2. REVIEW OF LITERATURE
CHAPTER 2

Review Of Literature

This chapter identifies the existing literature and research studies on Indian banking and the bank mergers studies. Indian banking is a matter of study by the various authors since independence in the light of socio-economic emphasis attached to the sector. In the post reform period several studies can be identified on broader issues such as efficiency, productivity-prudence, regulatory changes, technical efficiency, etc. Regulatory changes in the Indian Banks itself became a matter of study. Ownership of banks is another critical issue observed as Public Sector Banks (PSBs) dominate the Indian banking industry even in the reform era. Non Performing Assets (NPAs), Priority Sector Lending (PSL) Deregulation and competition were few interesting areas of study for many researchers. However it is observed that in various studies and the existing literature the authors have indicated at the structural changes and consolidation in the Indian banking sector. Few merger studies in the foreign context are also observed to understand the Critical issues and the various dimensions of the merger studies.

The literature review part is categorized into three and presented as follows:

PART –I

2.1 The studies on Indian banking indicating at the consolidation, restructuring, M&A etc.
2.2 Review of the existing studies on Indian bank mergers
2.3 The dimension of merger studies in other Indian sectors
2.4 The bank mergers across the world - the global perspective of bank mergers
2.5 The studies on joint ventures, strategic partnering and the related topics - to understand the present studies in this domain
2.6 Presents the motivations of the study

PART II

2.7 A Review of M&A Trends in Indian Banking Sector and description of merger cases
PART III

2.8 Identification of the research gap

The chronological order is maintained in the review of literature to present it in an organized and systematic way.

2.1 Studies on Indian Banking Indicating at the Banking Sector Consolidation

This part of the review presents the meaning and definition of bank, major developments in Indian Banking and the views on banking sector consolidation.

2.1-1 The Meaning and Definition of Banking

The origin of the word ‘bank’ is traced to the Italian ‘banca’, ‘banc’ or ‘banque’, which means a bench which is derived from a practice in Europe where money changers and moneylenders displayed their coins on the benches and conducted their business. Hence the term bank refers to the bench on which the business of money changing and money lending was conducted.¹

The Banking Regulation Act 1949 explains, “Banking means the accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheques, draft, and order or otherwise.”²

2.1-2 Process of Reform and Consolidation

In India the process of industrialization was slow due to thrust on agriculture in the various five year plans and restrictive licensing regime. This has led to the diversification of business activities, in the areas to which the licenses were available and resulted in the emergence of conglomerates. Indian business sectors witnessed various friendly and hostile bids since 1986. This trend was seen in various manufacturing sector such as cement, textiles, aluminum and other allied industries. In the post reform period, a lot of policy changes were initiated by amending the
Chapter-II  

Monopoly Restrictive and Trade Practices Act, introducing SEBI Take over code and allowing foreign investment has boosted the pace of M&A.

\(^3\)Jayanth and others (1998)\(^4\) analyze the productive efficiency of 70 Indian commercial banks during the early stages (1986–1991) of liberalization using Data Envelopment Analysis (DEA) to calculate technical efficiency scores. The study finds that publicly-owned Indian banks have been the most efficient, followed by foreign-owned banks and privately-owned Indian banks. The similar liberalization impact analysis of productive efficiency is carried out by Arunava (1997) and others\(^5\). This differential performance in Indian banking industry confirms the expectation that, in the absence of well-functioning capital markets, there may not be significant differences in the performance of private and public enterprises. Their analysis highlights the importance of creating appropriate institutions prior to pursuing privatization in developing countries.

Pradeep Shrivastav (1999)\(^6\) rightly identifies that there are consolidation wave not just amongst banks but also between Banks and non-bank financial firms His study focuses on whether bigger banks are better and to what extent the financial sector reforms of 1990s made banks efficient? He uses econometric scale – Ray scale of economies to analyze the economies of scale and scope. He identifies that most of the banks are operating below the optimum size; hence there is greater chances for consolidation. Bigger banks are observed to be the cost efficient banks. The results do suggest, however, the need to develop a comprehensive “competition policy” for the banking sector as part of further policy reforms.

The negative impact of bank failures are highlighted by D.M.Nachane (2000) and others.\(^7\) They opine that bank failures generate serious negative externalities for the economy as a whole. These externalities take a wide variety of forms. The use of public money to bail-out insolvent banks can endanger efforts to rein in budget deficits. When capital falls to very low levels, the authorities can force mergers or acquisitions, or proceed to closure.

