CHAPTER-1
INTRODUCTION

1.1 Introductory Aspect of the Study:

"Banking is the lifeblood of any economy. So how can there be an economic recovery without a corresponding effect on the banking sector?"

Analysts- Dalal and Broacha Stockbroking

"The banking sector will see some kind of shakeout in the next few years with a spate of mergers and acquisitions resulting in widening the scope and quality for small banks,"

Rajesh Mokashi, Executive director of credit rating agency CARE.

The banking sector plays an all-encompassing role of a catalyst towards the socio-economic development of a country (Bonin and Wachtel,1999; Jaffe and Levonian, 2001; Rajan and Zingales, 1998; Wachtel, 2001). The Indian banking sector is referred to as the backbone of the Indian economy and occupies an important and pivotal place in a developing country like India. Since the inception of economic and banking reforms in 1990, there have been 22 amalgamations in the banking sector (Arunava Bhattachrya, C.A.K Lovell, Pankaj Sahay, 1997). Prior to 1999, most of these amalgamations were triggered due to weak financial and operating performance of the target bank, whereas post 1999, the amalgamations were primarily triggered for business and commercial reasons (Lakshmi Narayana, 2005;Monika, 2014). The post reform period saw a series of notable mergers and acquisitions, the prominent amongst them were Times Bank with HDFC Bank and Bank of Madura with ICICI bank. These acquisitions in the banking industry were clear indication that the banking sector was all set on the journey of consolidation with both the private sector banks and public sector banks on the lookout of suitable target banks (Aggarwal A.K., 2006; Goyal K.A. and Joshi Vijay,2011; Kuriakose Sony and Giresh Kumar G.S. ,2010; R Srivassan et al,2009). Few public sector banks, as in the case of State Bank of India, also planned to merge with their peers to consolidate their capacities and reap the benefits of economies of scale and scope and reduced costs (Anjali Prasad, 2004). It was the forces of liberalization, privatization and globalization that brought about a revolution and transformed the face of the financial sector especially the Indian banks (Sharma Meena, 2005;Lakshminarayan
P., 2005). There has been a paradigm shift from a regulated economy to a deregulated one and also in the manner of conducting business by banks. Globally mergers and acquisitions have become a significant tool of corporate restructuring and the financial services industry has also experienced merger waves leading to the surfacing of very big banks and financial institutions (Beena, 2004; Rhodes, 1998). The significant force for mergers is severe competition among firms in the same industry which puts focus on economies of scale, cost efficiency, and profitability. The other factor behind bank mergers is the “too big to fail” opinion (Berger, et al, 1999).

In the post liberalization period of the Indian economy, the financial regulatory authorities and Reserve Bank of India* in particular have taken several steps towards consolidating the Indian banking sector (Panwar, 2011). These consolidation efforts are based on the fundamental belief that it would result in increased market reputation of the Indian banks and would result in synergies for the banks through economies of size, scale and scope (Lakshminarayan P., 2005). Apart from these benefits it would also enable each Indian bank to acquire adequate capacities and capabilities to compete and sustain the global competition which has increased due to opening of the Indian economy, especially in the post-liberalization period. Research studies show that analyzing the bank’s efficiency is noteworthy from both the macroeconomic as well as microeconomic perspective (Arunava Bhattacharya, Lovell and Pankaj Sahay, 1997; Suresh Kumar, 2013).

From the macroeconomic perspective it talks about the steps taken by the financial authorities, especially the Reserve Bank of India to structure and liberalize the Indian banking system and from the microeconomic perspective it deals with the efficiency and gain of each bank and its impact on the cost structure and stability of the financial market

*The central bank of India. Every country has its own central bank. The central bank of USA is called the Federal Reserve Bank, the central bank of UK is Bank of England and the central bank in China is known as the People's Bank of China and so on. Most central banks were established around the early twentieth century.
There has been a momentous revolution in the Indian banking system. This revolution has addressed several aspects of technology, modernization in product and service mix and customer reach. With advancement in technology and sophistication, the expectations of banking consumers have also increased (Humphrey, Willeson, Bergendahl and Lindblom, 2006). With an increase in competition that has become intense, with the arrival of foreign banks on the Indian banking platform, customers have several choices of banks available (Schneider, B. and Bowen, D.E., 1985). Hence survival of banks is becoming a major challenge in the arena of global competition (Khan Azeem Ahmad, 2011).

Banks need to be financially healthy to face the global competition and leverage on opportunities. Due to this growing intensity of competition, banks experience the urge of growth using inorganic tools like mergers and acquisitions (Satish Kumar and Lalit K. Bansal, 2008), since possibilities of organic growth and tools to increase market share have been completely exhausted (Satish Kumar and Lalit K. Bansal, 2008; Yadav and Kumar, 2005).

Research studies in this area do not adequately bring out the effects of restructuring in the Indian banking sector (Lakshminarayan P., 2003). Since banking system is the life line of the economy, and its efficiency is of vital importance to a developing country like India, studies addressing the effectiveness of this consolidation and its impact on the financial performance of banks become imperative. Such studies would also enable the policy makers to sharpen their thinking in the area and help them in adopting a more rigorous and decisive approach to bank consolidation to achieve the results desired. Besides this, it is evident from research literature that mergers and acquisitions has been an effective tool in restructuring of Indian banks (Satish Kumar and Lalit K. Bansal, 2008). Most of the research studies that aim at addressing the impact on the financial performance of banks due to mergers, assume either a market based approach or an accounting based approach (Healey, Palepu, and Ruback, 1992; Pawaskar, 2001; Ravencraft and Scherer, 1987). Event studies to ascertain the impact of mergers on banking performance post-merger require technical information and share price data which is readily available only for listed banks whose shares are publicly traded, however the accounting based study, linked to
accounting data is readily available in the financial statements of the banks (Beena, 2004; Sinha Pankaj and Gupta Sushant, 2011). The present study based on the accounting approach attempts to provide practical evidence of “Pre-Merger versus Post-Merger Performance evaluation of Public sector banks vis-à-vis Private sector banks in India that have merged during the period 1993-1994 to 2004-2005.”

1.2 Concept- Financial System:

Financial system is ‘a set of complex and closely connected or interlinked financial institutions, or organized and unorganized financial markets, financial instruments and services which facilitate the transfer of funds’. This structure refers to the outline and sequential order of the financial system in which it operates.

A financial system comprises of financial institutions, financial instruments, financial services and financial markets all the above would be regulated by various regulators such as Ministry of Finance, The Company Law Board, Reserve Bank of India (Central Bank), Department of Company Affairs, Insurance Regulatory and Development Authority (IRDA), Department of Economic Affairs, Securities Exchange Board of India (SEBI) etc. all these facilitate the smooth and efficient flow of funds in a legal way.

The Chart No-1.1 will depict the structure of the Indian Financial system:
The above chart depicts the entire structure of the Indian financial system; the focus of this study is only on the banking organizations.

1.3 Concept- Bank:

Bank in general terminology is referred to as a financial institute or a corporation which is authorized by the state or central government to deal with money by accepting deposits, giving out loans and investing in securities. A bank is a financial institution that provides banking and other financial services to their customers. Banks are a subset of the financial services industry.

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there was no security for public savings and no uniformity regarding loans disbursement. So as to overcome such problems the organized banking sector was established, which was fully regulated by the Indian government. The organized banking sector functioned within the financial system to provide loans, accept deposits and provide other banking services to the Indian customers.
The word ‘Bank’ has been coined from the Italian word ‘Banca’ which means a bench. The European money leader used to display their coins for the customer on the benches and from there came the definition of a bank.

The Banking Regulation Act of 1949, Sec 5 (i) (b) defines banking as
“Banking means accepting for the purpose of lending or investment, deposits of money from public repayable on demand or otherwise and withdrawal by cheque, drafts order or otherwise”.

Thus, the prime dictum of the bank would be accepting deposits from the public and lending for productive investments and payable of the money through cheques, drafts or orders etc. Banks play a vital role in channeling funds for borrowers to productive investment opportunities, and ensure that the economy as well as the financial system runs efficiently and effectively.

The following functions of the bank explain the need of the bank and its importance:

- To ensure safety of customers savings.
- To control the supply of money and credit
- To repose public confidence in the working of the financial system, increase public savings promptly and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal standards and setting (i.e. rate of interest, period of lending etc) to all types of customers

In the present scenario Indian banking sector has close to three quarters of the country’s financial assets and banks have been growing at the rate of around 18 % (Monetary policy statement 2013-14, by D.Subbarao, Ex. Governor RBI). At the top of the Indian banking system is the central bank of India known as Reserve Bank of India. The Reserve Bank of India is responsible for the Indian banking system since 1935. The commercial banks in India are segregated into public sector banks, private banks and foreign banks. All these banks fall under Reserve Bank of India (RBI) classification of Scheduled Commercial Banks (SCBs) ". Public Sector Banks (PSB’s),
Private and Foreign Banks are known as Scheduled Commercial Banks as they are included in the Second Schedule of the Reserve Bank of India Act, 1934.

