the university town of Manipal, India.
- On 1 April 2020, the bank was merged into Canara Bank.
- The combined Bank will have 10,391 branches and 12,829 ATMs.
- It will have a combined strength of 91,685 employees.
- The amalgamated Bank shall massively enhance the reach of banking services to the larger public and augment the financial inclusion activities currently underway.

Amalgamation of Allahabad Bank with Indian Bank

1. Allahabad Bank was headquartered in Uttar Pradesh's Allahabad initially. It also had its presence in Gwalior district of Madhya Pradesh 45 years ago. The headquarters was later shifted to Kolkata after 20 years of establishment.

2. Allahabad Bank has the largest number of fixed assets as compared to other banks. The bank has the largest number of 3,230 branches across the country primarily located in UP, Bengal at number two, Bihar in the third position and Madhya Pradesh at four (150 branches).

3. Finance Minister Nirmala Sitharaman had announced the merger of several public sector banks in Budget 2020 held in March last year. The Indian Bank announced a share swap ratio of 115 equity shares of Rs 10 each for every 1,000 shares of Rs 10 each of Allahabad Bank. As per the scheme, Allahabad Bank was amalgamated into Indian Bank, along with nine other PSBs merged into four.

4. Allahabad Bank has the largest number of fixed assets as compared to other banks. The bank has the largest number of 3,230 branches across the country primarily located in UP, Bengal at number two, Bihar in the third position and Madhya Pradesh at four (150 branches).

5. It announced a fair equity share exchange ratio of 115 equities of Rs 10 each for every 1000 shares of Rs 10 of Allahabad Bank as part of the amalgamation of the latter in the Bank.

6. The Board of Directors, in a meeting, approved that the share exchange ratio, subject to statutory and regulatory approvals.

7. A grievance redressal committee headed by retired Judge of Madras High Court, Chitra Venkataraman was formed to address the grievances of minority shareholders individually and collectively holding at least one per cent of the total paid-up equity capital of one of these two Banks.

The Legal Implications of PSB Mergers

- Generally, the leading legislation to govern private banks and other related banking companies is the Banking Regulation Act of 1949 ("BR Act"), where such a merger between banking companies is guided by section 44A of the BR Act.

- Under this provision, a scheme of such amalgamation is required to be approved by a two-third majority of shareholders of each amalgamating company, present either in person or proxy at the respective general meeting so convened for the consideration of the scheme.

- What is to be noted here is the non-absolute applicability of the provisions of the Act as regards government-owned and state run-banks, including Regional Rural Banks.

Several benefits are pointed out by the government to support the restructuring of PSBs. When the large entities are created by merging the existing small businesses, it brings some economies of scale advantages like low costs. Following are the main advantages expected by the government out of the consolidation.

- **Operational efficiency will improve:** consolidation under big banks will enhance the operational efficiency. Large means the benefit of consolidated control.

- **Reduced number of boards:** With reduced number of banks, the government can reduce the number of bank boards as well. Number of boards will come down and the number of board members will be rationalized and reduced.

- **Cost of lending will come down:** with less fragmentation, cos structure will come down and this will help to reduce the interest rate for loans and deposits.

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- All the assets of the amalgamating banks will become the assets of amalgamated banks and hence the customers will enjoy the greater services of the Banks.

- All the existing customers of amalgamating banks will become the customers of the amalgamated bank. They just have to get their passbook, cheque book renewed as and when they visit the concerned branch.

- All the employees of the amalgamating banks will become the employees of the amalgamated banks and hence there will not be any effect on their employment.

- All the branches of the amalgamating banks will become the branches of amalgamated bank.

Impact of These Mergers on Shares

- The shares of the public sector banks closed after the mega merger of the PSU banks came into force. The Shares of Punjab National Bank dropped by 5.72%, while Canara Bank fell marginally by 0.17% on the BSE.
- On the other hand, Indian Bank gained 1.86% and Union Bank of India rose marginally by 0.17%.
- The wider market portrayed a weaker trend, with the 30 share BSE barometer tanking 1,203.18 points or 4.08% to close at 28,265.31.
- This consolidation of banks maintains certain significance as it took place at a time when the entire country is under the garb of the COVID-19 outbreak, which had triggered a long and continuous lockdown in the country.

