# MERGER OF BANKS : INDIAN PERSPECTIVE

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## Abstract

*Financial intermediation is a vital component in supporting the country's economic growth. The Indian banking sector has been constantly evolving and a major impetus came from the nationalisation of commercial banks with social objectives, subsequently, it has been witnessing a wide range of policy-induced reforms and structural changes since the early 1990s. A Bank merger is a situation where two banks combine their liabilities and assets to become one bank. Nearly every middle-market bank in India is planning to merge with another bank to expand its reach and gain new customers' attention. Merging helps a financial institution to grow faster and achieve huge credibility in the market. A merger gives a financial institution more capital to work with and upscale their geographic reach in which they operate. If a small bank wants to achieve financial goals quickly, it is a great option for it. One of the significant benefits of bank mergers is that it reduces the weakness and gets the market's competitive edge. In the merger process, the merging banks share information related to technology, cash, resources, data, etc.*

*The new steps toward consolidation of the public sector banks (PSB) are among the most distinguished events in the financial landscape of the country in recent years which would result in a major transformation, in line with the Narasimham Committee report (1991) to create a few but strong banks that can compete at the national as well as at the international level (Das, 2019). The paper, thus, upheld both the competition-stability as well as competition-fragility views for banks in India the paper provided evidence in support of the recent attempts at consolidation, merger among public sector banks and examined certain important aspects of concentration, competition and soundness of banks during the period.*

***Keywords: Merger, Banks, Acquisition***

**Introduction:**

The recent spate of consolidation of PSBs started with the merger of a few associate banks of State Bank of India (SBI) and another Public Sector Banks(PSB) with SBI in April 2017. Exactly after two years, i.e., in April 2019, two more PSBs were amalgamated with Bank of Baroda (BoB). The purpose was to form strong and competitive banks through consolidation among PSBs as announced by the Government of India (GoI, 2019). In April 2020, the Government of India (GoI) consolidated ten PSBs into four and termed it as mega consolidation (GoI, 2020). Punjab National Bank (PNB) and Union Bank of India (UBI) amalgamated two PSBs each while Canara Bank and Indian Bank merged one PSB each into them. Consequently, the number of PSBs went down from 27 in March 2017 to 12 in April 2020. It is, thus, observed that consolidation of PSBs, although recommended in 1991, was implemented since 2016 (GoI, 2017). The mega consolidation is expected to enhance the competitiveness of the PSBs and stimulate the banking activity in the country (GoI, 2020). Referring to the benefits enjoyed by large banks due to risk diversification, Gandhi (2016) mentioned losses of such benefits if the size of a bank exceeded a threshold.

**Objectives of the study:**

- To enlighten the list of merger and amalgamation of banks
- Need for merger
- Advantages and disadvantages by merging of banks
- Issues faced by mergers

**Need for the study:**

Pointing out the absence of clear research on the issue, it is also emphasised the need for such research to determine the soundness of Banks due to merger.

**Methodology:**

Data and information is collected from various reports like annual accounts of reserve bank of India, trends and progress of RBI, data from IBA, scheduled commercial banks (SCBs)

**Review of Literature :**

Regarding consolidation in the financial sector in emerging economies, the IMF (2001) suggested that consolidation facilitated relatively small-sized banks to expand activities, and thus, helped to increase efficiency in terms of cost and revenue. It, however, suggested that the consolidation of financial institutions added new dimensions in their regulation and supervision. Public policy and also theoretical views on the link between consolidation and fragility in the banking system are not uniform (Beck et al., 2005).

The OECD (2010) presented a rich review of analytical findings on the impact of concentration on banking system stability. Theoretical findings in the report suggested banking systems with a high degree of concentration as being profit worthy and less risk prone. The report also stated that banks were well-protected from concentration risk due to more diversification through a geographical spread and a higher range of products. The larger size also helped the banks in a system with a high degree of concentration on the deployment of advanced risk management tools. On the other hand, high market power might increase portfolio risk on account of higher lending rate, tempting towards riskier assets and implicit guarantee for too-big-to-fail status. Moreover, an increase in size could also create issues relating to transparency, regulation and internal control.