The public sector banks were wholly owned by the government of India before the reforms. The PSB’s are the biggest players in the Indian banking system and they account for 70 % of the assets of SCB’s in India.

Indian banking sector can be divided into two important eras the pre –liberalization era and post liberalization era since 1991 (Sen, Kunal and R. Vaidya, 1997). This sector has seen tremendous amount of changes in the post liberalization era (Lawrence and Longjam, 2003; Ram Mohan, T T., 2007). The banking sector was highly regulated before the reforms of 1991, which was the pre liberalization era (Agarwal, R. N, 2003; Mohan and Rakesh, 2005; Ram Mohan, T T., 2007). During this era banks were instructed to maintain a high reserve ratio, the interest to be given out by the banks on the deposits and the interest to be charged on loans was also guided by the Government (Sen and Vaidya, 1997). Government had created priority sectors ** and banks had to lend out money to these priority sectors as per the guidelines ***.

* Scheduled banks in India are those that are listed in the Second Schedule of the Reserve Bank of India Act, 1934. RBI includes only those banks in this schedule which satisfy the criteria as laid down vide section 42 (6) (a) of the Act.

**Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. Typically, these are small value loans to farmers for agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections, accessed at http://rbi.org.in/scripts/FAQView.aspx?id=87.

This had led to the growth of the PSB and PSB’s accounted for 90.8% of aggregate deposits of SCBs.

The pre-liberalization period witnessed low profitability, increasing number of nonperforming assets and operational inefficiencies (Sen, Kunal and R. Vaidya, 1997; Shirai, Sayuri, 2001). The pre liberalization period also witnessed many mergers just that these mergers where directed by RBI. These were generally the mergers, where in a weak bank was taken over by a strong bank on the directions of RBI (Franz, H. Khan, 2007). However in the present era, the competitive market dynamics are driving the present day mergers.

In the post reform era, after the reforms were brought out on the recommendations of the Narsimhan Committees I and II*, the Indian banking sector started to grow leaps and bounds. The post liberalization era saw marvelous amount of change. In the recent times this sector has been witnessing significant changes in terms of regulations and effects of globalization. These changes have brought about structural and strategic changes in the Indian banking sector. For every change to pick up pace, some originator is necessary. For the Indian banking system, liberalization, privatization, deregulation and other market reforms have acted as the catalysts (Jagdish R. Raiyani, 2010). To keep up with the changing environment many different strategies have been assumed by this sector to remain competent, survive competition and to rush forward in the global arena. One such strategy is through the route of consolidation via merger and acquisition (Khan Azeem Ahmad, 2011; Lakshminaryanan, P., 2005; Pawan Sharma, 2012). The Indian government and Reserve Bank of India have been in favor of these mergers taking place in the Indian financial sector (Aggarwal, R.N, 1996; Duvvuri Subbarao, 2013; Khan Azeem Ahmad, 2011; Sharma Manoranjan, 2011)

* Narsimhan Committee on banking sector reforms (1998).
1.4 The evolution of the Indian banking system:

The 18th century earmarked the foundation of the Indian banking system. This sector has witnessed a wide variety of revolutionary reforms since then. Initially this sector performed vanilla banking services in the form of accepting deposits and lending to customers. Banking industry in the pre-independence era was developed with the Presidency Banks which were subsequently change into the Imperial Bank of India and consequently into the State Bank of India. The banking industry in the initial era was largely dominated by private ownership. The initial days of the industry saw majority of private ownership. However with the era of nationalization, major steps were taken towards public ownership and accountability. Hence the era from 1969 to 1980 transformed and revolutionized the face of the Indian banking industry through nationalization. As granting licenses to banks was further liberalized, the industry also began recognizing the importance of private and foreign players in a competitive setting and began moving towards a greater liberalized setting.

The evolution of the Indian banking industry spans across two centuries (Manish Khanna and Saurabh Kaushal, 2013). During this period immense development has been made by the industry, both in terms of services as well as in terms of regulatory framework. The ownership structure, products and services offered and the technology deployed has also undergone sea changes during this period. The growth can be organized into four distinct stages (Goyal, K. A. and Joshi, V., 2011; Manish Khanna and Saurabh Kaushal, 2013).

- Stage- 1- Pre-Nationalization period (prior to 1955)
- Stage -2 - Era of nationalization and consolidation (1955-1990)
- Stage -3- Introduction of banking sector reforms and partial liberalization (1990-2004)
- Stage-4 - Liberalization continues (2004 onwards)

In 1947, when India became independent, the banking system in India was fairly well structured with over 600 commercial banks operating in the country. However, soon after independence, there was a standing view that the banks from the regal legacy were biased in favor of granting working-capital loans to large traders and bulky firms. These banks were against granting credit to small-scale enterprises, agriculturists and commoners. In order to overcome such biases and to
cover the banking needs of a larger part of the economy, the Government of India (GOI) created the State Bank of India (SBI) in 1955. Despite this effort, GOI was of the opinion that SBI’s banking services did not reach out to the small scale industries and that especially the agricultural sector was not covered adequately. This was largely because the industrial houses maintained cordial relations with the commercial banks that helped them in fetching credit. Moreover there was also a keen thought that Indian banks need to play a fundamental role in the development strategy of the country by mobilizing wealth from all the sectors that were considered critical for economic growth. This resulted in policy change decision which caused a change in allotment and management of credit by Indian commercial banks through the wave of nationalization that began in 1969. Indian banks were nationalized, with the main objective of branch expansion and to conduit funds in line with the objectives of the five-year plan. In the first phase of nationalization, 14 major banks were nationalized which were having 500 million and above aggregate deposits (Reserve Bank of India, Publication, Evolution of Banking in India, The Reserve Bank of India, 2008).

The second wave of nationalization occurred in 1980, in order to encourage priority sector lending, widen the branch network, to provide banking services to the rural masses and aid to bridge the public deficit. Six banks were nationalized in the second wave(Reserve Bank of India, Publication, Evolution of Banking in India, The Reserve Bank of India, 2008).

The Indian financial sector has experienced a momentous structural transformation since the beginning of the financial liberalization in 1990’s. Apart from these economic reforms, significant changes were brought about due to the effects of liberalization, privatization and globalization (LPG). These changes were evident in structure, strategies and foci in many industries (Barnabas and Mekoth, 2010). Post liberalization phase witnessed major developments in banking sector (Lawrence, Peter and I. Longjam, 2003; Sathye, Milind, 2003). This phase opened up foreign banks entry into India. It also brought about deregulation of foreign ownership and geographical expansion of the banking industry by encouraging foreign banks to enter into banking markets of developing economies. Thus, the effect of liberalization and globalization in the banking environment witnessed two major implications that is competitive viability of domestic banks versus foreign banks on one side and private banks versus public sector banks on

1.5 Present structure of the Indian banking sector:

The current structure of the Indian banking industry has been analyzed on the basis of its organized status, business as well as products. This sector has a diverse structure in terms of its status, business and products.

The organized banking system can be categorized into two categories, (Refer Chart No- 1.2), comprising of scheduled and non-scheduled banks. Largely, this segment comprises of the scheduled banks, with the unscheduled ones forming a very small component.

**CHART NO- 1.2: THE PRESENT STRUCTURE OF THE INDIAN BANKING SECTOR.**

(Summarized from D&B Industry Research Service, Dr.D. Subbarao, speaking notes, 2013)

The Reserve Bank of India is responsible for the Indian banking system since 1935. The commercial banks which are included in second schedule of Reserve Bank of India Act 1934, known as Scheduled Commercial Banks (SCB) are further classified into five different groups
based on nature of operation and ownership. (Refer Table No-1.1)

i) Nationalized Banks

ii) State Bank of India and its Associates

iii) Private Sector Banks

iv) Foreign Banks

v) Regional Rural Banks (RRBs) *

The PSB’s were wholly owned by the Government of India before the reforms and are the largest players in the Indian Banking system.