The benefits of M&A are highlighted by S.S.Tarapore (2000)\(^8\) in his study on Indian financial system. He opines that tightening asset classification, income recognition, provisioning and stipulations on minimum capital adequacy following the
commands of the Basel norms evoked larger holes in the balance sheets of banks. Banks were forced to rethink on lending policies to reduce risks. In the worst cases major restructuring by way of recapitalization, downsizing, and mergers and in some cases closure of financial intermediaries become necessary. M&As promote an accelerated acquisition of production facilities and capabilities, and access to strategic assets, product expansion, more revenue, more labour force, more economies of scale etc.

James A. Hanson (2001)\(^9\) focuses on the Indian banking prior and post liberalization considering certain indicators such as Deposit and loan rates, CRR-SLR. In the reformed era the author identifies the freeing of interest rates and reducing the directed credit as one of the major changes. The challenges of the liberalization identified as expanding the sources of funding, squeezed spread, increased competition. The paper identifies the key problems such as high NPAs, wages and the inability to access larger sources of funds. In addition to the above the author identifies, privatization of the bank ownership to improve the performance of the banks.

John Hawkins (2001) and others analyze the banking sector in emerging economies and hint at ‘what is the potential for bank mergers in the emerging economies?\(^{10}\) Banks in most emerging economies tend to be small. They throw light on various country experiences on market-driven and government-led consolidation. They rightly identify that market-driven consolidation is a relatively new phenomenon in the emerging economies. The authors opine as competition has intensified through deregulation, privatization and entry of foreign banks.

Sayuri Shirai (2001)\(^{11}\) focuses on banking sector reforms, and assesses whether the reform program has been successful so far in restructuring public-sector banks and if so, what elements of the program have contributed. He examines the reform program and its affect on the behavior of public-sector banks, foreign and new domestic banks’ and their contribution to the performance of the whole banking sector. Profitability is evaluated based on ROA, Cost, Income, equity etc. The study uses the concentration indicators and regression analysis to conclude that that the current policy of restructuring the banking sector through encouraging the entry of
new banks has so far produced some positive results. However, the fact that competition has occurred only at the lower end suggests that bank regulators should conduct a more thorough restructuring of public-sector banks.

Financial sector reforms and its implication on financial development is analyzed by T. G. Arun and J. D. Turner (2002). The ratios such as financial issues to national income, stock of financial claims to net capital formation, intermediation ratio, new issues ratio are analyzed in the study. It compares the figures of 1960s and 1990s. The study identifies the need for gradualist approach to reforms in developing economies as they require time to build sufficient regulatory institutions and supervisory authorities.

Most of the authors have viewed nationalization of Indian banks as a socio economic measure adopted by the fiat for branch expansion and credit extension. They identify the present ‘banking structure’, as an outcome of a process of expansion, reorganization and consolidation. Advent of technology has changed the delivery channels in banking sector. The author feels that a complete privatization of banks cannot be ruled out in the future. In the reformed market banks are being market driven by adopting innovation and diversification into financial services.

Petya Kovea (2003) analyses the impact of reforms on the performance of commercial banks in India. In particular, the behavior of industry concentration, cost of intermediation, and profitability of the banking sector are analyzed for a period between 1991-2001. Concentration, bank spreads, and bank profitability are constructed and used in the empirical analysis. Then the cross-sectional and time-series properties of the data are examined in a panel regression framework, under a variety of model specifications and estimation methods. He finds that the cost of intermediation has decreased and the PSBs registered less profitability compared to private and foreign banks and their entry has decreased industry concentration and increased the competition.

K.V. Kamath (2003) and others discuss challenges and opportunities in Indian banking and express that as suggested by the Narasimham Committee, bank mergers could be market-driven instead of externally imposed. The consolidation process
could lead to emergence of four or five large banks with country-wide presence and offices abroad who could act as national champions. At the same time, smaller private sector banks and foreign banks will continue to co-exist mainly as niche players.

Saibal and A.Das (2004) study Indian banking liberalization and choose to conduct a study on ‘market discipline’ as significant efforts have been made to promote the role of market forces in regulating the banks. They identify the improvement in the disclosure norms with regard to NPA, capital adequacy, ROA on government holding etc. The dependent variance is identified considering the various parameters. In this study they opine that many areas previously reserved for the public sector have been opened up to the private sector and government disinvested to improve deficit. Many sick public sector units have been referred to the Board for Industrial and Financial Reconstruction (BIFR) for rehabilitation. He observes that the market solutions to the problem of sick enterprises through voluntary mergers and takeovers are becoming more common.