Allen and Gale (2000), Boyd et al. (2004), Boot and Thakor (2000), Boyd and Prescott (1986) and Méon and Weill (2005) found that increase in concentration had a favurable impact on soundness at an individual as well as systemic level (OECD, 2010).

A banking system with higher concentration could also face the risk of contagion (Beck, 2008). Some of the views claimed that stability was more in a banking system with higher concentration, as banks in a competitive environment might take undue risks due to excessive pressure on profits that could cause fragility concern in the system, while banking system with a high degree of concentration due to a smaller number of banks facilitated better portfolio diversification and lesser burden on the supervisor (Beck, 2008). Some other views, however, suggested that policymakers were likely to focus more on bank failures in a banking system with a lesser number of banks and hence would give higher subsidies due to 'too big/ important to fail' policy which would tempt the banks to take higher risks that might eventually result in fragility in the system (Mishkin,1999).

Talwar (2001) did not find a significant impact of consolidation on the banking system, possibly because there were fewer instances of consolidation in the 2000s.

Bhattacharya and Das (2003) also found that in spite of some mergers in the late 1990s, the impact on concentration in banking was not significant. Regarding competition in the Indian banking system, Prasad and Ghosh (2005) found it as monopolistic for the period 1997-2004. RBI (2008) rejected the monopoly and perfect competition hypotheses and favoured the view that revenue generation by Indian banks happened under monopolistic competition, where the period covered was from 1990 to 2007.

Misra (2011) found monopolistic competition for the Indian banking system in his study that covered the period from 1997 to 2008.

It was also indicated by Subbarao (2013) about a monopolistic situation in view of significant asymmetry in the size of banks in the country. Ansari (2013) found monopolistic competition among banks in India for the period 1996–2011 based on an augmented Boone indicator. Dutta (2013)'s study that covered the period from 1997-98 to 2004-05, found improvement in a competitive environment in the banking sector in India during post-reform. S

arkar and Sensarma (2016) found monopolistic competition for the period from 1999-2000 to 2012-13.

Sinha and Sharma (2016) found a non-linear relationship between stability index and competition for Indian banks based on their study for the period from 2000 to 2015. They suggested that concentration and competition worked simultaneously to support the competition-fragility view for Indian banks. In their 2018 paper, they found that the Indian banking market operated under monopolistic competition for the period 2000-2014 but observed a decline in the intensity of competition in 2008-14 vis-à-vis that in 2000-07 (Sinha and Sharma, 2018).

Kumar and Gulati (2019) also found monopolistic competition in the banking sector in India in their study for the period from 1998-99 to 2015-16. Based on the risk-adjusted Lerner Index, Arrawatia et al. (2019) found improvement in competitive condition for the overall period 1996 to 2016 in Indian banking. Rakshit and Bardhan (2019) found that the Indian banking system was competitive in general in their study for the period 1996-2016 based on the Lerner index, adjusted Lerner index, and Boone indicator. Li et al. (2019) also found monopolistic competition for the banking sector in India in their study for the for the period 2005 to 2018.

**Mergers in the Indian Banking Industry**

Bank mergers in India were government policy driven during the nationalisation phase (1960 to 1969), when distressed banks were consolidated with stronger banks. Subsequently, however, there was a relative null in the merger activity till the economy embarked on the liberalisation process (Table 1). The intellectual rationale for bank mergers in the post-liberalisation period was provided by the Narasimhan Committee Reports (1991, 1998)—that recommended banking consolidation, both in the public and private sectors and even with financial institutions and NBFCs—to make them stronger and more competitive.