**TABLE NO-1.1: SHARE OF BANKS IN THE BANKING SECTOR**

<table>
<thead>
<tr>
<th>Type of Banks</th>
<th>Number of Banks</th>
<th>Number of Branches</th>
<th>Percentage Share of Number of Branches</th>
<th>Market Share of Assets (Percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector</td>
<td>26</td>
<td>67,466</td>
<td>83.0</td>
<td>72.8</td>
</tr>
<tr>
<td>Private Sector</td>
<td>20</td>
<td>13,452</td>
<td>16.6</td>
<td>20.2</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>41</td>
<td>323</td>
<td>0.4</td>
<td>7.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>87</strong></td>
<td><strong>81,241</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>


1.6 Legal categorization of banks and its spread:

1.6.1 Scheduled Banks:

A scheduled bank is a bank that is listed under the second schedule of the RBI Act, 1934. All scheduled banks have to fulfill certain conditions to have been classified as a

* The main purpose of RRB’s is to mobilize financial resources from rural / semi-urban areas and grant loans and advances mostly to small and marginal farmers, agricultural labourers and rural artisans.
scheduled bank. These conditions are in respect of paid up capital and reserves. Apart from this they also have to satisfy RBI that its banking affairs are not carried on in a manner that is detrimental to the interest of the depositors and customers.

Scheduled banks are further classified into commercial banks and cooperative banks. The basic difference between scheduled commercial banks and scheduled cooperative banks is in their holding pattern. Scheduled cooperative banks are cooperative credit institutions* that are registered under the Cooperative Societies Act. These banks work according to the cooperative principles of mutual assistance.

**Scheduled Commercial Banks (SCBs):**

Scheduled Commercial Banks (SCBs) are largely responsible for the business of the scheduled banks. Scheduled Commercial Banks in India may be broadly categorized into the four groups based on their ownership and/or their style of operations. These are comprised of Public Sector Banks (26) (PSBs), Private Banks (20), Foreign Banks (41) and Regional rural banks as at August 2013 (Refer Table No-1.1). Together they fall under the Reserve Bank of India (RBI) classification of Scheduled Commercial Banks (SCBs). The public sector banks, which prior to reforms were wholly state owned, are comprised of nationalized banks and the State Bank of India and its Associates. Majority equity holding in the former is with the Government of India while the RBI holds majority equity in the latter. Private sector banks include the old private sector banks and the new generation private sector banks which were incorporated according to the revised guidelines issued by the RBI regarding the entry of private sector banks in 1993. As at end-March 2013, there were 14 old and 7 new generation private sector banks operating in India. State Bank of India and its five associates are known as a separate category of SCBs, because of the distinct statutes (SBI Act, 1955 and SBI Subsidiary Banks Act, 1959) that govern them.

Foreign banks are present in the country either through complete branch/subsidiary route presence or through their representative offices. Regional Rural Banks (RRBs) were set up in September 1975 in order to provide banking services to the rural economy and develop the rural economy. As of March 2013, there was 82 RRB’s operating in the country. (Refer Table No-1.2)

**TABLE NO-1.2: STATISTICS RELATING TO COMMERCIAL BANKS.**

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Commercial banks</td>
<td>291</td>
<td>288</td>
<td>222</td>
<td>182</td>
<td>173</td>
<td>170</td>
<td>167</td>
<td>167</td>
<td>173</td>
</tr>
<tr>
<td>a) Scheduled Commercial banks</td>
<td>286</td>
<td>284</td>
<td>218</td>
<td>178</td>
<td>169</td>
<td>166</td>
<td>163</td>
<td>163</td>
<td>169</td>
</tr>
<tr>
<td>of which : Regional Rural Bank</td>
<td>196</td>
<td>196</td>
<td>133</td>
<td>96</td>
<td>90</td>
<td>86</td>
<td>82</td>
<td>82</td>
<td>82</td>
</tr>
<tr>
<td>b) Non-Scheduled Commercial Banks</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Master Office File (latest updated) on commercial banks, Department of Statistics and information Management, RBI.

*Scheduled co-operative banks:*

The cooperative banking sector is the oldest section of the Indian banking system. Due to its vast geographical presence it is an important instrument of financial inclusion on a large scale. The co-operative banks are registered and administered by state governments under the respective co-operative societies acts of the respective states. They are also governed by the provisions of the Banking Regulation Act, 1949; they come under the control of the RBI as well. While the administrative aspects of these banks, registration, management, organization, recruitment, amalgamation, liquidation, etc are controlled by the state governments, matters related to banking are governed by RBI directives.
Both RBI and National Agricultural Board of Rural Development Bank * have taken rigorous measure to improve the financial stability of these banks since it wanted to encourage the concept of financial inclusion. Presently there are 26 scheduled co-operative banks in the country.

1.6.2 Non-Scheduled Banks:

Non-scheduled banks known as Local Area Banks** also function in the Indian banking system. As at end-March 2012 there were four such banks operating in India. Local area banks are banks that are set up under the scheme announced by the government of India in 1996***, in order to set up new private banks having a local character; with jurisdiction over a maximum of three contiguous districts. They aid in mobilization of funds of the rural and semi urban districts. Initially six such licenses were granted, but the license of one of such banks was cancelled due to irregularities in operations, and the other bank was amalgamated with Bank of Baroda in 2004 due to its weak financial position.

* NABARD is an apex Development Bank that facilitates credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts. It also has the mandate to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure prosperity of rural areas.

** The Local Area Bank Scheme was introduced in August 1996 pursuant to the announcement of the then Finance Minister. In his budget speech, the Finance Minister referred to the setting up of new private local banks with jurisdiction over two or three contiguous districts. He observed that this would enable the mobilization of rural savings by local institutions and make them available for investments in the local areas. The Local Area Banks (LABs) were expected to bridge the gaps in credit availability and strengthen the institutional credit framework in the rural and semi-urban areas.

All these banks have a widespread network through their branches. (Refer Table No-1.3)

### TABLE NO-1.3: NUMBER OF OFFICES OF COMMERCIAL BANKS IN INDIA DURING 2007-2013.

<table>
<thead>
<tr>
<th>Bank group</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI and its associates</td>
<td>14313</td>
<td>14680</td>
<td>15859</td>
<td>16913</td>
<td>18240</td>
<td>19027</td>
<td>19787</td>
</tr>
<tr>
<td>Nationalized Banks $</td>
<td>35866</td>
<td>37443</td>
<td>39283</td>
<td>41011</td>
<td>43654</td>
<td>46389</td>
<td>50527</td>
</tr>
<tr>
<td><strong>Public sector banks</strong></td>
<td><strong>50179</strong></td>
<td><strong>52123</strong></td>
<td><strong>55142</strong></td>
<td><strong>57924</strong></td>
<td><strong>61894</strong></td>
<td><strong>65416</strong></td>
<td><strong>70314</strong></td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>4817</td>
<td>4828</td>
<td>4703</td>
<td>4926</td>
<td>5245</td>
<td>5061</td>
<td>5610</td>
</tr>
<tr>
<td>New Private Sector Banks</td>
<td>2017</td>
<td>2598</td>
<td>3637</td>
<td>4335</td>
<td>5235</td>
<td>6984</td>
<td>8258</td>
</tr>
<tr>
<td>Private Sector banks</td>
<td>6834</td>
<td>7426</td>
<td>8340</td>
<td>9261</td>
<td>10480</td>
<td>12045</td>
<td>13868</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>259</td>
<td>272</td>
<td>279</td>
<td>295</td>
<td>310</td>
<td>319</td>
<td>324</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>14787</td>
<td>14827</td>
<td>15065</td>
<td>15508</td>
<td>15790</td>
<td>16185</td>
<td>16698</td>
</tr>
<tr>
<td>Local Area banks</td>
<td>41</td>
<td>48</td>
<td>48</td>
<td>49</td>
<td>54</td>
<td>54</td>
<td>57</td>
</tr>
<tr>
<td>All Commercial banks</td>
<td>72100</td>
<td>74696</td>
<td>78874</td>
<td>83036</td>
<td>88523</td>
<td>94019</td>
<td>101261</td>
</tr>
</tbody>
</table>

Data on Number of offices include administrative office and $ includes IDBI Bank

Source: Master Office File (latest updated) on commercial banks, Department of Statistics and Information Management, RBI.

1.7 The Indian banking scenario today:

Globalization, technological development and volatile stock market have created an unprecedented competitive environment for organizations across the world including banks (Kuppuswamy V. and Villalonga B, 2010) With the advent of liberalization, privatization and globalization, survival of corporate has become a challenge (Goyal K.A. and Joshi Vijay, 2011; Mehta Jay and Kakani Ram Kumar, 2006). It is becoming increasingly difficult for managers to create value that would delight the shareholders on a continuous basis (R.N. Arun and Raghunatha Reddy, 2007). India has a well-developed banking system. Most of the banks in
India were founded by Indian entrepreneurs and visionaries in the pre-independence era to provide financial assistance to traders, agriculturists and budding Indian industrialists. Indian banks have played a significant role in the development of Indian economy by inculcating the habit of saving in Indians and by lending finance to Indian industry.