Prasad and Saibal Ghosh (2005) examined the degree of competition in the Indian banking system for two sub periods between 1996-2004, e.i 1996-99 and 2000-2004, using Panzar Rosse approach. The study tests the model using interest revenue and total revenue as dependent variables for two different bank groups – PSBs and private - foreign banks. The result points at monopolistic behavior of banks across time periods of analysis. The bank groups found in the developed markets and competitive nature of the Indian banking system is not significantly different from the banking system in other countries. The validation of monopolistic competition during the second sub-period suggests that the recent trends toward consolidation led to more competition rather than less competition in the banking sector. They infer from the results that there is scope for further consolidation in the banking industry without compromising competition considerations. They clearly identify the structure of the banking system is currently being shaped by the three Cs: competition, convergence and consolidation.

Reforms, productivity and efficiency in Indian banking is also examined by Rakesh Mohan (2006). Author identifies the ambiguity in various approaches such as the production approach, the intermediation approach, operating (income-based)
approach and more recently the modern approach. Using the modern approach the author identifies the improvement in intermediation cost, non interest income and productivity factors of the Indian banks over 1992 to 2004. The paper examines PSBs, private and foreign banks. While observing some of the key ratios, he observes that PSBs are still lagging behind. Hence the question still remains: will greater scope for mergers and acquisitions within and between public and private sector add to greater efficiency?

Another dimension of liberalization is identified by Chandrashekhar and Pal (2007). They identify that liberalization also involves freedom to acquire financial firms. This often triggers a process of consolidation. It allows for a process of segment-wise and systemic consolidation of the financial system, with the emergence of larger financial units and a growing role for foreign firms in the domestic financial market.

A study on trends in important banking indicators for the 25-year period from 1981 to 2005 is carried out by Ramasastri and others (2006). Analyzing the data from balance sheets of banks, the paper draws some important conclusions for the banking sector as a whole as well as for different bank groups. It explores the changes in the credit disbursal, the Private sector banks concentrated mainly on industrial houses and influential borrowers, the needs of growing small scale industry and farming equipment and inputs are unfocussed. They also throw light on social control and nationalization, the growth and the bottlenecks in the nationalization phase, the reforms and the major transformation during the reforms. Author finds that at present, banks in India are venturing into non-traditional areas and generating income through diversified activities other than the core banking activities through exploring strategic mergers and acquisitions possibilities.

Pandit (2006) conducts a study to examine three specific questions related to transmission mechanism in the post-liberalization period. Firstly how monetary policy “shocks” transmit their influence in a Value At Risk (VAR) framework, and how effective are the chosen policy instruments? Secondly, how does bank lending respond to changes in monetary policy? Thirdly, is there any asymmetry in the lending behavior of ‘big’ and ‘small’ banks? Evidence support the fact that the response of big
banks to monetary policy shocks differs from that of small banks, with the latter being more compliant. In particular, large banks with a wider resource base can more successfully insulate their loan supply from policy shocks \textit{vis-à-vis} the small banks with limited opportunities to access markets for resources in a controlled monetary policy regime. This would imply that \textit{bank mergers and other moves towards consolidation in the banking sector, to create bigger banks}. The study suggests that the bank size can be determined based on the assets.

Ali Ataullah and Hang Lee (2006)\textsuperscript{22} tests hypotheses regarding the possibility of a relationship between three elements of the Economic Reforms (ERs) (fiscal reforms, financial reforms, and liberalization) – and bank efficiency in developing countries. Bank efficiency is measured using DEA focusing on the relationship between the measured efficiency and various bank-specific characteristics and environmental factors. The results show an improvement in the efficiency of banks, especially that of foreign banks, after the ERs. They find a positive relationship between the level of competition and bank efficiency. However, a negative relationship between the presence of foreign banks and bank efficiency is found. Furthermore, the study reveals that fiscal deficits negatively influence bank efficiency.