In contrast to the nationalisation phase, the consolidation during the post-liberalisation phase was primarily market-driven with an objective to enhance efficiency and gain greater resilience. The banking sector made a turn around in 1994-95 with a net profit of 27 PSBs after incurring losses in the previous two financial years (Talwar, 1998). Moreover, eight new private sector banks started functioning during the period from May 1994 to April 1995 (RBI, 1995). 2019-20 was the latest year up to which data on annual accounts of SCBs were available at the time of preparation of the paper

The consolidation of a few Public Sector Banks was the prime news of 2020. The count of Public Sector Banks plummeted to 12 banks. This is indeed a significant reduction. The aftermath of this consolidation is the matter of discussion in this article, particularly dealing with the issues of such mergers.

India is the sixth-largest economy in the world. The Gross Domestic Product of India in the year 2014 is $1.85 Trillion and in 2018 the rate elevated to $2.7 Trillion. The Gross Domestic Product (GDP) reflects how big the economy is. The Government is striving to make India's GDP rate $5.33 Trillion by 2024. The mega-merger of Public Sector Banks which we will explain eventually here was a step taken by the Government to achieve the $5.33 Trillion economies. Important issues, as well as merits, are described here for readers' perusal.

The nationalization of the State bank of India in 1955 marked the beginning of the Public Sector Banking System in India. The merging history of public sector banks goes back to 2008 when the State Bank of Saurashtra got merged with the State Bank of India. The State Bank of India which was established in 1955 by the nationalization of the Imperial bank of India is the largest bank today. 2010 witnessed the merger of the State bank of Indore with the State Bank of India. The mega-merger of the subsidiaries of the State Bank of India occurred in 2017. In addition, Vijaya Bank and Dena Bank merged with Bank of Baroda in

2019. Another mega-merger is the latest one that occurred in 2020 which is explained subsequently here.

India witnessed in 2017, the mega-merger of the State Bank of India. The State Bank of Mysore, State Bank of Travancore, State Bank of Hyderabad, State Bank of Patiala, State Bank of Bikaner, and Jaipur and Bhartiya Mahila Bank Ltd merged with State Bank of India.

This made SBI one among the top 50 banks in the world. The merger resulted in achieving Economies of Scale. The increase in the branch network with more qualified employees and effective resources combined with the hike in the price of shares of SBI proved the merger as a successful one.

During 1997-2022, there were 40 bank amalgamations, out of which 12 were between private sector banks (PVBs) and PSBs, 16 were amongst PSBs and the remaining 12 were between PVBs and foreign banks. The consolidation of State Bank of India (SBI) with its associates (during 2008-2017) and the mega merger of ten banks into four in April 2020 account for majority of PSB mergers. Further, bank amalgamations prior to 1999 were primarily triggered by weak financial conditions of the acquiree banks whereas post-1999, business and commercial considerations (such as, the need for increasing market share, operational synergies, acquisition of a business unit or segment, etc.) have also influenced mergers between healthy banks (Leeladhar, 2008).

The study covers all registered M&As in the Indian commercial banking industry between 1997 to 2020. The following criteria was used for a merger to be considered under the study: (a) consistent data availability in line with the research design; (b) both the acquirer and the acquiree bank should either belong to public sector (PSB) or private sector (PVB) bank-group, and (c) a single merger application within the period of analysis, although there could be multiple acquiree banks during the same merger year. In cases with multiple mergers in consecutive years, the latest merger application was considered and a single merger observation was considered for cases where multiple acquiree banks were merged with an acquirer in the same year.[5] After applying these criteria, the sample reduced to 17 merger cases during 1997-2017 (Annex I) and five merger cases during 2019-2020 (Annex II). Table 2 illustrates the descriptive statistics of the acquiree and acquirer banks involved in M&As during 1997-2017.

Bank-level financial data from 1994 to 2022 was compiled from audited financial statements of banks and Statistical Tables Relating to Banks in India (STRBI) published by the Reserve Bank of India (RBI). Apart from acquiree and acquirer banks, data was also collated for all the remaining PVBs and PSBs operating in India, as the latter group formed the 'control group' for statistical analysis.