In a dynamic global environment, growth opportunities and challenges come in various shapes and sizes, and they require innovative approach. Now-a-days domestic banks in emerging economies, including India, are stuck in the most compelling scenario of either to perform or perish (Duvvuri Subbarao, 2013). Traditionally, managers had concentrated on organic business growth, and achieved corporate growth by internal expansion or organic growth model (Sathye Milind, 2003). But, the changing market forces have necessitated banks to identify their competitive advantage so that they can reposition themselves to exploit the opportunities globally (Beena, P.L., 2008; Suresh Kumar, 2013).

In short, organizations are now looking forward to make hay while the global economy is shining brightly. Mergers and acquisitions have thus become an important tool for survival and growth in today's growing competitive market (Devos, E., Kadapakkam, P.R., and Krishnamurthy, S., 2008; R. Srivassan et al., 2009). More and more banks have been driven to acquisition as a growth strategy to secure and enhance complementary skills and resources, improve their technology portfolios, regional presence, customer relationships, distribution arrangements and operational competence (Suresh Kumar, 2013).

This trend of consolidation through mergers and acquisitions has spread through almost all the industry (Kumar, Satish and Bansal, Lalit. K., 2008; K. Mohan, 2006). However this trend is most evident in the banking industry (K. Mohan, 2006; ASSOCHAM study, 2009). Over the past decade, the banking industry has experienced an unprecedented level of consolidation as mergers and acquisitions among large financial institutions have taken place at record levels (Lakshminaryanan, P., 2005). In the last three years alone more than 1500 mergers have occurred in the US market.

This phenomena has been prevailing both in the developed and developing economies. But it is gaining more prominence in the present competitive business environment. The banking sector
which plays a very vital role in the economic development of India have been witnessing tremendous change (Deolalkar, G.H., 1999; V. Gangadhar, G. Naresh Reddy, 2007). The various players in the banking arena have already begun to feel the heat of the intense competition (Kishore Chandra Padhya, 2007). Merger and acquisition is one among the various modes of restructuring resorted by banks to ensure better growth prospects (B.K. Bhoi, 2000; Dilip Kumar Chanda, 2005; Panwar, S., 2011). Some of the reasons for this growing tendency of adopting merger and acquisition tactics are increasing needs to achieve economies of large scale, brand building and expansion of branch network over a larger geographical area. It is believed that by undergoing such merger and acquisition deals banks will emerge stronger, increase their earning capacity and strengthen their capital base (Devos, E., Kadapakkam, P.R., and Krishnamurthy, S., 2008).

Another up and coming reason for rapid consolidation in this sector is the growing presence of the foreign banks in the country. Currently foreign banks have been permitted to buy stakes in the Indian banks*. This adds more oil to the spreading fire of competition as foreign banks would consider mergers and acquisitions as a quick method of inorganic growth. In order to expand their presence in the Indian scenario they would join hands with other Indian banks. Such deals would enable it to have collective strength while doing banking business. With the changing era, Indian banking system is shifting from a system of large amount of small banks to a structure where in there are small number of large banks. This structure has already crept into the developed economies and has made history; however in emerging economies like India, this system is gaining prominence in present times. It therefore becomes important to understand and study whether mergers and acquisitions have enhanced the performance of Indian Public Sector Banks and

Indian Private Sector Banks and whether the desired objectives set in the acquisition have been achieved?

The Reserve Bank of India and other Indian financial regulators have supported such changes and are in favour of mergers and acquisition in the Indian financial system (K. Mohan, 2006; V Gangadhar and G Naresh Reddy, 2007). In recent times the global economy witnessed grave issues in terms of slip of financial and banking services and plummeting demand. Predictions of the financial sector became very uncertain causing recession in major economies (Madan Mohan Dutta and Suman Kumar Dawn, 2012). However, amidst all this pandemonium India’s banking sector has been amongst the few to preserve resilience (Vidyakala, k., Madhuvanthi, S., 2009).

A gradually increasing balance sheet, advanced pace of credit extension, increasing profitability and efficiency, lower incidence of nonperforming assets and focus on financial inclusion have contributed to making Indian banking sector vivacious and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling. The way forward for the Indian banks is to innovate and to take advantage of the new business opportunities and at the same time ensure continuous assessment of risks.

Thus, it has become far more essential to understand the role of the banking industry in nurturing the long term growth of the economy. The Indian banking industry which was clearly identified as an institution that takes deposits and lends money has come a long way. The Indian commercial banks offer a large variety services such as bank-assurance, remittances and securities trading. To keep abreast with the changing times and to remain aggressive in the global arena banks need to revolutionize in structure and constitution. With the lack of time at hand the chosen path is inorganic growth and hence mergers and acquisitions have emerged as the desired route to achieve growth.
1.8 Mergers and acquisitions in the Indian banking sector:

Corporate restructuring has gained considerable importance all over the world, because of intense competition, globalization and technological changes (Azhagaiah, R., and Sathish Kumar, T., 2011; Beena .P.L, 2004). The structural reforms started in the early 1990,s have compelled the Indian industries to adopt some centered strategies like rebuilding their existing structure by giving up non-core activities on one hand and taking up strategies like mergers and acquisitions on the other hand, the banking companies are no exception to this (Sen, Kunal and R. Vaidya ,1997). This process gained pace after the opening up of the Indian economy and flow of Foreign Direct Investments (FDI) * through various routes (Agarwal, R. N ,2003). This method of restructuring through inorganic path is quite at its juvenile stage in the Indian banking sector; in the western countries this method has gained momentum. The Indian banking sector is the life line of the economy. The banking sector reforms introduced in the early nineties and amendments made in these reforms are testimony to the overall economic reform program aimed at improving the competitiveness and effectiveness of the banking system. These reforms also aimed at making the banking system protected and sound. These reforms have ensured that capital adequacy of Indian banks are in line with international norms. Another notable achievement is that the level of non- performing assets (NPA’s)** has also reached controllable levels. Inspite of these developments there are still some of other issues that need to be dealt with by Indian banks on war footing like complying with Basel Norms***

*Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds, accessed at http://en.wikipedia.org/wiki/Foreign_direct_investment.

**Non Performing Assets (NPA’s): NPA is a classification used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principal payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in non-performing loans and often results in massive write-downs.

***Basel: Basel I is the round of deliberations by central bankers from around the world, and in 1988, the Basel Committee on Banking Supervision (BCBS) in Basel, Switzerland, published a set of minimum capital requirements for banks. This is also known as the 1988 Basel Accord, and was enforced by law in the Group of Ten (G-10) countries in 1992. Basel I is now widely viewed as outmoded. The world has changed as financial conglomerates, financial innovation and risk management have developed, and a more comprehensive set of guidelines, known as Basel II, are in the process of implementation by several countries. Basel III was developed in response to the financial crisis.
and facing competition from foreign banks. It is also evident that prior to 1999, the acquisitions were primarily triggered by weak financial performances and non adherence to norms. These reasons changed in the post 1999 period where acquisitions were more triggered by business and commercial reasons. The post reform era witnessed a series of notable mergers and acquisitions. (Refer Table No -1.4).

Development of structural, operational and financial efficiency of commercial banks has always been an issue for discussion in the Indian policy milieu and Government of India in consultation with Reserve Bank of India. The regulators have emphasized on restructuring of the Indian banking system with thrust on consolidation with three to four large banks at the all India level and the remaining at regional level. In order to set in the trend of consolidation, the regulators favored mergers among strong banks (Lakshminaryanan. P.,2005), both in the public sector and private sectors and even with financial institutions and non-banking financial institutions.

