1. INTRODUCTION
Chapter-1

Introduction

Banking system plays a major role as a financial intermediary in any economy. In most emerging markets, banking sector assets comprise well over 80% of total financial sector assets. Efficient intermediation creates a virtuous cycle of mobilizing saving, disbursement of credit and higher resource generation. Thus, development of the financial system is essential to sustain higher economic growth.

1.1 Indian Banking: A Brief Historical Perspective Growth and Banking Crisis

The key feature of Indian banking is the dominance of the state ownership. Reserve Bank of India (RBI) is the regulator and the Indian Banking sector has experienced structural changes to suit the needs of the time since independence.

The contribution of banks to Indian economic growth through Priority sector lending is remarkable. The extent of penetration of banking system in India, as measured by the proportion of bank assets to Gross Domestic Product (GDP) has increased from 50% in the second half of nineties to over 80% a decade later.

This section explains the developments in the Indian banking sector phase wise starting from pre independence era, then post independence to nationalization, followed by nationalization to pre liberalization and finally post reforms era.

1.1-1 Pre Independence Era

In Pre-independence era, 600 commercial banks were operating in India. Banking is an ancient business in India with some of the oldest references in the writings of Manu. Bankers and banking activities were existing in India, even before the British and other foreign nationals entered India. Modern banking (i.e. in the form of joint-stock companies) may be said to have had its beginnings in India as far back as in
1786, with the establishment of three Presidency Banks under Presidency Bank's Act (Bank of Calcutta, Bank of Bombay and Bank of Madras). In 1921, all Presidency Banks were amalgamated to form the Imperial Bank of India. Imperial Bank carried out limited central banking functions prior to establishment of RBI. It engaged in all types of commercial banking business except dealing in foreign exchange. The *Swadeshi* movement witnessed the birth of several indigenous banks including some of the leading banks of today such as the Punjab National Bank, Bank of Baroda and Canara Bank.

1.1-2 Establishment of RBI – 1934
Hilton young Commission recommended the establishment of the central bank in India, following the same in 1927 a Bill was introduced in Legislative Assembly but was not approved. ‘Central Banking Enquiry Committee’ (1931) viewed it as a matter of supreme importance hence a Bill was introduced again in 1933. The Reserve Bank of India Act 1934 was passed and the RBI was set up by the Government of India in April 1935, with a share capital of Rs. 5 crores.

The bank was nationalized in 1949. The main reason to nationalize RBI was the concentration of shares in the Bombay region (shares were meant to be equally distributed in 5 regions), moreover immediately after the independence there was a felt need to integrate the policies initiated by RBI and Government. Reserve Bank Act 1948 enabled the Central Government to acquire the entire share capital of RBI and it started functioning as the state owned bank. The three main functions performed by RBI are; central banking functions, supervisory functions and promotional functions. The establishment of RBI filled the gap of absence of the central bank in the Indian banking industry, in the pre independence period.

1.1-3 The Bank Failures
The Bank crisis and bank failures were witnessed by the Indian banks since 1913. The following table indicates the number of banks failed in Indian banking sector.
### TABLE 1.1-3.1 Bank Failures in Indian Banking During 1913 to 1948

<table>
<thead>
<tr>
<th>Period</th>
<th>No. of Banks Failed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913 - 1917</td>
<td>108</td>
</tr>
<tr>
<td>1922 - 1936</td>
<td>373</td>
</tr>
<tr>
<td>1937 - 1948</td>
<td>620</td>
</tr>
</tbody>
</table>

At the time of independence the challenge was managing weak and small banks. There were 544 non scheduled banks and 96 Scheduled Commercial Banks (SCBs). To enquire into these failures ‘The Central Enquiry Committee’ (1931) was appointed, which identified the following reasons for the failure of banks.

- Insufficient capital and illiquidity
- Combining non banking activity
- Irrational lending and asset liability mismatch
- Mismanagement of funds
- Speculative investments
- Absence of central bank and proper regulations

These failures felt the need for proper regulation in the banking sector.

### 1.1-4 Post Independence Era

The bank failures in the pre independence era and continuation of the same in the post independence period pressurized the need of prudent regulation and structural changes in the Indian Banking sector. The developments during post independence are explained below.

#### 1.1-4.1 Banking Regulation Act 1949

This law relating to banking is the outcome of a gradual process of evolution. Before 1949 the ‘Indian Companies Act 1913’, governed banking companies which contained special provisions relating to banking. The political uncertainty inside the country and outside affected the deposits position which affected the growth of banking system. To protect the interest of the stakeholders, the ‘Banking Regulations Act’ was passed in the year 1949. The Act was given wide powers in the area of bank supervision, licensing powers and the authority to conduct inspections in RBI. The Act was amended a number of times since 1949 to bring in the structural changes in the Indian banking sector.
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1.1-4.2 Setting Up of SBI

The Imperial Bank of India enjoyed a special position in Indian banking due to its association with the Government and later with RBI. The failure of ‘Credit Cooperative Movement’, to assist farmers and rural credit pushed the Government to increase its ownership in banking system on the recommendation of ‘Rural Credit Survey Committee’, appointed by RBI. An Act was accordingly passed in Parliament in May 1955 and the State Bank of India was constituted on 1st July 1955. Later, the ‘State Bank of India (Subsidiary Banks) Act’ was passed in 1959, enabling the State Bank of India to take over eight former State-associated banks as its subsidiaries (later named Associates). Thus more than a quarter of the resources of the Indian banking system came under the direct control of the State.

The State Bank of India was thus born with a new sense of social purpose aided by the 480 offices comprising branches, sub offices and three Local Head Offices inherited from the Imperial Bank. The concept of banking as mere repositories of the community’s savings and lenders to creditworthy parties was soon to give way to the concept of purposeful banking. The State Bank of India was destined to act as the pacesetter in this respect and led the Indian banking system into the exciting field of national development.

1.1-4.3 Nationalization of Commercial Banks and Bank Failures

Even after setting up of SBI the credit disbursement targets of the Government were not met as planned. In spite of all these developments, independent India inherited a rather weak banking and financial system marked by a multitude of small and unstable private banks whose failures frequently robbed their middle-class depositors, of their life’s savings. The rehabilitation of weak PSBs was the concern of many amendment Acts to Banking Regulation. Amendment Acts of 1960, 1961 and Nationalization Act vested more and more powers with RBI to issue moratorium and execute the scheme of amalgamation.

RBI was empowered in 1960, to force compulsory merger of weak banks with the strong ones. The total number of banks was thus reduced from 566 in 1951 to 85 in 1969. In 1967 the policy of social control over the bank was announced with a view to change management and distribution of credit by commercial banks.
Following nationalization Act 1969, nineteen largest public banks were nationalized which increased the share PSBs in banking deposits to 86\%\textsuperscript{9}. The process is explained below.

**Banking companies (Acquisition and Transfer of undertakings) Ordinance on 19 July 1969**, in terms of which the Central Government acquired 14 major Indian banks which had deposits exceeding Rs 50 crore as on 1st Friday of June 1969. The basic objective behind this move was to avoid concentration of banking and to spread the service to the larger sections of the society. The credit was directed to agriculture and small scale industries. The second phase of nationalization was carried out in 1980 and 6 more banks were nationalized having deposits not less than Rs.200 crore.

Post independence in the planning era, major steps was initiated to control the banking activities.\textsuperscript{10} Thus 90\% of the banking assets were owned by the PSBs following the nationalization. T.N Haleja\textsuperscript{11} identifies the growth of PSBs and the eventual downfall of these banks. The growth areas were identified as follows; **Expansion of branches** which was one of the major objectives of nationalization was fulfilled. Number of branches increased from 8262 in 1969 to 62346 in 1995. 66\% of these branches were opened in the unbanked area.