**Annexure – I**

**Annex I: List of M&As during 1997-2017**

| Sr. No. | Name of Transferor Bank/ Institution | Name of Transferee Bank/ Institution | Date of Amalgamation | Merger Type |
|---|---|---|---|---|
| 1 | Punjab Co-operative Bank Ltd. | Oriental Bank of Commerce | April 8, 1997 | PVB to PSB |
| 2 | Bareilly Corporation Bank Ltd. | Bank of Baroda | June 3, 1999 | PVB to PVB |
| 3 | Times Bank Ltd. | HDFC Bank Ltd. | February 26, 2000 | PVB to PVB |
| 4 | Bank of Madura Ltd. | ICICI Bank Ltd. | March 10, 2001 | PVB to PVB |
| 5 | Benares State Bank Ltd. | Bank of Baroda | June 20, 2002 | PVB to PSB |
| 6 | Nedungadi Bank Ltd. | Punjab National Bank | February 1, 2003 | PVB to PSB |
| 7 | Global Trust Bank Ltd. | Oriental Bank of Commerce | August 14, 2004 | PVB to PSB |
| 8 | Ganesh Bank of Kurundwad Ltd. | Federal Bank Ltd. | September 2, 2006 | PVB to PVB |
| 9 | United Western Bank Ltd. | IDBI Ltd. | October 3, 2006 | PVB to PSB |
| 10 | Bharat Overseas Bank Ltd. | Indian Overseas Bank | March 31, 2007 | PVB to PVB |
| 11 | Sangli Bank Ltd. | ICICI Bank Ltd. | April 19, 2007 | PVB to PVB |
| 12 | Centurion Bank of Punjab Ltd. | HDFC Bank Ltd. | May 23, 2008 | PVB to PVB |
| 13 | State Bank of Saurashtra | State Bank of India | August 13, 2008 | PSB to PSB |
| 14 | Bank of Rajasthan | ICICI Bank | August 12, 2010 | PVB to PVB |
| 15 | State Bank of Indore | State Bank of India | August 26, 2010 | PSB to PSB |
| 16 | ING Vysya Bank | Kotak Mahindra Bank | April 01, 2015 | PVB to PVB |
| 17 | State Bank of Bikaner and Jaipur<br>State Bank of Hyderabad<br>State Bank of Mysore<br>State Bank of Patiala<br>State Bank of Travancore<br>Bhartiya Mahila Bank | State Bank of India | April 01, 2017 | PSB to PSB |

Note:PSB: Public Sector Bank, PVB: Private Sector Bank

Source: STRBI, Various Issues.

| Annex II: List of Bank M&As during 2019-2020 | | | | | |
|---|---|---|---|---|---|
| **Sr. No.** | **Name of Transferor Bank/ Institution** | **Name of Transferee Bank/Institution** | **Official Announcement Date** | **Date of Amalgamation** | **Merger Type** |
| 1 | Vijaya Bank<br><br>Dena Bank | Bank of Baroda | January 02, 2019 | April 01, 2019 | PSB to PSB |
| 2 | Oriental Bank of Commerce<br><br>United Bank of India | Punjab National Bank | August 30, 2019 | April 01, 2020 | PSB to PSB |
| 3 | Syndicate Bank | Canara Bank | August 30, 2019 | April 01, 2020 | PSB to PSB |
| 4 | Andhra Bank Corporation Bank | Union Bank of India | August 30, 2019 | April 01, 2020 | PSB to PSB |
| 5 | Allahabad Bank | Indian Bank | August 30, 2019 | April 01, 2020 | PSB to PSB |
| Note: The merger between Lakshmi Vilas Bank and DBS India Pvt. Ltd., being a M&A transaction between PVB to FB, was not considered for the study<br><br>Source: STRBI, Various Issues. | | | | | |

**The Benefits Of Bank Mergers**

Nearly every middle-market bank in the industry is looking to either acquire another bank or be acquired, and it's likely that yours is no exception. Many banks see an acquisition or merger as a chance to expand their reach or scale up operations quicker. Yet, a bank acquisition is not without its drawbacks as well – particularly for the unprepared banking executive.