Restructuring of Weak banks:

With a view to restructure weak banks, the Government of India has adopted the route of mergers. This restructuring was with the motive of safeguarding the interest of the weak banks. Many small and weak banks have been merged with other banks mainly to protect the interests of depositors (Khan Azeem Ahmad, 2011). These may be classified as forced mergers. When a specific bank shows symptoms of financial distress such as huge NPAs, wearing away in net worth or considerable decline in Capital Adequacy Ratio, RBI imposes moratorium under Section 45(1) of Banking Regulation Act, 1949, for a specific period, on the operations of weak bank. In this moratorium period, RBI identifies a strong bank and asks that bank to prepare a scheme of merger. In the merger scheme, usually the acquiring bank takes up all assets and liabilities of the weak bank and ensures payment to all depositors in case they wish to withdraw their claims. Almost all the pre-reform period mergers fall in this category. In the post-reform period, out of twenty two mergers which have taken place so far, thirteen of them have been forced mergers; the chief reason for forced mergers was protection of the interest of the depositors and to safeguard the interest of the weak banks.
Voluntary mergers:

There are few mergers in the Indian banking sector with expansion, diversification, and overall growth as the primary objectives (Manish Khanna and Saurabh Kaushal, 2013). The first of its kind in the post 1993 period was the acquisition of Times Bank by HDFC bank subsequently followed by Bank of Madura’s acquisition by ICICI Bank. In some of these cases the target banks suffered from the problem of low profitability, high NPAs and lack of alternate avenues to increase Capital Adequacy. Hence the only available option was merger. Though there was no direct regulatory intervention the motive behind these mergers were also economies of scale economies and market power.

TABLE NO -1.4: LIST OF MERGERS AND ACQUISITIONS IN THE INDIAN BANKING INDUSTRY SINCE POST LIBERALIZATION.

<table>
<thead>
<tr>
<th>Name of the Transferor Bank</th>
<th>Name of the Transferee Bank</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Bank of India</td>
<td>Punjab National Bank</td>
<td>March 1993</td>
</tr>
<tr>
<td>Bank of Karad Ltd</td>
<td>Bank of India</td>
<td>September 1993</td>
</tr>
<tr>
<td>Kashi Nath Seth Bank Ltd.</td>
<td>State Bank of India</td>
<td>January 1996</td>
</tr>
<tr>
<td>Bari Doab Bank Ltd</td>
<td>Oriental Bank of Commerce</td>
<td>April 1997</td>
</tr>
<tr>
<td>Bareilly Corporation Bank Ltd</td>
<td>Bank of Baroda</td>
<td>June 1999</td>
</tr>
<tr>
<td>Sikkim Bank Ltd</td>
<td>Union Bank of India</td>
<td>December 1999</td>
</tr>
<tr>
<td>Times Bank Ltd.</td>
<td>HDFC Bank Ltd</td>
<td>February 2000</td>
</tr>
<tr>
<td>Bank of Madura Ltd.</td>
<td>ICICI Bank Ltd</td>
<td>March 2001</td>
</tr>
<tr>
<td>ICICI Ltd</td>
<td>ICICI Bank Ltd</td>
<td>May 2002</td>
</tr>
<tr>
<td>Benares State Bank Ltd</td>
<td>Bank of Baroda</td>
<td>June 2002</td>
</tr>
<tr>
<td>Nedungadi Bank Ltd.</td>
<td>Punjab National Bank</td>
<td>February 2003</td>
</tr>
<tr>
<td>South Gujarat Local Area Bank Ltd.</td>
<td>Bank of Baroda</td>
<td>June 2004</td>
</tr>
<tr>
<td>Global Trust Bank Ltd.</td>
<td>Oriental Bank of Commerce</td>
<td>August 2004</td>
</tr>
<tr>
<td>IDBI Bank Ltd.</td>
<td>IDBI Ltd</td>
<td>April 2005</td>
</tr>
<tr>
<td>Bank of Punjab Ltd.</td>
<td>Centurion Bank Ltd</td>
<td>October 2005</td>
</tr>
<tr>
<td>Ganesh Bank of Kurundwad Ltd</td>
<td>Federal Bank Ltd</td>
<td>September 2006</td>
</tr>
<tr>
<td>Bank Name</td>
<td>Acquirer Bank Name</td>
<td>Date</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>----------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>United Western Bank Ltd.</td>
<td>IDBI Ltd.</td>
<td>October 2006</td>
</tr>
<tr>
<td>Bharat Overseas Bank Ltd.</td>
<td>Indian Overseas Bank</td>
<td>March 2007</td>
</tr>
<tr>
<td>Sangli Bank Ltd.</td>
<td>ICICI Bank Ltd.</td>
<td>April 2007</td>
</tr>
<tr>
<td>Lord Krishna Bank Ltd.</td>
<td>Centurion Bank of Punjab</td>
<td>August 2007</td>
</tr>
<tr>
<td>Centurion Bank of Punjab Ltd.</td>
<td>HDFC Bank Ltd.</td>
<td>May 2008</td>
</tr>
<tr>
<td>The Bank of Rajasthan</td>
<td>ICICI Bank Ltd.</td>
<td>August 2010</td>
</tr>
</tbody>
</table>

**Source:** Summarized from Report on Trend and Progress, RBI, Various Issues, VIII competition and consolidation, 04 Sep 2008.

The highlights amongst them were Bank of Baroda acquiring Benares State Bank Ltd., Oriental Bank of Commerce acquiring Global Trust Bank Ltd., Times Bank with HDFC and reverses mergers of ICICI and ICICI Bank. The Indian Banking sector is all armed for consolidation with both the Indian commercial banks seeking to acquire foreign banks as well as to foray their presence the world over.

The process of consolidation* in the Indian banking system through the process of mergers and acquisitions has begun. What is the raison d'être behind bank mergers and acquisitions? These rationale supports to justify that mergers and acquisitions is imperative in the banking sector.

Large number of studies conducted on mergers and acquisition, suggests that it is most widely used strategic option by organizations for growth purpose. Grant Thornton (2006) conducted a survey of Indian corporate managers across various sectors.

Their findings revealed that mergers and acquisitions continued to be a significant form of business strategy for Indian corporate. (Refer Table No-1.5)

**TABLE NO-1.5: OBJECTIVES OF INDIAN CORPORATE FOR MERGERS AND ACQUISITIONS:**

<table>
<thead>
<tr>
<th>Rationale of Mergers and Acquisition</th>
<th>Response (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>To improve revenues and profitability</td>
<td>33</td>
</tr>
<tr>
<td>Faster growth in scale and scope</td>
<td>28</td>
</tr>
<tr>
<td>Acquisition of new technology or competencies</td>
<td>22</td>
</tr>
<tr>
<td>To eliminate competition and increase market share</td>
<td>11</td>
</tr>
<tr>
<td>Tax shields and investment savings</td>
<td>3</td>
</tr>
<tr>
<td>Any other reason</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Grant Thornton (India), The M&A and Private Equity Scenerio, 2006.

**1.9 Meaning of Mergers and Acquisitions:**

In the pursuit of growth, corporate resort to wide range of corporate restructuring activities like expansion, shrinkage, and changes in structure and ownership styles (Chakravarthi Anand, 2006). Expansion is carried out through mergers, acquisitions, tenders offers and joint ventures. The phrase mergers and acquisitions are often used interchangeably. The distinction between a "merger" and an "acquisition" has become increasingly unclear in various respects especially ultimate economic outcome(Sherman and Hart, 2006). From a legal point of view, a **merger** is a legal consolidation of two companies into one entity (European Central bank,2000;Gaughan,2002 ; Jagersma,2005) whereas an **acquisition** occurs when one company takes over another and completely establishes itself as the new owner (in which case the target company still exists as an independent legal entity controlled by the acquirer) (Chunlai Chen and Findlay,2003; European Central bank,2000). Either structure can result in the economic and financial consolidation of the two entities. Usually mergers occur in a friendly setting, where executives from the acquiring and target company conduct a thorough due diligence and ensure successful completion and integration of the two firms. Acquisitions on the other hand could
include friendly as well as hostile deals, wherein the target company may be acquired much against its wishes, though mechanisms like open market operations (Jagersma, 2005).

1.9.1 Mergers:

A merger is a combination of two or more companies into one company. One or more company may merger with an existing company or they may merge to form a new company. In a merger there is a complete amalgamation of the assets and liabilities as well as shareholders interests and business of the merging companies. As per Institute of Chartered Accountants of India, Statement of Accounting Standards (AS-14) - Accounting for Amalgamations- Laws in India use the terms Mergers and Amalgamation interchangeably.

This may take two forms:

i. Merger through absorption and

ii. Merger through consolidation.

Where absorption is merger of two or more companies into an existing company, whereas consolidation is a combination of two or more companies into a new company.

(i) Types of Mergers:

Mergers appear in three forms (Mirvis and Marks, 1992), based on the competitive relationships between the merging parties. The term chosen to describe the merger depends on the economic function, purpose of the business transaction and relationship between the merging companies (Nakamura, 2005).