Prakash Singh (2007)\textsuperscript{23} views, Indian banks have to be encouraged to expand fast, both through \textit{organic growth and through consolidation}, in order to fuel the growth of large firms and to strengthen their risk assessment systems, for catering to the requirements of smaller firms. The study finds that Indian Banking sector is poised for tremendous growth and with proper policy framework in place, it would be very soon, matching their global counterparts on most of the relevant banking indicators/ parameters (except size). Government is also planning to kick-off \textit{consolidation in the sector by lining up a series of merger and acquisition proposals for the public sector banks}.

Richa and Bodla (2007)\textsuperscript{24} find that reforms have led to the increase in resource productivity, increasing level of deposits, credits and profitability and decrease in non-performing assets. However, the profitability, productivity, financial and operational
efficiency, has come under pressure because of changing environment of banking. They identify the key determinants of profitability of Public Sector Banks in India. The analysis is based on step-wise multivariate regression model used on temporal data from 1991-92 to 2003-04. The study has indicated that the variables such as non-interest income, operating expenses, provision and contingencies and spread have significant relationship with net profits for PSBs, private and foreign banks. They express their concern over shrinking spread and its impact on profitability in the competitive environment.

A contrary view on banking growth is expressed by T.T.Ram Mohan (2007)\textsuperscript{25}. The paper explores the factors underlying the improvement in performance and visits some of the current areas of interest such as credit growth, privatization, entry of foreign banks and consolidation. There is a room for consolidation in Indian banking particularly in old private sector banks and cooperative banks. Through mergers these weak banks can emerge as viable regional players. He opines that mergers in PSBs are not must as they have registered organic growth in the past. Mergers would be an irritating and wasteful distraction for bank's management. The author feels that pre-reform and post reform are not mutually exclusive. The improvement seen today is the return for the investments in the past.

Mishra and others (2007)\textsuperscript{26} identify the changes envisaged by RBI, to gradually deregulate this sector to the foreign banks. Some of these regulations include the proposals such as lifting the ceiling on voting rights in banks, smoothen mergers and acquisitions of private banks, permit foreign banks to set up subsidiaries in India. The author identifies that the appetite for credit and newer banking products is increasing. This also implies that there is a scope for consolidation, amongst various bank sectors as well as financial institutions so as to be able to provide these newer products and services to customers.

Another study in Indian Banking Sector (Chinmoy, John, Phani 2008)\textsuperscript{27} considers liberalization and its impact on agency costs. This paper attempts to study the abnormal gains posted by the private sector banks post liberalization. On February 2002 RBI issued a circular that signaled a policy liberalization facilitating acquisition of Private Sector Banks by foreign entities. The gains of the Private Sector Banks were
Chapter II Review of literature

quite high compared to nationalized banks. The paper analyses the firm specific abnormal returns using cross sectional regressions and find a significant relationship between firm specific abnormal returns and factors typically associated with a bank’s potential for takeover. These results provide first empirical support for Stulz’z hypothesis that one cause of the valuation gains associated with liberalization is the expected gain from a reduction of agency costs.

The above studies clearly focus on the reforms, performance of the public sector banks and the issues related to performance of these banks. The studies hint towards the restructuring of the banking activities through consolidation. In the reform period the performance of the PSBs was the area of concern for most of the researchers. Many have indicated that M&A is a better and the faster way of expansion.

2.2 Studies on Mergers in Indian banking

Adrian, Geetha, Tom and Jones\(^2^8\)(2006) offers an insight into the effectiveness of economic policy reforms in the Indian Banking System by examining the efficiency benefits of mergers among Scheduled Commercial Banks in India over the post-reform period 1991-92 to 2004-05. It does this by using the methodology developed by Bogetoft and Wang (2005). It also provides a metric for judging the success or failure of a merger. Overall, bank mergers in the post reform period possessed considerable potential efficiency gains stemming from harmony gains. Post merger efficiency analysis of the merged bank with a control group of non-merging banks reveals an initial merger related efficiency advantage for the former did not show a sustained increase thus failing to provide the merging banks with a competitive advantage compared to their non-merging counterparts.

Chinmoy Ghosh (2006) \(^2^9\) and others study foreign investment limit in Indian banking, when the RBI issued a circular that signaled a policy liberalization facilitating acquisition of private sector banks in India by foreign entities. Portfolios of private sector and nationalized banks posted significant value gains in the days surrounding the announcement. The gains by private sector banks were almost double those of nationalized banks. The study analyzes the firm specific abnormal returns
using cross-sectional regressions and finds a significant relation between firm-specific abnormal returns and factors typically associated with a bank’s potential for takeover.