**Deposit mobilization** rate increased and almost doubled in 1995 (18\%). Bank credit also expanded from Rs.3590 crore to Rs.164418 crore. **Rural lending** increased as 58\% of the total branches were rural branches. By 1990s banks also diversified their activities and setup various subsidiaries.

The social banking and *fiat interference* in banks’ operations again made banks non viable. These banks faced the problem of huge NPAs, continuation of regional disparities as eastern and north eastern regions still remained unbanked. The banks were structurally weak as profitability declined, capital levels declined, internal control systems failed and the banks were not following the standardized accounting and disclosure norms. The banks were also involved in the security scams.

**1.1-4.4 Nationalization to Pre-reform Period**

During 1980-1991 regulators exercised the highest repression and social control over banks. The social thrust continued and Priority Sector Lending (PSL) target was increased to 40\%. The policy of social equality has led to the inefficiencies in the
Indian banking system. Indian banks were used as the medium of the government’s spending policies. As Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR) and directed credit were 15%, 40%, and 40% respectively. Banks had very little freedom to utilize the deposits. The CRR and SLR saw a steep increase from 2% and 25% in 1960 to 15% and 38.5% in 1991. Regulations in India meant financial repression which refers to stringent laws, formal reserve regulations, informal controls, price fixation in banking and directed credit program. Significant progress registered by Indian Banking after nationalization were in 3 aspects- branch expansion, deposit mobilization and loan disbursements. Mass banking, social banking and less monitoring of loans has led to piling up of Non Performing Assets (NPAs) in PSBs. An internal group of RBI studied the question of priority sector credit and recommended that directed lending has to be continued with regard to small borrowers. Directed lending if continued has the potential to generate huge employment. Priority sector lending was 40% of total credit and Agricultural credit occupied 18% of the total credit. Till early 1990s Public Sector Banks (PSBs) were enjoying a near monopoly status. They were serving as captive market for government securities in the wake of higher level of SLR-CRR requirements and private investment restrictions.

1.1-4.5 Indian Banking Post 1991
The piled up NPAs, heavy government funding to sustain the weak banks and the overall pressure on the growth of economic development in terms of Rupee devaluation, Balance of Payment (BoP) deficit in late 1990s led to the process of liberalization, privatization and globalization. As per General Agreement on Trade and Services GATS) India has agreed for Financial Services Agreement under which banking, insurance and financial services sector were opened for foreign investment. The details of the reform period are explained under banking sector reforms.

1.2 Structure of the Indian Banking System
The Indian banking system consists of the Reserve Bank of India (RBI), State Bank of India and its Associates, other nationalized Public Sector Banks (PSBs), Private and Foreign Banks, Exchange Banks, Co-operative banks, special purpose banks such as
Land Development Bank, NABARD, Industrial banks, Regional Rural Banks (RRBs) and indigenous bankers. The below table summarizes the same.

Development in Indian banking from 1975 to 2009 indicates that though there is no much increase in the number of SCBs, the branches have increased 4 times, the deposits and credit has grown more than 250 times in size. The table 1.2-1 presents the phase wise development in Indian banking system.

**TABLE 1.2-1 Number of Scheduled Commercial Banks as on March 2008-2009**

<table>
<thead>
<tr>
<th>Description of the Bank</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Commercial Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SBI group &amp; Public Sector Banks</td>
<td>28</td>
<td>27</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>23</td>
<td>22</td>
</tr>
<tr>
<td>Foreign banks</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td><strong>A. Total Scheduled Commercial banks</strong></td>
<td>79</td>
<td>77</td>
</tr>
<tr>
<td>Other Scheduled Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional Rural banks</td>
<td>91</td>
<td>86</td>
</tr>
<tr>
<td>Scheduled Co-operative banks</td>
<td>69</td>
<td>69</td>
</tr>
<tr>
<td><strong>B. Total number of Other SCBs</strong></td>
<td>160</td>
<td>155</td>
</tr>
<tr>
<td><strong>C. Total of SCBs (A+B)</strong></td>
<td>239</td>
<td>232</td>
</tr>
</tbody>
</table>

*Source: RBI Trends and Progress Report on Indian Banking 2008, Annexure-I*

**TABLE-1.2-2 Growth Indicators of Commercial Banks - 1975 to 2009**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of SCBs</th>
<th>RRBs</th>
<th>Branches No's</th>
<th>Deposits Rs. In Crore</th>
<th>Credit Rs. In Crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>74</td>
<td>0</td>
<td>18730</td>
<td>12545</td>
<td>8955</td>
</tr>
<tr>
<td>1980</td>
<td>75</td>
<td>73</td>
<td>32419</td>
<td>33377</td>
<td>22065</td>
</tr>
<tr>
<td>1985</td>
<td>81</td>
<td>183</td>
<td>51385</td>
<td>77075</td>
<td>50921</td>
</tr>
<tr>
<td>1990</td>
<td>74</td>
<td>196</td>
<td>59752</td>
<td>173515</td>
<td>105450</td>
</tr>
<tr>
<td>1995</td>
<td>85</td>
<td>196</td>
<td>62367</td>
<td>386859</td>
<td>211560</td>
</tr>
<tr>
<td>2000</td>
<td>99</td>
<td>196</td>
<td>65556</td>
<td>851593</td>
<td>454069</td>
</tr>
<tr>
<td>2005</td>
<td>88</td>
<td>196</td>
<td>70606</td>
<td>1732858</td>
<td>1124300</td>
</tr>
<tr>
<td>2009</td>
<td>79</td>
<td>84</td>
<td>82408*</td>
<td>4063204</td>
<td>3000906</td>
</tr>
</tbody>
</table>

*Source: compiled from various statistical tables in RBI publications
*As per the RBI reports, data of 2009 is provisional.*
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1.3 Reforms in Indian Banking Sector

Process of reforms was initiated due to the problem of high inflation with huge money supply and increasing demand for goods and services. Protection, lack of competition, and restrictive policies on expansion resulted in diseconomies of scale, inefficiency and less risk of competition amongst the industries. As a result of which Indian industries could not compete in export market on the other hand imports went increasing and also the demand was increasing. Rupee was devalued in the early seventies and Government had to seek massive assistance from the IMF and World Bank and as per their prescription economic policies started progressively changing. Government Controls were being withdrawn gradually. But far-reaching economic reforms were brought about only in the years 1991 and there after. Then the need of the hour was acceleration of exports, imports to support exports or to increase the supply of goods to meet the increasing demand, flexibility in industrial-financial activities and to integrate with the global economy.

The various committees constituted by RBI since 1985 are:

- Report of Sukhmoy Chakravarthi Committee (1985), initiated the process of financial sector reforms in India.
- The report of Mr. N. Vaghul (1987) is a follow-up report of the Sukhmoy Chakravarthi Committee Report.
- In 1991 after the advent of the Economic Reforms, the recommendations of the Committee on Financial System (popularly known as Narasimhan Committee) provided the impetus for further initiatives.
- A second report was submitted by Mr. Narasimhan in the year 1997 signaled the need for the 2nd phase of Financial & Banking Sector Reforms-1998

1.3-1 Narasimham Committee Recommendations

The Government of India appointed the ‘Narasimham Committee’, to examine all aspects relating to structure, organization, functions and procedures of the financial system. The report identified the major drawbacks of the system such as the reasons for NPA in PSBs, impact of directed lending on mounting up of NPA, small and fragmented banks which are not competitive globally, reconsideration of reserve ratios, administered interest rates etc.
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- ‘Narasimham Committee Report 1991’, the first report of the committee suggested 3 to 4 large banks which could compete globally. The report favored 8 to 9 national banks with large branch network and universal banking concept. Local and rural banks were recommended to carry out financing of rural and agricultural needs. They also suggested that private and foreign banks should be allowed to operate in Indian banking. The committee opined that the way to the recommended banking system is through market driven mergers and acquisitions based on profitability considerations. The dominance of directed lending was recommended to be removed along with interest rate deregulation. The committee recommended the implementation of Basel norms.