**Scale**

A bank merger helps your institution scale up quickly and gain a large number of new customers instantly. Not only does an acquisition give your bank more capital to work with when it comes to lending and investments, but it also provides a broader geographic footprint in which to operate. That way, you achieve your growth goals quicker.

**Efficiency**

Acquisitions also scale your bank more efficiently, not just in terms of your efficiency ratio, but also in terms of your banking operations. Every bank has an infrastructure in place for compliance, risk management, accounting, operations and IT – and now that two banks have become one, you're able to more efficiently consolidate and administer those operational infrastructures. Financially, a larger bank has a lower aggregated risk profile since a larger number of similar-risk, complimentary loans decrease overall institutional risk.

**Business Gaps Filled**

Bank mergers and acquisitions empower your business to fill product or technology gaps. Acquiring a smaller bank that offers a unique revenue model or financial product is sometimes easier than building that business unit from scratch. And, from a technology perspective, being acquired by a larger bank might allow your institution to upgrade its technology platform significantly.

**Talent And Team Upgrade**

While not a factor on the balance sheet, every bank benefits from a merger or acquisition because of the increase in talent at leadership's disposal. An acquisition presents the possibility of bolstering your sales team or strengthening your team of top managers, and this human element should not be ignored or downplayed.

**Disadvantages :**

**Poor Culture Fit**

Plenty of prospective bank mergers and acquisitions only look at the two banks on paper – without taking their people or culture into account. Failure to assess cultural fit (not just financial fit) is one reason why many bank mergers ultimately fail. Throughout the merger and acquisition process, be sure to thoroughly communicate and double-check that employees are adapting to the change.

**Not Enough Commitment**

Execution risk is another major danger in bank mergers. In some cases, banking executives don't commit enough time and resources into bringing the two banking platforms together – and the resulting impact on their customers causes the newly merged bank to fail completely.

Avoid this mistake by dedicating enough resources for a full integration of the two financial institutions.

**Customer Impact And Perception**

While undergoing an M&A event at your bank, it's critical that you pay attention to the impact it has on your customers. Especially with smaller community banks, customers often respond very emotionally to a bank acquisition – so it's essential that you manage customer perception with regular, careful communication. And once the merger or acquisition is fully underway, remember to consider the impact on your customers at every stage: Anything from changing technology platforms to financial products could impact your customers negatively if you don't pay attention.

**Compliance And Risk Consistency**

A final danger to consider during your next merger or acquisition is the risk and compliance culture of each bank involved. Every financial institution handlesbanking compliance and federal banking regulations differently, but it's important that the two merging banks agree on their approach moving forward. When two mismatched risk cultures clash during a bank merger, it negatively affects the profitability of the business down the road if they haven't come to a working solution.

Bank mergers and acquisitions are complex procedures with the possibility of extraordinary payoff – or extraordinary peril – so it's important that you handle your upcoming M&A event with care. Keep these benefits and dangers in mind as you combine the processes of each different bank, and you'll be on your way to a successful merger or acquisition.

Issues faced by Indian public sector banks post-merger

**Non-performing assets ratio**

A problem faced by merging of banks occurs when the Non-Performing Assets ratio is higher in any or all of the merging banks. For instance, the Non-Performing Assets ratio of Bank A is 2% and that of Bank B is 4%. Now, suppose Bank B is merging with Bank A. This of course will enlarge the Non-performing asset ratio of Bank B, and adversely affect its financial health, leading to a problematic situation.

Unemployment of bank employees

Mergers may also cause unemployment of bank employees. Employees may lose their job after the merger due to excess staff or as a part of reducing operating costs.

**Managerial efficiency**

Forcing a public sector bank to accommodate a weak bank, thereby, absorbing the liabilities, may reduce the managerial efficiency of the strong bank and it can also lead to a reduction in the incentive of the strong bank to perform well. This in turn will affect the overall financial performance of banks.