Jay Mehta and Ram Kumar (2006) view fragmentation as a threat to stability. They analyse the performance of the bank sector and the equity market benchmark index in India and USA (considering beta, standard deviation and daily mean returns) and indicated that the returns are more in India but risk is also higher in bank stock. The paper also considers average CAR for foreign, private, public sector and State bank group and finds that many banks may find it difficult to maintain 9% capital to risk weighted asset ratio. Recent reports on banking sector often indicate that India is slowly but surely moving from a regime of 'large number of small banks' to 'small number of large banks'. The aim of this paper is to probe into the various motivations for mergers and acquisitions in the Indian Banking sector. Given the increasing role of the economic power in the turf war of nations, the paper looks at the significant role of the state and the central bank in protecting customer's interests vis-à-vis creating players of international size.

Another merger event study analysis which focused on the share price returns in case of Indian banks' merger announcements considered both forced (bailout) mergers and voluntary mergers and reveals that in case of forced mergers neither the bidder nor the targets' stocks gained from the merger (M. Jayadev and Rudra Sen Sharma 2007). However in case of voluntary mergers the bidders' stocks gained more than that of the targets'. The study also includes a qualitative approach of surveying the various bank managers to identify the critical issues in mergers. To cope up with the external environment the authors recommend mergers in Indian banking.

The similar event study is conducted by Manoj and Jagandeep (2008). The study analyses five mergers in the Indian banking sector to capture the returns to shareholders as a result of the merger announcements. They focus on the shareholder wealth effects of bank mergers. Using the single-factor model the study finds that the average Cumulative Abnormal Return (CAR) of the bidder banks is positive and substantial. These results are statistically significant also. Thus, the bidder banks got significant positive abnormal returns. The two-factor model results reveal that the merger announcement in the Indian private sector banks generated a positive and
statistical significant CAR to the shareholders of the bidder banks. The single-factor model finds that the combined CAR for all target banks is positive, significant and substantial. The combined CAR has been propped up due to very high CAR registered by Bank of Madura.

The merger announcements in the Indian banking industry have positive and significant shareholder wealth effect both for bidder banks and target banks. The market value weighted CAR of the combined bank portfolio as a result of merger announcement is 4.29% in a three-day period (-1, 1) window and 9.71% in 11-days period (-5, 5) event window.

The trend and motivators of consolidation in the banking industry worldwide and in India are explored by Dr. Meera Sharma. The Indian merger possibilities are evaluated based on scale efficiency study and relates cost-output. Scale efficiency can be estimated based on two approaches- production approach (Producing customer accounts), intermediation approach (deposits and loans). The study follows the second approach using Ray Scale economies. The very small size banks are identified as potential targets using the scale and mostly these banks are from old private sector and foreign banks. The study identifies that capital adequacy, market expansion, cost cutting, technology, diversification etc as the major rationales for merger. The paper concludes that Indian banking sector would witness more M&As and calls for forward looking approach from the regulators to ensure growth and stability. The article finds strong evidence of circumstances that might favour consolidation in Indian banking.

Prakash Singh considers 6 bank mergers post 2000 and undertakes a DEA. The study tests cost and profit efficiency of the acquiring banks post merger. These efficiency scores were calculated for the banks not involved in merger, both from public and private sector to understand the future trends in consolidation.

K Srinivas analyses pre and post merger analysis of 6 banks. 5 years before and 6 years after the merger analysis is carried out based on CAMEL model. The study does not find any significant change in the observed parameters.

From the above studies it is clear that there are very few merger studies pertaining to Indian Banking sector.
2.3 **Merger Studies in Other Indian Sectors**

Nagesh (2000)\(^{36}\) opines that although the bulk of the M&A deals have taken place in manufacturing, deals in services sector have gradually become important in the recent years. Banking and financial services, advertising, other business services and travel agencies account for a significant number of deals in the recent years especially in the 1999-2000. It is in tune with the worldwide trend of growing international trade and investment in services.

Mergers in private corporate sector in India is observed by Beena (2000).\(^{37}\) The study tracks the merger cases between 1990 and 1995. The acquiring firms were distinguished based on manufacturing and others, total asset size and some selected ratios. The study focuses on different type of mergers such as horizontal, vertical etc and the impact on assets and size of the acquiring firms. The growth rates in selected financials are presented.