- ‘Narasimham Committee Report 1998’, the second report on banking sector on the structural issues made the following recommendations. Mergers between banks and Developmental Financial Institutions and Non Banking Finance Companies need to be based on synergies and business specific benefits. It identifies the necessary business focus mergers for PSBs and also states that mergers should not be a bailout plan of weak banks. It also recommended improvement in the supervisory system and changes in the disclosure of bank performance. They favored the strengthening of the RRBs to cater to agriculture and allied activities and recommended the budgetary provisions to strengthen the priority sector instead of burdening the banks. They also identified microfinance as the best hope. In addition to the above the committee suggested the recapitalization of PSBs through public issue.

1.3-2 Structural Changes Post Narasimham Committee Recommendations 1991-2000

Banking and Financial sector reforms were introduced during 1992 to 1995, followed by the second phase in 1998. Financial sector reforms encompassed broadly institutions especially banking, financial markets, monetary-fiscal, external sector management, legal and institutional infrastructure. The major motives behind these reforms were to provide functional autonomy to the PSBs, creating competition by allowing new banks, improving the performance and stability of the existing banks, market driven rates and reducing the overall government control. Diversification of
ownership, while retaining public sector character of these banks has led to greater market accountability and improved efficiency without loss of public confidence and safety.

Following the recommendations of the committee, in 1993 private banks' entry was allowed. A paradigm shift for the Indian banks from social orientation to commercial viability was encouraged by exercising decontrol and operational freedom to the banks. Market determined interest rates were something new to the banks as it called for better Asset Liability Management (ALM). Reforms came as a solution to the decades of non-commercial orientation, directed lending, loan waivers and increasing NPAs.

Impressive institutional reforms have also helped in reshaping the financial marketplace. A ‘Board for Financial Supervision’ (BFS), constituted in 1994 to supervise and inspect banking companies, financial institutions and non-banking companies. On similar lines, a ‘Board for Regulation and Supervision of Payment and Settlement Systems’ (BPSS), was constituted to regulate and supervise all types of payment and settlement system. The efforts to restore the health of the banking system\(^{21}\) has involved the restoration of PSBs’ net worth, allowing competition, standardized disclosure etc.

Many steps were taken in 1995-96 to reduce controls and remove operational constraints in the banking system. These include interest rate decontrol, liberalization and selective removal of Cash Reserve Ratio (CRR) stipulation, freedom to fix foreign exchange open position limit and enhanced refinance facilities against government and other approved securities.

The control of Government in PSBs was intended to reduce to enable the banks to access capital market to strengthen the capital base. ‘Banking Companies (Acquisition and Transfer of Undertakings) Act’, 1970/1980 was amended with effect from July 15\(^{th}\) 1994, permitting the general public to contribute up to the share capital.

Working group to review the system of on-site supervision over banks (1995) recommended CAMELS (Capital adequacy, Asset quality, Earning quality, Management, Earnings, Liquidity, & Systems) model to assess banks. Off Site Monitoring Surveillance (OSMOS) was introduced as a part of crisis management to
spot vulnerable institutions. Working group on Internal Control and inspection headed by Mr.R.Jilani (1997-98) was formed with a view to capture a position of a bank having subsidiaries and Joint ventures.

1.3-3 Banking Policy Reforms Post 2000

The major changes brought after 2000, a decade after the liberalization of the economy aimed at strengthening the reform process.

- RBI had constituted a ‘Joint Parliamentary Committee (2002)’, a Working Group to evolve guidelines for voluntary mergers involving banking companies. Based on the recommendations of the Group, the guidelines, process of merger proposal, determination of swap ratios, disclosures, the stages at which Boards will get involved in the merger process and norms of buying / selling of shares by the promoters before and during the process of merger have since been finalized.

- ‘The Negotiable Instruments (Amendments and Miscellaneous Provisions) Act’, 2002 expands the erstwhile definition of 'cheque' by introducing the concept of 'electronic money' and 'cheque truncation'.

- ‘Securitisation Act’, was enacted in 2003 to enhance protection of creditor rights.

- The ‘Credit Information Companies (Regulation) Bill 2004’, was enacted by the Parliament to enhance the quality of credit decisions and facilitate faster credit delivery.

- From 2009 the FDI in Banking is proposed to be allowed up to 74%.

1.4 Recent Developments and Trends in Indian Banking Sector

The following are the issues and challenges faced by the Indian Banking system post reform period.

1.4-1 Consolidation to Create Banks of Global Size

Complete compliance to Basel-II norms and Risk management in Banks are gaining attention of the policy makers. Capital requirements, supervisory review and market discipline are the mutually reinforcing pillars. The risks faced by the banks are credit risk (when borrower fails to meet his obligations to the bank in time.) , market
risk (fluctuations in interest rates, Forex rates, maturity mismatches, structural and legal risks) and operational risk (inadequate internal processes, people failure and systems failure).

1.4-2 Technology Investment

Technology induction to enable faster service, presently ‘Indian Financial Network’, (INFINET), a Wide Area Satellite based Network using VSAT technology, Shared Payment Network System, initiatives for Electronic Fund Transfer have already been undertaken. A Real Time Gross Settlement (RTGS) system, with system requirement specifications to take into account international best practices and the specific requirements of Indian banking is being developed.24

1.4-3 Reorganizing the Rural Branches

Increased focus on viability and profitability of bank branches, the decreasing trend in the quantum of government control over banking system calls for the reorganization of the rural branches. Banking through novel methods to reach the rural mass, banks can follow business facilitator model-identifying intermediaries such as Non Government Organizations, Self Help Groups, Farmers’ club, Insurance Agents, Panchayaths etc.

1.4-4 Competition

Deregulation increased competition25 and encouraged the entry of private and foreign players. Competition has squeezed the spread.

Today banks are forced to look at other sources to enhance the profitability. There is a retail banking thrust and customers are demanding more and more value added services.

1.4-5 High Non Performing Assets (NPAs) Calls for Prudent Operations

Efficient Asset Liability Management (ALM), risk management systems to improve the stability and reduce the Non Performing Assets (NPAs) are the major thrust areas in the reformed phase for banks. The real NPAs could be high as they are calculated based on 180 days default and not on 90 days which is an international standard.26

1.4-6 Capital Adequacy, Bank Recapitalization

Banks were allowed to recapitalize to meet the capital adequacy norms. The banks can strengthen their capital base using any of the following instruments other than equity:27
• Innovative Perpetual Debt Instrument (IPDI) eligible for inclusion in tier-1 capital
• Debt capital instruments eligible inclusion in tier-2 capital
• Perpetual non-Cumulative Preference shares eligible for inclusion in tier-1 capital (subjected to law in force time to time)
• Redeemable cumulative preference shares eligible for inclusion in tier-2 capital (subjected to law in force time to time)

1.4-7 Basel Norms

Base-I is a simplistic approach to risk transference and credit risk mitigation. It was not structured to keep pace with the rapid rate of financial innovation that was seen in internationally active banks. Limitations of Basel-I (1988) accord have been failure to organize differing credit quality within the same general asset type. It did not take into account the covariance between the different types of risks which has resulted in distortion in bank activity by creating tax on certain activities. Basel committee proposed a new accord in 1999 which were finalized in the year 2004 to drive the banks to adopt more comprehensive risk management system.28

Basel-II encourages ongoing improvements in risk measurement, assessment and mitigation. It provides a methodology for transforming banks into vibrant and stable entities in globally competitive and dynamic financial markets. It points towards RAPM (Risk Adjusted Performance management) and RAROC (Risk Adjusted Return on Capital). The 3 pillars of Basel-II are equally important29

• 1st pillar prescribes minimum levels of capital
• 2nd pillar prescribes the supervisory review process
• 3rd pillar prescribes market driven disclosures.