Analysis of Public Sector Banks Mergers

- The merged PSBs total assets account for about 90% of all the PSBs. So the following analysis of data of all PSBs can be considered equivalently for the merged PSBs in the same reasoning.

- The following data has been summarized from RBI’s Financial Stability Report released in January 2021.

- Credit growth (y-o-y) of all banks, which had declined to 5.7% by March 2020, plummeted further to 5.0% by September 2020. For PSBs, credit growth zoomed from 3.0% in March 2020 to 4.6% in September 2020.

- The other business component or deposit growth of all banks was buoyant at 10.3% (y-o-y), driven by precautionary savings. PSBs recorded a growth of 9.6%, among the highest in the last five years.

- On the earnings front, PSBs net interest income (NII) grew at a much higher rate of 16.2% in September 2020 (13.0% in March 2020).
- Net interest margin (NIM) jumped up in September 2020. However, growth in other operating income (OOI) plummeted to 1.2% from 29.2% in March 2020.

- Earnings before provisions and taxes (EBPT) of PSBs grew by 17.6%. Return on assets (RoA) and return on equity (RoE) improved substantially with the recovery in RoE of PSBs being particularly noteworthy after languishing at sub-zero and near zero levels for the past four years.

- So profits parameters have recorded significantly optimistic growth for the merged PSBs in FY21.

Merits of a Bank Merger

- A large capital base would help the acquirer banks to offer large loans amount.
- Service delivery can get improved.
- Recapitalization need from the government to reduce.
- Customers will have a wide array of products like mutual funds and insurance to choose from, in additional to the traditional loans and deposits.
- Technological upgradation can be considered.
- Merger helps to reduce the cost of operation and
- It helps improve the professional standard.
- Provides better efficiency ratio for business operations as well as banking operations which is beneficial for the economy.
- Multiple posts get abolished, resulting in substantial financial savings.
- Banking mergers improve risk management.
- Merger helps the geographically concentrated regionally present banks to expand their coverage.

Demerits of a Bank Merger

- Bank officials and unions of PSBs are against the merger due to issues with employment, seniority, tenure, superannuation etc..
- Few large inter-linked banks can expose the broader economy to enhanced financial risks.
- The local identity of small banks is not that big.
- Customers feel harassed initially. This in reality has materialized and the banks are working on this.
- Acquiring banks have to handle the burden of weaker banks, resulting in risk exposure.
- It is difficult to manage the people and culture of different banks.
- Merger destroys the idea of decentralization as many banks have a regional audience to cater to and customers often respond very emotionally to a bank acquisition.
- Larger banks are more vulnerable to global economic crises, bail outs can cripple the entire country's economy.
- Coping with staffers' disappointment could be another challenge for the governing board of the new bank which could lead to employment issues.

Conclusion

- The banking industry has been experiencing major Mergers and Acquisitions in the recent years, with a number of global players emerging through successive Mergers and Acquisitions in the banking sector. The current study indicates that the pre- and post- Mergers and Acquisitions of selected banks in India have no greater changes in profitability ratio; a few banks are satisfactory during the study period.

- But in future, there are robust projections of improvements in profitability. However, results specify that mergers led to higher level of cost efficiencies for the merging banks. Merger between distraught and strong banks did not produce any significant efficiency gains to participating banks. However, the forced merger among these banks prospered in shielding the interest of depositors of frail banks but stakeholders of these banks have not revealed any gains from mergers.

- The findings also establish that M&As impact on the shareholder value. The findings assert that the structural factors such as relative sizes of merging partners, technique of financing M&As and the number of bidders in M&As have the ability to influence the realization of a M&As success.

- The findings indicate the importance of considering the size of a potential target, the method to be used in funding M&As. The findings note that the structural factors acting autonomously have the potential to influence the shareholder value. This infers that the administration of banks and other organizations intending to undertake M&As should seek to evaluate and consider how these structural factors are likely to impact on the achievement of the intended M&As.

- The Indian financial system requires very huge banks to absorb several risks that have appeared from operating in local and international market. The prime aspects for future mergers in Indian banking industry included the challenges of free convertibility and requirement of large investment banks. Therefore, the Government and policy makers should be more thoughtful in endorsing merger as a way to gain economies of scale and scope.

THANK YOU