Horizontal Merger
A horizontal merger occurs between business firms in the same industry. Horizontal merger is a business consolidation that occurs between firms who operate in the same space, often as competitors offering the same good or service. Horizontal mergers are common in industries with fewer firms, as competition tends to be higher and the synergies and potential gains in market share are much greater for merging firms in such an industry (Carey, 2000 in Harvard Business Review, 2001; Gaughan, 2002).
**Vertical Merger**
A vertical merger occurs between two business firms producing different goods or services for one specific finished product. A vertical merger occurs when two or more firms, operating at different levels within an industry's supply chain, merge their operations (Chunlai Chen and Findlay, 2003). Most often the logic behind this merger is to increase synergies created by merging firms and build an efficient supply chain (Coyle, 2000).

**Conglomerate Mergers**
This is a merger between firms that are involved in totally unrelated business activities. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve banks that are looking for product extensions or market extensions.

Conglomerate Mergers could be either
i. Market extension mergers or
ii. Product extension mergers.

**Market Extension Mergers**
A market extension merger takes place between two banks that deal in the same products but in separate markets. The main purpose of the market extension merger is to make sure that the merging banks can get access to a bigger market and that ensures a bigger client base.

**Product Extension Mergers**
A product extension merger takes place between two banks that deal in products that are related to each other and operate in the same market. The product extension merger allows the merging banks to group together their products and get access to a bigger set of consumers. This ensures that they earn higher profits.
1.9.2 Acquisitions:

The term acquisitions refer to acquiring of one company by another company. The control may be acquired either through purchase of majority of shares carrying voting rights, or controlling the composition of board of directors of the target company. The acquired company continues to exist but its share holder’s change without change in constitution.

1.10 Motives for banking mergers and acquisitions:

Research literature that explores the motives for banks to engage in mergers and acquisitions transactions have frequently cited synergy and valuation (the deal having a positive Net Present Value) (Trautwein, 1990) as the basic motives for any banking merger and acquisitions. The motives that are referred to in any acquisition can be summarized in the following four points (Gaugham, 2002)

1. As a way for banks to expand speedily;
2. To gain advantage of economies of scale and scope;
3. To increase size and therefore have access to a larger customer base, better access to capital markets and thereby financial benefits like lower cost of capital;
4. Have access to target banks management expertise.

A study (Calipha, Tarba and Brock, 2011) that reviewed mergers and acquisition motives and success factors in their article cited few motives like entering a new market, gaining new scarce resources, achieving synergies and other managerial and organizational factors that are associated with acquisitions i.e. relative size of acquisition partner, managerial involvement, culture and organizational structural issues etc. as few motives for banking acquisitions. The following can be some of the motives for mergers and acquisitions that are exclusively related to the Indian banking sector.
a. Stability and growth to bank:

Banks that desire rapid expansion in size or market share or diversification in the range of their products may find that a merger can be used to fulfill these objectives instead of going through the voluminous process of organic growth or diversification (Ghosh, A., 2001; Goyal Dr. K.A. and Joshi Vijay 2011). The Indian banking sector is considerably fragmented that creates lots of stress for Indian banks to maintain the statutory limits. Such fragmentation also poses risks for Indian banks. Fragmentation also erodes power of the top banking players in favor of other smaller banks (Dr. Rupa Rege Nitsure, 2008).

Also with a rise in competition and in the race to join the global band wagon, the fragmented banks with no economies of scale, low capabilities to manage risks and poor market power at times end up taking excessive risks resulting in irretrievable loss to their depositors. This also affects the financial regulators and the central bank negatively. History has several cases of such fragmentation issues in the past years:

a. Madhavpura Mercantile Co-operative Bank:
Nineteen customers had unsecured loans of more than INR 10 billion.

b. Global Trust Bank:
This bank had momentous coverage to high risk mid-size corporate and an excessive exposure to capital markets.

c. South Indian Co-operative Bank:
Increasing Non Performing Assets (NPAs) from unwarranted lending to small group of customers.

d. Nedungadi Bank:
Large part of the bank had significant exposure to plantation industry being in the southern part of the country. A larger reason was that the credit risk management systems of the bank were weak.

Alternatively banks can achieve the growth objective in a short period by merging. In addition, such a strategy is often less costly than the alternative of developing the necessary capability and capacity using the organic strategy.
b. **Entry into new markets and market leadership:**

Mergers enhance the value for shareholders of both banks through the amalgamated banks access to greater number of market resources (Gaughan, 1999; Mc Clure, 2009; Sherman and Hart, 2006). With addition to market share a bank can afford to control the price in a better manner with a consequent increase in profitability. Mergers are often undertaken on the underline of increased market share and to become a market leader. It reduces competition and thereby increases market standing and protects the position of the banks in the market. Mergers also protect dominant positions and eliminate the threat of increased competition.

Mergers and Acquisitions provide an effective platform to enter into new markets (Trautwein, 1990), add customer base and new customer network. Since banks are the lifeline of the economy, a thorough analysis would have to be done whether it is economically justifiable to enter into such markets, since very often in the enthusiasm of encashing on the banks core competency, banks may often tend to ignore some key elements in acquisitions which may lead to negative consequences.

c. **Diversification:**

Mergers and Acquisitions help in diversifying group lines of business and thereby reduce risks. It also helps to increase technical, marketing and financial resources and leads to increased market share (Coyle, 2000).

d. **Managing Bankruptcy Risks:**

Recent studies (Hannan and Pilloff, 2006) have proved that globally, mergers and acquisitions in banks significantly reduce the bankruptcy risk of the merged entity. Obviously, mergers would also provide these benefits to banks in India thereby reducing their bankruptcy concerns.
e. **Bottom Line Growth:**

Mergers and acquisitions or restructuring also help banks improve in three other areas as listed below which reinforces the cost management strategies through economies of scale and scope:

i. **Economies of Scale:**
   An acquirer bank would have the capabilities to improve the collections, service processes, distribution, infrastructure and IT of the target bank. 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 (Fontaine, 2007; Gaughan, 1999; McClure, 2009). Another important advantage behind this kind of merger is that in this process, competition is reduced because merger eliminates competitors from the banking industry.

ii. **Economies of Scope:**
   An ability to grow products and segments and an opportunity to cross sell would enhance revenue. This could also result in obtaining more geographic growth (Sufian, 2011).

iii. **Synergy Benefits:**
   Implies a situation where the combined bank is more valuable than the sum of the individual combining banks. It refers to benefits other than those related to economies of scale ((Miller, 2008; Paulter, 2001).

Operating economies are one form of synergy benefits. Treasury performance would also improve as the cost of funds would reduce (hence, improve spread) and would have a better credit rating. A bank would also be able to leverage scale and improve its trading income.
f. Adherence to norms:

Adhering to institutional and regulatory framework in India is vital for domestic banks aspiring for global operations. The central bank i.e., the Reserve Bank of India (RBI) has suitably changed the country’s regulatory framework from time to time to support Indian financial institutions to withstand the competitive pressures placed on them due to increasing globalization. Proper steps have been taken to guide the banking sector to see that the banks pass through this transition phase by and large successfully. With the RBI regulating the Capital to Risk-Weighted Asset Ratio (CRAR) at 9%, a percent above the Basel III CRAR*, going forward many banks would not be able to meet these requirements and may have to go through restructuring in order to meet the regulatory requirements.

Furthermore there are a number of banks in India whose growth is restricted due to unavailability of capital. These banks have a significant depositor base but the market perception does not enable them to raise further funds. Such banks may need to restructure though acquisitions and may be potential targets for other banks. The banking sector reforms initiated in India has reached a critical stage. This is evident from the fact that Government’s stake in many public sector banks (PSBs) has gone down and other shareholders equity ownership in these PSBs has gone up. This leads to greater responsibility on the bank management since the level of accountability has increased.

Pressures of performance and profitability will have to keep the PSB’s always alert as the public shareholders expect good financial performance along with good returns on their equity. Some of these PSB’s are able to manage sustenance to a certain extent by low cost funds that are available due to the branch network spread over the length and breadth of the country. Mergers and Acquisitions will further boost this process for many other banks that cannot go through this exercise individually and need larger partners to execute them in terms of processes and resources.

1.11 Need of the study:

Over the past decade, the banking industry has experienced an unprecedented level of consolidation as mergers and acquisitions among large financial institutions have taken place at record levels (Lakshminaryanan, P., 2005). Merger and acquisition is one amongst the various modes of restructuring resorted by banks to ensure better growth prospects (B.K. Bhoi, 2000; Dilip Kumar Chanda, 2005; Panwar, S., 2011;)

Although there is adequate research literature on banking mergers and acquisitions, most of the studies have been done for the proficient markets of the developed world particularly US and UK. In India, very inadequate research has been done in the area of banking mergers and acquisitions. Very few studies conducted in India have explored the performance of banking mergers and acquisitions empirically in terms of their pre-merger versus post-merger performance using the CAMEL’s Framework.