Basel-II aimed at not just sensitizing capital to the risks assumed by banks but also aligning the strategies and policies of the banks to risk management. Speeding up planning and implementation of Basel-II credit technology forcing managers to focus on business benefits30 is the focus of Asian banks.
1.5 Operational Definitions

Corporate Restructuring is a process of expanding or contracting business activities either by asset restructuring or ownership restructuring. These exercises are undertaken to obtain the right size to meet the challenges of the market. Globally these exercises are carried out by various sectors with an objective to enhance productivity and growth. The various forms of corporate restructuring can be summarized under four heads - expansion oriented restructuring, Contraction oriented, corporate control oriented restructuring and restructuring to change ownership structure.

- Expansion oriented restructuring activities result in expansion of size, increase in product portfolio, market reach of the firm. These include mergers, tender offers, asset acquisition and Joint ventures.

- Contraction oriented restructuring leads to reduction in the size of the firm either to have manageable size or core competency. Spin-offs, Split-offs, Split-ups, Divestitures and equity carve outs lead to contraction in the size of the firms.

- Corporate control oriented restructuring refers to a process by which control over management is established through premium buy backs, stand still agreements, anti takeover amendments and proxy contests

- Change in ownership structure result in the changes in the ownership pattern of a company. Rather than the regular capital structure other variables are used to try out new operating strategy, new capital structure, and different cash flow pattern. Leveraged Buy Outs, Exchange offers, Going private, Employee Stock Option Plan (ESOPs) & Master limited Partnerships (MLPs) and Share repurchase can be listed under this.

1.5-1 Merger Forms and Types

Merger is a combination of two or more companies into a single company. A merger can be either in the form of amalgamation (Consolidation) or absorption (Acquisition).

Merger in the form of amalgamation leads to the formation of a new company. The merging companies lose their individual legal entity. This form of amalgamation takes place between equal size firms. Merger in the form of absorption or acquisition
occurs when a bigger company absorbs the smaller company. After the merger smaller company ceases to exist.

**Takeovers/Acquisitions** are a process of gaining control over for the utilization of corporate assets and resources, this can be obtained either by taking share holding control or by purchase of the asset itself. The accounting treatment differs depending upon the method of takeover.

Takeovers can again be classified into **friendly, hostile and bailout** takeover. The takeover is said to be friendly when the acquirer and target mutually agree and accept the deal. If the takeover comes as a surprise and not with the consent of the management of the target, such takeovers are called hostile. The bailout takeovers are the only option left for distressed organizations. They are carried out to nurture or support weak organizations. In the post reform period Indian banks have seen more of bailout mergers. Bailout mergers in most of the literatures have used the term forced mergers, the reason may be the acquirers, and supposedly healthy banks were forced to acquire the weak banks.

1.5-2 **Joint Ventures/Strategic Alliances**

*A joint venture* is a legal entity formed between two or more parties to undertake economic activity together. The parties to joint venture contribute equity to control the enterprise and share profits and expenses.

Though spin-offs, split-offs, equity carve outs, buy backs, sell-offs, Leveraged buy outs etc are the forms of corporate restructuring, the Indian banks have not experienced these forms of restructuring. As mergers and acquisitions and joint ventures have become the new strategy for growth the present study includes them.

1.6 **Corporate Restructuring in Indian Banking Scenario**

Post 1991 the Indian banks are engaged in corporate restructuring activities which are expansion oriented. The undercurrent of thinking is that the larger the bank the higher is its competitiveness with better prospects of survival. Globally mergers and Acquisitions have become a major way of corporate restructuring in financial services industry leading to the emergence of the large banks and financial institutions.
Indian Banks are too small in the global competition. Fragmentation poses increasing risk in the Indian Banking Sector. During the financial period 2001-2005, only four banks have been able to cross the market capitalization of Rs. 50 billion, included Bank of Baroda, HDFC Bank, ICICI Bank, and State Bank of India. There is only one bank from India in the top 100 list. Consolidation drivers globally for Financial Institutions (FIs) and Banks are faster growth, better returns to shareholders, regulatory and public policy changes.

Mergers in Indian banking system are not new. Since 1961 many mergers have taken place. Unlike in the past where the Government initiated the structural changes in the Indian banking system, a slow shift can be observed in the drive of Indian banks to cope up with the changing conditions.

In the light of operational definitions explained above this section observes the merger and joint venture experiences in the Indian banking sector.

1.6-1 Bank Mergers and Acquisitions: Indian experience

Consolidation is likely to gain prominence in Indian banks in the future. As the bottom lines of domestic banks come under increasing pressure and the options for organic growth exhaust themselves, banks in India will need to explore ways for inorganic expansion. This, in turn, is likely to unleash the forces of consolidation in Indian banking. M&A in Indian banking is not new and dates back from Imperial Bank of India, which was formed by the amalgamation of the three banks—the Bank of Bengal, the Bank of Bombay and the Bank of Madras, in 1921.

In 1960s and 1960 to 1970 Indian Banking experienced the maximum number of mergers. There was a slow down in the merger during 1970s and 1980s. Again with the changing regulatory norms, and liberalized market conditions the merger gained the prominence. Historically Indian banks followed merger to safeguard the interest of the stakeholders and to bailout a weak bank. It is the private sector banks changing the trends in mergers. They made it more a growth strategy, currently; large Indian banks such as State Bank of India, Bank of Baroda and ICICI Bank are planning their strategies to increase their balance sheet size through M&A. Medium sized banks such as HDFC Bank, Corporation Bank, PNB are looking out for suitable merger targets. Bank of Baroda is on the lookout for a bank with presence in north, east and
south. Bangalore based Vijaya Bank is keen on buying a northern bank while PNB is looking southwards. M&A in banking sector is analyzed below in Box-1 considering the drivers of mergers which will form the motives and resulting in merger benefits or impact.

**Box-1.6-1.1 Merger drivers – Motives and benefits**

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Motives</th>
<th>Benefits/ impacts</th>
</tr>
</thead>
</table>
| Signing GATS and agreeing to open up the financial sector for the global players by 2009. | • To cope up with the tighter norms  
• To obtain efficient size | • Higher capital adequacy  
• Lower NPAs  
• Increased efficiency and profitability |
| Banking sector reforms and financial sector reforms process in India to cope up with the international prudential norms. | • To bailout weak banks | • Safeguarding the interest of the various stakeholders and restore the confidence in the financial system. |
| Overall liberalization process | • To gear up to the increasing demand for funds and advanced banking and financial services form the fast growing industries. | • Creating consumer demand for the industrial produce and helping them to clear their produce. |
| Business drivers | • To improve performance and profitability | • Increased market share  
• Better returns to shareholders |

Compiled from various sources

The mergers occurred after 1960 is listed in a table (Annexure-2)

### 1.6-2 Joint Ventures in Indian Banking Sector

The major Indian banks such as SBI, ICICI Bank, HDFC Bank, PNB and few others have partnered in joint venture companies to diversify into Insurance, Mutual funds and other services. This was possible due to the liberalization of financial services and opening up of the sector to private and foreign investment. The banks which have not promoted their own product through JV started selling the financial product through strategic tie-ups with other financial product/service provider. This trend of forming JV companies has increased from 2000.