A merger is not a solution to bring down the number of bad loans. It can worsen the situation sometimes if not properly managed.

**Political pressure**

Non-performing assets are the major problem of any bank. Treating the cause of it is important rather than giving the burden to a stronger counterpart. Our country has witnessed political interference in what not. So is the case with banks. Many public sector banks are compelled to issue loans under political pressure even by compromising on the various criteria for issuing a loan. This eventually results in a growing number of Non-performing assets. Here, merging can only worsen the situation since merged banks with more lending power now have to issue more loans under political pressure.

**The issue faced by customers**

Another issue faced is by customers of public sector banks which got merged. The change in Indian Financial System Code (IFSC) blocks many of their funds. Also, old MICR cheques need to be replaced. They have to communicate the same to each of their lenders and that would be time-consuming and problematic. It is also likely that the account number and customer id may also change. Some customers may also face problems in merging their accounts if they have accounts in both transferee and transferor banks in the merger. Now, if they wish to close their accounts, banks may charge closing charges. Sometimes banks have to upgrade their system or technology to accommodate changes after the merger. This is altogether another headache for customers as they may face glitches in online banking and ATM services. Another probable event that may cause hardship to customers is the shut-down of some branches of the amalgamating bank. Customers who rely on such branches and are their home branches find it inappropriate.

**Unemployment**

The unemployment situation which already is a curse to India will worsen as fresh recruitments may come to a halt at least for se years.

**Merits of mergers of public sector banks**

The government of India’s determination and endeavour to help the banking sector that was ailing with a high rate of non-performing assets and consequent bad debts damaging its lending capacity paved the way for mega-merger in 2020.

Let's discuss the merits of the merger one by one.

**Recapitalization**

Coming to the merits of the merger of Public Sector Sanks, the foremost one is recapitalization. This leads to an increase in capital for lending. Lending is the primary function of any bank. An Enhancement in the lending rate means a rise in deposits. Among the indicators, these are vital in deciding the health of a bank.

**New generation banking**

Customers can now enjoy more ATMs and the services of next-generation banking. Having to choose from various services provided by new generation banks is indeed appreciable. They can explore their options in investment too. Departure from the traditional banking mechanisms in this technology-driven world is significant. Technical up-gradation on debit/credit cards is another merit. Some merged banks show high Non-performing assets ratio whereas some others show less. For example, the merger of Indian bank and Allahabad bank reflects a low non-performing assets ratio and the merged entity of Union Bank of India with Andhra Bank and Corporation Bank records a high non-performing assets ratio.

**Operating cost**

Reduction in operating costs is a significant outcome of the merger. This is evident from the merger of the State Bank of India and its subsidiaries. A Decrease in Management cost eventually results in less operation cost.

**Shareholders**

The impact of the merger on shareholders of Public Sector Banks differs depending on to which bank they get merged with, the non-performing assets ratio, etc.

**Global market**

The merger of Public Sector Banks results in the enlargement of anchor banks which will eventually aid them to enter the global market. An example of this is the 57$^{th}$ rank of the State Bank of India in the global bank ranking of 2021. The merger also enhances the customer base since the combined entity can now enjoy customers of two or more banks. Getting the benefits of enlargement and enhanced customer base, enable the combined entity to confront competition in the power and capacity of two or more banks. This is indeed better than resisting it in the capacity of a single bank.

**Conclusion**

Demerits always come with merits. One cannot exist without the other. Making the right decision should always be based on a careful analysis of the two. The Government's decision on Mega-Merger of Public Sector Banks invited many criticisms. It does have merits and demerits. This article explains both sides of the same coin that is the Mega-merger of 2020. Mergers can result in the economic growth and development of any nation due to their various merits. It also expands a business that is an important goal for any business. Thus tackling the demerits caused by mergers diligently and appropriately helps outweigh them.

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