It is therefore important to understand and study the impact of mergers and acquisitions on the performance of the acquiring Indian banks during the pre-merger versus post-merger period, whether mergers and acquisitions have enhanced the performance of Indian public sector banks and Indian private sector banks and whether the desired objectives set in the deal were achieved. As well as to study the impact of mergers and acquisitions on the post-merger performance of acquiring public sector banks vis-à-vis acquiring private sector bank with reference to bank mergers in India.

1.12 Conceptual Framework of the study:

The economic reforms of 1991 and intense competition both internationally and domestically have compelled Indian industries to restructure their business portfolios and operations and centre it on their core competencies; banks were no exception to this (Fortune India, 2003).

In India the restructuring of businesses and capabilities were undertaken through the route of mergers and acquisitions (Beena P, 2000; Goyal K.A and Joshi Vijay, 2011). As per the Accounting Standard-14, issued by the Institute of Chartered Accountants of India,
on accounting for amalgamations, amalgamations fall into two categories, based upon their nature.

Firstly amalgamation in the nature of merger, where there is a pooling of assets, liabilities and shareholders’ interest of the amalgamating company. The second type being amalgamation in the nature of purchases, wherein one company acquires another company and the shareholders of the acquired company seize to have any shareholdings in the equity of the combined company. Research studies on financial performance of banking mergers and acquisitions are largely based on overall banking performance, effect of banking mergers on the shareholders wealth and event study of stock price movements during the merger window period (Mantravadi Pramod and Reddy A Vidyadhar, 2007). There are very few studies that evaluate the pre-merger versus post-merger Indian bank performance using the financial performance indicators as listed in the CAMEL’s model.

(Anand and Singh, 2008), studied the effect of five specific mergers in the Indian banking sector on the shareholders wealth. The merger announcements had positive and significant shareholder wealth effect both for bidder as well as target banks. The findings of the study are in agreement with European and US bank mergers and acquisitions except for the fact that the value of mergers to the shareholders of bidder banks has been destroyed in US mergers. (Jagdish R. Raiyani, 2007), in his study explored the degree to which the merger created efficiency gains for the Indian banks. The study examined selected indicators of banking performance for a period of five years post-merger. The study indicated that the merger created profitability and liquidity efficiency for private sector banks rather than the public sector banks in India, however with respect to capital adequacy efficiency, the results showed that the merger created efficiency for public sector banks and not for the private sector banks. The study also observed that post-merger; the private sector banks had improved overall efficiency as compared to the public sector banks in India.

(Mehroz Nida Dilshad, 2012), calculated the efficiency of bank mergers in Europe using the event study method. The study evaluated the effects of banks mergers and their announcements
on the prices of stocks. The study showed that there were significant abnormal returns to the shareholders of the acquirer that were short-lived. At the end of the event window, the cumulative abnormal returns were 0. It was also observed that these abnormal returns were largely attributed to leakage of information that resulted in the rise of stock prices few days before the announcement of merger. The study also showed that cumulative abnormal returns were earned by the shareholders of the target bank only on the merger announcement day.

Few studies were conducted that addressed the motives behind banking mergers and acquisitions. (Mehta Jay and Kakani Ram Kumar, 2006), in their study identified the various motives for acquisitions in the Indian banking industry. His study stated that these reasons have undergone a major transformation in the post-liberalization period as compared to pre-liberalization which was characterized by strict control regulations and therefore had most of the mergers that came as a force from the regulatory authority. With business and commercial reasons being the centre focus of acquisitions in the post liberalization period; customer expansion, geographical expansion, synergistic gains, asset efficiency, positive cash flows and increased market valuations have become some of the significant motives in banking acquisitions. This study concluded that merger and acquisition is imperative to create few large banks. (Muslumov Alvosat, 2002), identified synergy as one of the significant motive behind the merger. This study examined the causes of acquisitions of 56 US industry mergers. The study concluded that the surviving firm had significant improvement in operating cash flows. There was also an improvement in the post-merger performance of the bidder firm.

Studies have also been conducted on the overall financial performance of the banks, using CAMEL’s model, but this model has not been exclusively applied to examine the pre-merger versus post-merger financial performance of Indian banks. The camel framework is a popular framework used by regulators, which uses financial ratios to help evaluate a bank’s performance (Yue, 1992). The five CAMEL factors, viz. Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality, and Liquidity, indicate the increased likelihood of bank failure when any of these five factors prove inadequate. The CAMELS ratings or Camels rating is a supervisory rating system originally developed in the U.S. to classify a bank's overall condition. This framework can be applied to every bank and credit union in the U.S and is also
implemented outside the U.S. by various banking supervisory regulators.

In 1979, the Uniform Financial Institutions Rating System (UFIRS)* was implemented in U.S. banking institutions, and later globally, following a recommendation by the U.S. Federal Reserve**. The system became internationally known with the abbreviation CAMEL, reflecting five assessment areas: Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality, and Liquidity. In 1995 the Federal Reserve and the OCC replaced CAMEL with CAMELS, adding the "S" which stands for financial (S)ystem. This covers an evaluation of exposure to market risk and adds the 1 to 5 rating for market risk management.

The ratings are assigned based on a ratio analysis of the financial statements, combined with on-site examinations made by a designated supervisory regulator. In the U.S. these supervisory regulators include the Federal Reserve, the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Federal Deposit Insurance Corporation.

Ratings are not released to the public but only to the top management to prevent a possible bank run on an institution which receives a CAMELS rating downgrade. Institutions with deteriorating situations and declining CAMELS ratings are subject to ever increasing supervisory scrutiny. Failed institutions are eventually resolved via a formal resolution process designed to protect retail depositors.

The components of a bank's condition that are assessed:

- (C)apital adequacy
- (A)ssets
- (M)anagement Efficiency
- (E)arnings
- (L)iquidity (also called asset liability management)
- (S)ensitivity (sensitivity to market risk, especially interest rate risk)

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**The Federal Reserve System (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. It was created on December 23, 1913, with the enactment of the Federal Reserve Act, largely in response to a series of financial panics, particularly a severe panic in 1907.
The application of CAMEL rating system for evaluating financial strengths of commercial banks has increased both domestically as well as internationally. At international level, several academic studies were conducted examining the effectiveness of this model in examining the financial performance of the banks. Study by (Barker, D and Holdsworth, D, 1993), find substantiation that CAMEL ratings are useful, to examine the banks performance even after controlling a wide variety of publicly available information about the condition and performance of banks. (Cole, R.A. and Gunther, J.W., 1998) examined a similar question and found that CAMEL ratings contain useful information. The Bangladesh Bank as a regulatory body has been applying the CAMEL model to calculate rating till date.

Apart from the prime regulator of commercial banks, academicians are also taking interest in utilizing CAMEL ratings to assess the financial soundness of commercial banks. (Purohit and Mazumder, 2003), in a recent research paper used this technique to measure the performance of BASIC, a government owned commercial bank promoting small and medium enterprises and found this framework as an apt framework to evaluate the performance of banks. (Piyu, 1992), rightly observed: “Currently, financial ratios are often used to measure the overall soundness of a bank and the quality of bank management. Thus, bank regulators may use financial ratios to help evaluate a bank’s performance as part of CAMEL rating system”

All of the above mentioned academic studies conclude that managerial information, as summarized by CAMEL ratings, is clearly useful in the regulatory monitoring of bank conditions.

Several studies have been conducted that analyze the pre-merger versus post-merger financial performance of banks using several tool, however there are very few studies using the CAMEL’s model to examine the pre-merger versus post-merger financial performance of Indian banks. Most of the studies that examine the pre and post financial performance of the bank use tools like Data Envelopment Analysis, Stochastic Frontier Approach, event study methodology, EVA analysis and ratio analysis tool. (Healey, Palepu, and Ruback, 1992), studied the post-acquisition accounting data for the 50 largest US mergers between 1979 and mid-1984, using the event study methodology and found
that the returns to the shareholders after announcement of the merger based on stock price movement of the merging firms are significantly related with improvement in post-merger operating performance. The study concludes that the post merger anticipated efficiency gains drive the share prices at announcement.

(Fare et al., 1992), developed a DEA-based productivity index which measured the productivity change over time. This index which is a useful tool for measuring the productivity changes of DMUs (Decision making units) over time has been employed in this study to track changes in average bank productivity post-merger. (Rehana Kouser and Irum Saba, 2011), explored the effects of merger on profitability of the bank by using six different financial ratios. The study selected ten commercial banks that faced mergers and acquisitions during the period from 1999 to 2010. The lists of banks were selected from the Karachi Stock Exchange (KSE). The results confirmed that performance of all commercial bank’s undergone mergers and acquisitions included in the sample had declined and that there was a sharp decline in profitability ratios, return on net worth ratios, invested capital and debt to equity ratios.