Financial services include leasing, hire purchase, consumer credit, investment banking, commercial banking, venture capital, insurance, credit rating, bill discounting, mutual funds, stock broking, housing finance, vehicle finance, mortgages and car loans, factoring etc. In India these services are provided by a) Non-banking Finance Companies, b) Commercial Banks, Merchant Banks.
The financial sector reforms changed the landscape of Money market, securities market, Insurance and Mutual funds activities in India. The opening up of financial services for private and global competition has opened up the numerous opportunities and challenges. The operational autonomy to the banks, interest rate deregulation and increasing competition have encouraged the Indian Banks to cross sell other than banking products. The Indian banks are operating in the financial market using the following business models:

- Wholly owned subsidiaries
- Partly owned subsidiaries
- Strategic tie ups and partnering sales
- Joint venture companies.

After the liberalization many private sector companies were established in the insurance sector. Out of 11 insurance companies only 4 were formed by the banks. Even in Mutual funds other than banking companies are the dominant players (Annexure-3 and 4)

There are two types of products/services portfolio expansion

- Own product, which is an extension of the existing brand name to capitalize an already established brand name
- Marketing tie-ups, licensed or registered intermediary to sell other than banking products (Financial services)

The second class of expansion has taken place in many banks as it is relatively simple. Developing their own financial product or expansion of business activities into financial services sector with the help of Joint venture requires investment is complex.

The common product/service offered by Indian Banks through Joint venture and strategic tie-up initiatives are Insurance (both life and non life), mutual funds, stock broking and securities service, merchant banking service, cards payment service, technology partnerships(SBI &TCS), and entry into international markets. *(Annexure 5 presents the details of the joint ventures in Indian banking)*
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1.7 Research Methodology

This part describes the methodology used for the current study. It includes Importance of the study, statement of the problem, objectives of the study, and the formulated hypotheses to test the objectives. Scope and limitations of the study is followed by the research design, samples and methods of data collection. The data analysis plan and chapter scheme are also presented.

1.7-1 Importance of the Study

In the light of above developments in Indian Banking, the current study undertaken emphasizes on corporate restructuring activities of the Indian banks.

An efficient banking system contributes extensively for the higher economic growth in any country. Studies related to this sector are very useful to the policy makers, industry leaders and many others who are reliant on the banking system. Reforms and deregulation have been the major developments in most of the countries including India. Consolidation and restructuring have been used as growth strategies, diversification strategies and the banking industry is consolidating at an accelerated pace in most of the developing economies. Due to state ownership the pace and the drivers of Indian bank mergers are different compared to most of other countries. In the post reform period the sector witnessed more of bailout mergers than business driven mergers.

Consolidation of banking and finance firms through the M&A route is a global phenomenon that has gained prominence since 1985. The universal banking through diversification can also be seen through joint ventures. The changing regulatory environment in both developed and emerging economies have witnessed restructuring of banks, and so in India.

Policy makers also opine that 19 PSBs should be reduced to 5 or 6. The question is whether the deal should strike between small banks and big banks or weak banks with stronger banks? Narasimham Committee also recommended the existence of few banks to obtain the scale efficiency. But this has raised a lot of objection and opposition from various stakeholders in the banking system and also from the outsiders. Larger competitors have to build sophisticated systems to allocate
regulatory capital optimally for both credit and operational risk. Initial supervision is necessary to compute the probability of default.\textsuperscript{40}

In most of the bailout mergers, the better performing PSB absorbed the burden of a loss making bank. In the light of policy changes, initiation by the policy makers, recommendation of the banking committees the business driven mergers are gaining significance. Any process of consolidation must come out of a felt need for merger rather than as an imposition from outside. The synergic benefits must be felt by the entities themselves. The process of consolidation that is driven by fiat is much less likely to be successful, particularly if the decision by fiat is accompanied by restrictions on the normal avenues for reducing costs in the merged entity. Thus, any meaningful consolidation among the PSBs must be driven by commercial motivation by individual banks, with the government and the regulator playing at best a facilitating role. \textit{Thus mergers and acquisitions in Indian banking can be thought of on merit, due to the difference in the merger approaches followed by the merging banks. It needs to be distinguished to explore the difference in the impact of these mergers.}

The concept of cross selling financial product by a bank is a new practice in Indian market. In the light of growing importance of non-interest income which is a less risky non-fund based activity, the study discusses the options followed by the Indian banks to cross sell the financial products. As some of the banks have leveraged their existing brand name (SBI Life, ICICI Prudential, HDFC Standard Life) it is important to explore the possible value creation by these ventures. There is both advantage and disadvantage in leveraging the existing bank name. The advantage is that the familiarity and the confidence can ease up the sale of products, the disadvantage is the possibility of risk exposure by the bank to the losses incurred by the JV company or by the financial stability and image of the JV partner. Hence the study also focuses on the recent Joint ventures, tie-ups by Indian banks which is a new path of expansion oriented restructuring exercise chosen by the Indian banks.
1.7-2 Statement of the Problem

One of the statements of Narasimham Committee II recommendations on economic reforms states "There is clearly a need for consolidation of structure which could be brought about essentially through a process of negotiation rather than imposed merger on profitability consideration and also for reasons of business strategy." Though there are 28 PSBs only 7 of them were the acquiring firms post 1991. Of 24 private sector banks only 3 of them were the acquiring firms. It can be observed that banks are not involved in the M&A activity uniformly in the post 1991. Due to this fact the banks are grouped into 2 i.e. banks involved in merger and banks not involved in merger activity in the post reform period (1991). It is found appropriate to understand the opinion of the various stake holders towards voluntary consolidation and the bank mergers.

Another step towards the universal banking is through cross selling financial products. Significance of non-interest income which is a fee based income is gaining significance in the reform period. The non-interest income can be accelerated either by providing fund transfers, investments and other banking services. The cross selling of financial products is another means to improve the non-interest income. The JV helps the banks to diversify the business. This in turn reduces the risk of investment for the investors as bank’s portfolio is diversified. As a restructuring plan the JV not only contributes to the expansion of activities but also to diversify the portfolio and reduce the risk of investment.

Thus, it is clear from the above statements that there is a need for merger of two or more strong banks on commercial considerations, which is market driven to maximize synergies and also to expand and diversify the portfolio through Joint ventures. The idea is the strong and well diversified bank can absorb the shocks and survive in challenging market conditions. Hence the selected title for the current research is:

“A Study of Corporate Restructuring in Indian Banking Sector – Post 1991”.

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1.7-3 Objectives of the Study

The proposed study focuses on two aspects of bank mergers. Primarily the study proposes to enquire the opinion of the various stakeholders such as top management, employees/union through a survey. Then the study focuses on the financial statements to analyze the efficiency of business driven and fiat driven mergers and joint venture exercise.

The proposed research has the following objectives.

- To explore the conceptual background and development of banking and restructuring activities focusing on ongoing reforms.
- To identify the forced and voluntary mergers, post 1991, the reasons and objectives behind these mergers.
- To understand and explore the opinion and perception of the employees representing the Officers Association/Union and top management, towards business driven mergers.
- To compare pre and post merger performance of acquiring bank in forced and voluntary mergers considering
  i. The regulatory compliance
  ii. Size efficiency
  iii. Productivity and employee benefits
  iv. X-efficiency
  v. Shareholders’ return.
- To compare the targets and the acquirers in forced and voluntary mergers.
- To understand Banks’ foray into Joint ventures and strategic tie ups and exploring relevant benefits from the expansion strategy.

1.7-4 Hypotheses of the Study

Based on the above stated objectives of the study, the hypotheses are formulated for empirical verification. They are:
Hypotheses of the Survey:

**Ho1** Employee Representatives of banks engaged in merger and banks not engaged in merger do not perceive any major change in the job security, working conditions, perks and benefits post merger.

**Ha1** Employee Representatives of banks engaged in merger and banks not engaged in merger perceive major change in the job security, working conditions, perks and benefits post merger.

**Ho2** There is no significant differences in the opinions of the top management representing the banks engaged in M&A and banks not engaged in the M&A towards the merger motives, influencing factors, gains and approaches to mergers with reference to business driven mergers.

**Ha2** There is significant differences in the opinions of the top management representing the banks engaged in M&A and banks not engaged in the M&A towards the merger motives, influencing factors, gains and approaches to mergers with reference to business driven mergers.

Hypotheses for the Financials Analysis

**Ho3** There is no significant difference in pre and post merger regulatory compliances of fiat driven acquirers and voluntary acquirers

**Ha3** There is significant difference in pre and post merger regulatory compliances of fiat driven acquirers and voluntary acquirers

**Ho4** There is no significant difference in pre and post merger size efficiency of fiat driven acquirers and voluntary acquirers

**Ha4** There is significant difference in pre and post merger size efficiency of fiat driven acquirers and voluntary acquirers
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H05 There is no significant difference in pre and post merger productivity of fiat driven acquirers and voluntary acquirers.

Ha5 There is no significant difference in pre and post merger productivity of fiat driven acquirers and voluntary acquirers.

H06 There is no significant difference in pre and post merger X-efficiency of fiat driven acquirers and voluntary acquirers.

Ha6 There is significant difference in pre and post merger X-efficiency of fiat driven acquirers and voluntary acquirers.

H07 There is no significant difference in pre and post merger profitability of fiat driven acquirers and voluntary acquirers.

Ha7 There is significant difference in pre and post merger profitability of fiat driven acquirers and voluntary acquirers.

Hypothesis for Targets and Acquirers Features Analysis

H08 There is no significant difference in the target and acquirers features among Fiat driven and voluntary bank mergers

Ha8 There is significant difference in the target and acquirers features among Fiat driven and voluntary bank mergers

Hypotheses for Analysis of Joint Ventures

H09 There is no significant difference in growth rates of non–interest income to total income and Interest income to total income of banks involved in Joint Ventures and others.
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**Ha9** There is significant difference in growth rates of non-interest income to total income and interest income to total income of banks involved in Joint Ventures and others.

**Ho10** There is no significant difference in ‘business generated through bank channel’ between the Bank promoted insurers and non bank promoted insurers.

**Ha10** There is significant difference in ‘business generated through bank channel’ between the Bank promoted insurers and non bank promoted insurers.

**Ho11** There is no significant difference between the growth rates of ‘assets under management’ for Bank Sponsored or promoted Mutual Funds and others.

**Ha11** There is significant difference between the growth rates of ‘assets under management’ for Bank Sponsored or promoted Mutual Funds and others.

1.7.5 Scope of the Study
Banking as a sector comprises complex issues related to their structure, regulations, role as an intermediary, performance and economic development. Restructuring exercise also includes broader issues such as business gains, viability, sustainability and also affects various stakeholders and economy at large. The ever changing banking business environment to achieve a competitive business practice throws open a lot of issues to explore.

The studies on efficiency gains of restructuring exercises in the developed economies may not be applicable in the Indian context due to structural difference in the system. The current regulatory interference in bank mergers, the shift in policy makers approach and the restructuring strategy adopted by market leaders provides the incidental shift in the approach. If their moves provide the empirical evidences of the business gains and improvement in efficiency it provides the support for the policy makers to initiate and facilitate more of market driven – business focused restructuring.
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exercises. This can also motivate the followers in the industry to choose the appropriate growth and expansion strategies.

The current study emphasizes more on the performance comparison of fiat driven mergers and voluntary mergers which have taken place in the post reform period. It explores whether the few voluntary merger experience can guide further consolidation in the Indian banking, especially amongst PSBs. The study attempts to understand the opinions of the employee representatives and top management towards voluntary mergers. The study also comprises the analysis of joint venture strategy adopted by the Scheduled Commercial Banks.

1.7-6 Limitations of the Study

- The survey results cannot be generalized. The responses are only of the representative units.
- The Likert's scale only indicates the extreme positive and negative attitudes but does not measure it.
- The study does not focus on all merger cases post 1991. It covers only those mergers occurred post 1997 to May 2008.
- The finding of the study cannot be generalized to all the industries.

1.8 Research Design

The current study undertaken on Indian banking is descriptive and exploratory in nature. It is a deductive study as there are already established merger theories hypothesising the various merger gains and reasons held at various industries and sectors across the countries. Hence the research design is formulated in accordance with the requirements of the current topic of the study. The study uses both primary and secondary data for testing the hypothesis.

The research undertaken used different research tools to collect the data: a questionnaire survey is used to collect Primary data from the respondents. The respondents are classified into top management, employees representing Officers Association/union. Secondary data is collected from various published and syndicated sources to analyze the financial implications.
1.8-1 Survey Frame Work
The following section explains the survey plan. Two different survey was conducted for employee representatives and top management.

1.8-1.1 Survey of Top Management
Target Population
For the survey of Top management – the target population is Chairman/MD/CEOs or the senior executives of the Corporate planning Departments or the Strategy departments.

For this purpose two bank groups are identified – the banks involved in merger activity (either fiat driven or business driven) and the banks not involved in the merger activity in the post reform period.

Sampling – Top Management Survey
In Indian Banking three types of scheduled banks can be identified, namely, Scheduled Commercial Banks, Regional Rural Banks and Scheduled Co-operative Banks. The total number of these banks in the Indian Banking sector is 235, as on 31st March 2009. The study proposes to represent Scheduled Commercial Banks (SCBs) which totals to 77 and represents 33% of the scheduled banks. Keeping in view the scope of the present study this bank group is identified based on convenient and judgmental sampling method. The judgmental point here is the bank has to be a Scheduled Commercial Bank as the present study analyses the mergers in only the SCBs. From the chosen bank group, the respondents were identified. The addresses were collected to represent planning or strategy department of the bank. Thus either the Executive Director or the planning executive addresses were collected and 77 questionnaires were sent. Out of this 77 banks Punjab National Bank, Bank Of India, SBI, Oriental Bank of Commerce, Bank Of Baroda, Union Bank of India, HDFC Bank, ICICI Bank, Federal Bank and Indian Overseas Bank were the banks involved in merger activity in the post reform period. Of the banks quoted above these 10 banks are included. The other group contains 67 banks which did not involve in any type of merger activity.
1.8-1.2 Employee Representatives Survey

Target population identified for the survey is office bearers of employee Association and union. As a first step the list of all banks employee associations were collected. In addition to individual bank's association, there is an All India level representative unit of employee association and union. The details of these employee representative units are provided below.

Sampling

The total size of Principal Office Bearers in all India representative employee units of 27 PSBs and 6 Private Banks are approximately 1500. (Collected through an interaction with President, All India Indian Overseas Bank Officers Association). Through simple random sampling method 10% of the total population i.e. 152 representatives were considered as sample. Since the representatives considered are principal office bearers of all state units and all bank representative organization, the representation is given to all regions and banks. The addresses were collected from the websites.