(Stephen A. Rhoades, 1993), studied 898 banks merged during the period 1981 to 1986 to examine the efficiency effects of horizontal bank mergers and to discover whether banks involved in horizontal mergers achieve efficiency improvements relative to other firms. The study measured the efficiency using various expense ratios. The results based on logit analysis indicated that during 1981-1986, horizontal bank mergers did not result in efficiency gains although all the merger were alleged to be the ones most likely to result in efficiency gains.

Although there is adequate research literature on banking mergers and acquisitions, most of the studies have been done for the proficient markets of the developed world particularly US and UK. In India, very inadequate research has been done in the area of banking mergers and acquisitions. Very few studies conducted in India have explored the performance of banking mergers and acquisitions empirically in terms of their financial performance pre-merger versus post-merger, using the CAMEL’s Framework.
The present study makes an attempt to fill these voids and proposes to evaluate the pre-merger versus post-merger performance of Indian banks that have merged during the period 1993-94 to 2004-2005 using CAMELS Framework.

1.13 Statement of problem:

Several studies have been conducted that analyze the pre-merger versus post-merger performance of banks using several tool, however there are very few studies using the CAMEL’s model to examine the pre-merger versus post-merger performance of Indian banks as well as evaluate the post-merger performance of acquiring banks. Most of the studies that examine the pre-merger versus post-merger performance of the bank use tools like Data Envelopment Analysis, Stochastic Frontier Approach, Event Study Methodology, EVA analysis and Ratio Analysis Tool.

Although there is adequate research literature on banking mergers and acquisitions, most of the studies have been done for the proficient markets of the developed world particularly US and UK. In India, very inadequate research has been done in the area of banking mergers and acquisitions. Very few studies conducted in India have explored the performance of banking mergers and acquisitions empirically in terms of their pre-merger versus post-merger performance using the CAMEL’s Framework.

Under this backdrop the present study attempts to fill these voids and proposes to analyze whether mergers and acquisitions have contributed towards the enhancement of performance of Indian banks. The primary objective of this research is to evaluate the impact of mergers and acquisitions on the performance of the acquiring Indian banks during the pre-merger versus post-merger period by analyzing the variables explicated in the CAMEL model, with reference to bank mergers in India during the period 1993-94 to 2004-2005 and to study the impact of mergers and acquisitions on the post-merger performance of acquiring public sector banks vis-à-vis acquiring private sector bank by analyzing the variables explicated in the CAMEL model, with reference to bank mergers in India during the period 1993-94 to 2004-2005. The period is so chosen so as to have a post-merger period of 10 years ending 2014-2015.
During this period there was a mix of both public sector bank acquirers as well as private sector bank acquirers as well as a blend of both voluntary as well as forced mergers and acquisitions.

1.14 Scope of the study:

During the period of study there were nine banking mergers and acquisitions, where the acquirer was a Public Sector bank or a Private Sector Bank and the present study covered all the nine commercial banks (7-Public Sector acquirer banks and 2- Private sector acquirer banks) that had merged between 1993-1994 to 2004- 2005. The period was so chosen so as to ensure that the performance evaluation of bank during the post-merger period could be studied for a period of ten years ending 2014-2015.

1.15 Research Objectives:

1.15.1 Main Objective

1. To analyze the pre-merger versus post-merger performance of acquiring Public Sector Banks and acquiring Private Sector Banks.

2. To analyze the post-merger performance of acquiring Public Sector Bank vis-à-vis acquiring Private Sector Bank.

3. To find out if mergers and acquisitions can contribute for improvement in performance of Indian Public Sector Banks and Indian Private Sector Banks.

1.15.2 Sub-Objective

1. To understand the perspective and views of banking experts on the motives of Indian banking mergers and acquisitions.
1.16 **Research Hypothesis:**

To validate the objectives of the study the following is the hypothesis. The hypothesis are tested by applying the appropriate test.

H01: There is no significant difference in the pre-merger versus post-merger performance of acquiring banks.

H02: There is no significant difference in the post-merger performance of acquiring Public Sector banks vis-à-vis acquiring Private Sector bank.

There are twenty two parameters based on the CAMEL Model that evaluates the performance of banks. Therefore based on these twenty two parameters specific hypothesis have been detailed in Chapter-3 - Research Methodology.

*The detailed hypothesis are formulated and mentioned in Chapter-3- Research Methodology.*

1.17 **Limitations of the study:**

There are some limitations inherent in the present study.

- The sample size used for the study although is limited, yet it is the universe sample and includes all banking mergers and acquisitions taken place during the period 1993-1994 to 2004-2005.
- An important limitation was in getting the financial data for banks prior to 1989, hence the pre-acquisition and merger performance evaluation is restricted to a period of five years pre-merger as the earliest acquisition covered in the study is in the year 1993-1994, which implies that the pre-merger five years period begins at 1988-1989.
- Another limitation was in the nature of the overall CAMEL rating used: the rating lays emphasis on the factors of management soundness and earnings. Further, the model does not take into consideration other forms of risk (such as credit risk). Further studies can...
incorporate other risk factors into the framework to provide a more comprehensive measure of banking performance.

- Due to the privacy policy of banks certain information is not available in the public domain, if banks can part with some information which is not in public domain, it would further help such studies.
- Towards the in-depth interview respondents, very few top level banking executives could be successfully approached.

1.18 Chapter Scheme:

The study is presented in the following Chapters

Chapter-1: Introduction:

This Chapter includes Introductory aspect of the study, Introduction to the financial system, Evolution and present structure of the banking sector, Present scenario of the Indian banking industry, Mergers and acquisitions in Indian banks, Meanings and Definitions, Conceptual Framework of the study, Need for the study, Statement of problem, Scope of the study, Research Objectives, Research Hypothesis, Limitations of the study and Chapter Scheme.

Chapter-2: Literature Review:

This chapter includes a review of studies related to the study. It is categorized into Concept, Studies to analyze the impact of mergers and acquisition in the global context, Studies to analyze the impact of mergers and acquisition in the Indian context.

Chapter-3: Research Methodology:

This chapter contains Research Design, The CAMEL Research Model, Research Hypothesis, Data Collection, Sample Size, Research Instruments and Statistical tools for Analysis and Interpretation.
Chapter-4: The CAMEL Model:

The CAMEL Model and all the CAMEL Model Variables are explained explicitly in this chapter.

Chapter-5: Details of banks merged:

This chapter includes a brief profile of all the acquirer banks as well as the detail reasons of the merger. This chapter explains what were the reasons for RBI to initiate the forced merger. It also details out the business and commercial reasons in case of voluntary deals.

Chapter-6: Analysis and Interpretation of Pre-Merger versus Post- Merger Performance of Acquiring Banks with respect to Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity.

This chapter analyzes the performance of the acquiring banks covered in the study during the pre-merger and post-merger period. For this study the well accepted CAMEL Rating Framework Parameters viz., Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity to elicit the performance of acquiring banks during the pre-merger versus post-merger period. These performance indicators are compared for a period of five years before and five years after the acquisition period

Chapter-7: Analysis and Interpretation of Post- Merger Performance of Public Sector Banks Vis-à-vis Private Sector Banks with respect to Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity.

This chapter analyzes if there is a significant difference in the post-merger performance of the acquiring Public Sector Banks vis-à-vis the acquiring Private Banks covered in the study during the period of ten years post-merger or acquisition ending 2014-2015 on the well accepted CAMEL Rating Framework Parameters viz., Capital Adequacy, Asset Quality, Management Efficiency, Earnings Quality and Liquidity.
Chapter-8: Structured Interview Analysis:

This chapter includes the perspective of banking experts on the motives of Indian banking mergers and acquisitions as well as their views if mergers and acquisitions in Indian banks enhance the performance of Indian public sector banks and Indian private sector banks.

Chapter-9: Details of select bank mergers and acquisitions during the period 2005-2006 to 2013-2014:

This chapter analyzes the performance of select acquisitions that took place during the period 2005-2006 to 2013-2014 using the renowned CAMEL Model Framework. In this section an analysis is taken up of the pre-merger versus post-merger performance of banks that have undergone mergers or acquisitions during the period 2005-2006 to 2013-2014.

Chapter-10: Findings and Conclusions.

Chapter-11: Recommendations and Utility of the Study:

1.19 References:


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