TABLE 1.8-1.1 Respondents Chosen for the Survey

<table>
<thead>
<tr>
<th>Units</th>
<th>Number</th>
<th>Total representative Office Bearers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Associations representing Public Sector Banks</td>
<td>27</td>
<td>50</td>
</tr>
<tr>
<td>(Representing all India representative unit constituted at their Head Office) (Nationalized Banks 20 and 7 SBI and its associates)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee Associations representing Private Sector Banks</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>(Representing all India representative unit constituted at their Head Office) (Lakshmi Vilas Bank, Dhanalakshmi Bank, Bank of Rajasthan, South Indian Bank and City Union Bank)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All India Bank Officers' Association (AIBOA)</td>
<td>1</td>
<td>50</td>
</tr>
<tr>
<td>(Principal Office Bearers and Central Committee Members)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All India Bank Officers' Confederation (AIBOC)</td>
<td>1</td>
<td>42</td>
</tr>
<tr>
<td>(Executive Committee Members)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total of the respondents considered for the survey</td>
<td></td>
<td>152</td>
</tr>
</tbody>
</table>

Further the respondents were categorized into 2 groups; representatives representing merger and non merger group.
1.8-1.3 Questionnaire Design

Since the research is descriptive and exploratory in nature, the questionnaires were structured and designed according to the objectives set out in the previous section. Summated rating method advocated by the Likerts’ is found most appropriate scale to be used. The respondents can indicate their preference / attitudes easily choosing between strongly agree to strongly disagree. Item analysis is preferred to ensure that final items evoke wide response and discriminate among those with positive and negative attitudes. Mainly rating and ranking technique is used in the questionnaire.

Questionnaire for Employees representing the officers association and union

The study proposes to enquire employees’ views and perceptions towards business driven mergers. The objectives of the survey are to understand the issues and concerns influencing employees towards voluntary merger.

The questionnaire contains 23 questions. The first part collects views on job security of the employees. Second part of this questionnaire collects opinion about the working conditions and the last part tries to understand their opinion about perks and benefits.

Questionnaire for Top Management

The survey proposes to enquire ‘the difference in views and perceptions of the management towards merger type, amongst the banks involving in merger activity and the banks not involving in the merger activity in the post reform period. The survey explores the factors influencing merger, the merger gains, external-regulatory factors influencing the merger and the possible approaches towards voluntary consolidation as preferred by the bank groups

Questionnaire contains 29 questions, in which the first part questions are about understanding their opinion about the factors influencing bank mergers. Second part asks questions about the impact of the mergers. Part three questions enquire the merger gains. Part four questions are related to the merger approach.
1.8-1.4 Primary Data Collection

The mailed questionnaire method is found appropriate to survey the top management considering the fact that the head quarters of banks are located at various places across India. A questionnaire was been executed to them through mail. This mode is preferred considering the scattered presence of the bank headquarters across India. The similar approach is followed for surveying employees representing Officers Association/Union as the office bearers are spread across.

1.8-1.5 Data Analysis Plan – Survey

Data analysis plan explains the various parameters used and the statistical tools and technique to be used to test the hypotheses. The data collected from top management is analyzed using central tendency and ‘t’ test, determining the difference in the mean distributions between the bank groups surveyed.

1.8-2 Financial Analysis Framework

This part explains the structure of financial analysis carried out for merger analysis and joint venture analysis.

1.8-2.1 Time Period of the Study

The study tracks the merger events in the Indian banking post 1991 for the purpose of identification of fiat driven and voluntary mergers. Thus mergers between 4/9/93 to May 2008 are identified. **However for the purpose of analysis the time period identified for the merger study is 8/4/1997 to May 2008.**

For the Joint venture analysis the data is considered between March 2003 and March 2009. This period is selected as the activities are identified only post 1998-99. In the initial years is considered as gestation period hence the analysis is focused from 2003.
INTRODUCTION

### TABLE – 1.8-2.1 The list of mergers post 1991.

<table>
<thead>
<tr>
<th>No.</th>
<th>Acquirer Bank</th>
<th>Target Bank</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>New Bank Of India</td>
<td>Punjab National Bank</td>
<td>4-9-1993</td>
</tr>
<tr>
<td>2</td>
<td>Bank of Carad Ltd</td>
<td>Bank Of India</td>
<td>1993-1994</td>
</tr>
<tr>
<td>3</td>
<td>Kashi Nath Seth Bank</td>
<td>State Bank Of India</td>
<td>1-01-1996</td>
</tr>
<tr>
<td>4</td>
<td>Punjab Co-op Bank Ltd</td>
<td>Oriental Bank Of Commerce</td>
<td>8-4-1997</td>
</tr>
<tr>
<td>5</td>
<td>Bari Doab Bank Ltd</td>
<td>Oriental Bank Of Commerce</td>
<td>8-4-1997</td>
</tr>
<tr>
<td>6</td>
<td>Bareilly Corp. Bank Ltd</td>
<td>Bank Of Baroda</td>
<td>3-6-199</td>
</tr>
<tr>
<td>7</td>
<td>Sikkam Bank Ltd</td>
<td>Union Bank of India</td>
<td>22-12-1996</td>
</tr>
<tr>
<td>8</td>
<td>Times Bank India</td>
<td>HDFC Bank Ltd</td>
<td>26-2-2000</td>
</tr>
<tr>
<td>9</td>
<td>Benaras State Bank Ltd</td>
<td>Bank of Baroda</td>
<td>20-07-2002</td>
</tr>
<tr>
<td>10</td>
<td>Nedungadi Bank Ltd</td>
<td>Punjab National Bank</td>
<td>1-2-2003</td>
</tr>
<tr>
<td>11</td>
<td>Bank Of Madura</td>
<td>ICICI Bank</td>
<td>10-3-2001</td>
</tr>
<tr>
<td>12</td>
<td>South Gujarat Local Area Bank</td>
<td>Bank of Baroda</td>
<td>25-06-2004</td>
</tr>
<tr>
<td>13</td>
<td>Global Trust Bank Ltd</td>
<td>Oriental Bank Of Commerce</td>
<td>14-8-2004</td>
</tr>
<tr>
<td>14</td>
<td>Bank Of Punjab</td>
<td>Centurian Bank</td>
<td>29-6-2005</td>
</tr>
<tr>
<td>16</td>
<td>United Western Bank Ltd</td>
<td>IDBI Ltd</td>
<td>3-10-2006</td>
</tr>
<tr>
<td>17</td>
<td>Lord Krishna Bank</td>
<td>Centurian Bank Of Punjab</td>
<td>29-8-2007</td>
</tr>
<tr>
<td>18</td>
<td>Sangli Bank</td>
<td>ICICI Bank</td>
<td>19-4-2007</td>
</tr>
<tr>
<td>19</td>
<td>Bharat Overseas Bank</td>
<td>Indian Overseas Bank</td>
<td>31-3-2007</td>
</tr>
<tr>
<td>20</td>
<td>Centurion Bank of Punjab</td>
<td>HDFC Bank</td>
<td>May 2008</td>
</tr>
</tbody>
</table>

### 1.8-2.2 The Samples of the Financial Analysis Study

There are 20 merger cases identified post 1991. One of the mergers include IDBI Ltd (a Developmental Financial Institution) as an acquirer hence excluded from the analysis. Out of the remaining 19 mergers 13 of them were fiat driven and 6 of them were identified as voluntary mergers. Based on the data availability and suitability the 11 mergers occurred during April 1997 to May 2008 were considered for the analysis. The samples were selected based on the convenience of the data availability. Different groups identified are presented below.
• For the immediate impact analysis and 2 years pre and post merger analysis, 4 voluntary mergers and 7 fiat driven mergers were considered.

• For the target size analysis 5 voluntary mergers and 4 fiat driven mergers were considered for the purpose of analysis

There are studies evaluating pre and post merger performances exploring from 2 to 4 years pre and post merger period (Stavros).

The sampling method used in joint venture analysis is judgmental sampling. Since the total number of banks is 81, and the banks which have adopted the cross selling practices through Joint ventures and strategic alliance are only few. Only those banks are selected which satisfied the set parameters. The parameters are the completed years in Joint venture, the total income earned by the banks and the range of products expansion through JV. The year of entry is a significant parameter due to early entry into the market results overcoming the gestation period.

In case of Joint ventures by Indian Banks only 5 banks are selected which are actively involved in JV activity. To compare another 2 bank groups were identified based on the stated parameters.

1.8.2.3 Data Analysis Plan

The merger is analyzed in three stages. Firstly the immediate impact analysis is carried out to understand the immediate impact due to merger. The percentage changes in selected parameters are used to standardize the data. Secondly the pre and post merger performance is compared of each bank considering two years prior to merger and two years post merger and then compared with the group. Thirdly the targets features were identified and compared based on selected parameters. In all these case comparison of means, deviation and variances are considered and statistically tested using the student 't' test to understand the significance.

A t-test is a hypothesis test in which the test statistic has a Student's t distribution if the null hypothesis is true. It is applied when the population is assumed to be normally distributed but the sample sizes are small enough.

The t-test assesses whether the means of two groups are statistically different from each other. This analysis is appropriate to compare the means of two groups. To test
the significance, need to set a risk level (called the alpha level). In social research, the "rule of thumb" is to set the alpha level at 5%. This means that five times out of a hundred you would find a statistically significant difference between the means even if there was none (by "chance"). The degrees of freedom (df) for the t-test, the degree of freedom is the sum n1+n2-2. If 't' calculated < t table value, accept the null hypothesis and vice versa.

When there are unequal sample sizes, variance is unknown equal variance is assumed. This test is used only when it can be assumed that the two distributions have the same variance. (When this assumption is violated, see below) The t statistic to test whether the means are different can be calculated as follows:

$$t = \frac{\bar{X}_1 - \bar{X}_2}{\sqrt{(N1-1)S^2_1 + (N2-1)S^2_2 \over (N1+N2) - 2}^{\frac{1}{2}} x \sqrt{\frac{1}{N1} + \frac{1}{N2}}}$$

1.8-2.4 Financial analysis - Parameters and Ratios used
The explanations to the parameters used in evaluation are as follows:

**Regulatory Compliance and solvency** is observed as one of the drivers of bank mergers. To analyze regulatory compliance and solvency two parameters are considered. **Capital Adequacy Ratio (CAR)** (which is minimum of 9% but RBI has specified Indian banks to follow 10%) during pre and post merger in all forced and voluntary merger cases are analyzed. CAR is the ratio of capital and reserves to various risk weighted composition of assets. The objective is to ensure adequate capital base to safeguard solvency.

Non Performing Assets (NPA) to Net Assets, which is another indicator of solvency, is also considered under this. Lowering NPA remained the focus of commercial banks in India. NPAs are loan assets of the bank on which both interest and principal is not recovered for more than 90 days. As total NPAs vary based on the size of lending, it won’t be appropriate to consider the total volume. Therefore NPA to Net Assets is considered. Net assets are assets excluding doubtful and loss assets.
Scale efficiency indicates the growth in deposits, advances and total assets. Mergers aim at increasing size hence changes in growth rates pre and post merger in deposits, advances and total assets are considered.

X-efficiency is related to Managerial efficiency which checks whether there is any cost reduction to produce the output. The standard ratios used for this analysis in the banking context is Interest expenses to interest income, total expenses to interest income, total expenses to total advances. Mergers are supposed to improve the performance by reducing the cost using the better managerial skills of the acquirer.

Productivity is analyzed considering the Business Per Employee (BPE) and Profit Per Employee (PPE). Business per employee is calculated using total income divided by the total number of employees.

Finally profitability and shareholders returns are analyzed using Return On Assets (ROA), Return on Equity(ROE), Earning Per Share(EPS) and Book Value Per Share(BVPS).

\[
ROA = \frac{PAT \text{ (Profit After Taxes)}}{\text{average Total Assets}}.
\]

\[
ROE = \frac{\text{PAT available to equity holders}}{\text{average equity}}.
\]

\[
EPS = \frac{\text{PAT available to equity holders}}{\text{total number of equity shares outstanding}}.
\]

\[
BVPS = \frac{\text{Net worth}}{\text{total number of equity shares}}.
\]

Joint Venture Analysis

It is a descriptive research which tests the hypothesis. It is a parametric test using t-test. The study based on the secondary data collected from the capital line database, websites of the regulatory bodies and also from company websites. Banks having promoted Joint Venture companies in the area of insurance and mutual fund are compared with the banks having no joint venture investment. The cross selling of financial products is basically undertaken to increase the non-interest income component hence the parameters considered for the analysis are the percentage of average non-interest income to total income and average interest income to the total income is considered for analysis. The business generated through bank channel is identified for the various bank and non bank promoted insurers to identify the difference.
To analyze mutual fund joint ventures the Compounded Annual Growth Rate (CAGR) in the assets under management for bank promoted and others are considered between March 2003 and March 2009. The student ‘t’ test explained above is used for analyzing the difference between bank promoters and others.

\[ \text{CAGR} = \left(\frac{FV}{BV}\right)^{1/n} - 1 \]

2009 value is Future Value (FV), and 2003 value is Base value (BV), the number of years considered is 6.

1.8-2.5 Data Sources

The data used in this study related to bank mergers’ performances rely heavily on the published accounting data. For this study the data and information is collected from the internal data sources such as published annual reports of the banking companies and Banking company websites. The external data sources used to collect historic data are the syndicated sources such as the reports of the regulatory bodies (IRDA and AMFI) Capitaline Database, CMIE Business Beacon database and RBI publications- Trends and Progress Reports (yearly Reports).

1.8-3 Chapter Scheme

The research thesis consists of six main chapters. The description of the same is provided below.

Chapter One introduces the conceptual background and development of banking and restructuring activities focusing on ongoing reforms in the Indian Banking industry in general and provides some facts and figures about the industry. This chapter also highlights the need, scope, and importance of the study.

The Second part of this chapter discusses the research methodology of the current study, where objectives, hypotheses, research design, samples, questionnaire design, data collection methods, data analysis plan and limitations are discussed.

Chapter Two identifies the forced and voluntary mergers, post 1991, the reasons and objectives behind these mergers. It also describes a brief review of literature relating
to banking industry, in which the contributions of various scholars and the work of different researchers are highlighted.

Chapter Three presents the Computations, data related to survey of top management and employees through tables, analysis and interpretation of the data.

Chapter Four presents the data analysis and interpretation of financial analysis and efficiency. There are two sections in this chapter. Section 1 presents pre and post merger financial analysis. Section 2 presents the target and acquirer features analysis.

Chapter Five presents the Computations, data related to joint ventures in the form of tables, analysis and interpretation of the data.

Chapter Six is the concluding part of the report. In this chapter, major findings of the study are summarized. Based on the analysis and interpretation, the results are drawn and suggestions and recommendations are given.
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