A study on mergers in Indian Aviation industry is carried out by Sudhir Warier (2007).\(^{38}\) The author identifies increasing competition and cost concerns are the major drivers of mergers in Indian aviation sector.

Kale (2009)\(^{39}\) focuses on overseas acquisitions of the Indian firms and examines the primary reasons driving this trend. Indian companies are engaging in overseas acquisition to primarily gain access to new markets, advanced technologies or products, and to acquire management talent that has the mind-set and skills to operate businesses in more advanced or competitive conditions. Data show that thus far, Indian companies have also fared reasonably well in their acquisitions, both in terms of meeting their acquisition objectives and creating value for shareholders.

Another study on cross border acquisition was carried out by Sougata and others (2009).\(^{40}\) They also try to understand the distinctive features of Indian multinationals as acquiring firms in cross border acquisitions.

2.4 **The Bank Mergers Across the World**

Exploring the merger studies in US and other parts of the world reveals the possible dimensions of the bank merger studies and also throws light on the models of analysis. The bank merger studies in US dates back to 1973 by Harold Demesetz and he
identifies the higher profitability due to higher concentration. During 1980s a lot of studies on bank mergers were witnessed on variety of issues such as productivity-efficiency gains, risk and return, efficient market structure hypothesis, market structure and competition, target features-pricing, strategic suitability of merging banks considering lending practice and pricing, shareholder’s wealth etc, are summarized below. There were many studies observed, the important ones are summarized below.

2.4-1 Economies of Scale Studies

The studies suggest that the scale economies appear to be a valid motivation for mergers. Scale economies studies in banking are extremely sensitive to the researchers’ statistical techniques and data definitions.

The relationship between size and risk is provided in a paper by Nellie and Rhodes(1988). They studied several measures of bank risk relative to the firms’ total assets, geographic diversification, average number of branches per market and other variables. They found a positive and statistically significant relationship between risk and bank size that is the larger the bank size, lower the volatility in earnings. The increase in geographic dispersion and number of branches per market reduces the risk of failure, implying that the acquiring banks may be able to lessen their risk by entering into new markets or expanding branch network in their own markets.

Ben and Joao 1997 study the risk effects of US bank acquisitions which differ from merger and only those banks are considered which maintained separate entity even after acquisition. They follow 2 step procedures; first they compute the risk for sample organization and then normalize this measure by subtracting the mean of the same measure calculated for the set of all banks in the industry. The 3 indicators of banking organization risk adopted in most of the literature. Standard deviation, coefficient of variation of banks’ profitability and ‘z’ score as a measure of bank’s probability of bankruptcy. They find that the recent consolidation in banking industry is producing less risky organizations which are too big to fail.
2.4-2 Market Structure Studies
Apart from the effect of bank size on risk and efficiency the question of whether concentrated banking markets are less competitive than non-concentrated ones has received considerable attention.

Paolo, Nicola (2003) analyzed overall impact of deregulation and consolidation on bank competition in Italy during 1984 to 1997. They estimated Lerner indexes, a complement ratio to marginal cost and price. The study covers 5 locations within Italy which helped them to identify the relevant banking market. They have focused on market concentration and competition. The indexes remained unchanged initially and showed a decline in the later part of the study. The study did not find any evidence to prove that the consolidation worsened the competition.

2.4-3 Targets and Acquirers Related Studies
There were several studies on premerger characteristics of targets and acquirers.

Hunter, William, Wall, Larry (1989) study the key target bank characteristics of 559 US mergers between 1981-1986 and find that most of the target had above average profitability, faster deposit and asset growth, a higher ratio of loan to earning assets and better leveraged. These findings were consistent with some of the previous studies. It also focuses on strategic acquirer’s profile. They analyze the data using cluster analysis.

Dario, Fabio and Carmelo (2002) study the efficiency of Italian Banks’ distinguishing mergers from Acquisitions, before and after striking the deal. They use the balance sheet data and ratios. The determinants of M&A are estimated multinomial logit regression. They find that the acquisitions are aimed at improving the quality of loan portfolio of the target bank, whereas mergers are aimed at expanding the acquirers services.

Another post merger study is carried out by Morris and Alan (2004) for 579 US bank merger between 1986 and 1998, testing the hypothesis that the post merger performance is driven by the targets asset quality, cost control and revenue and whether overall profitability of the buyer is predictive? They mainly analyze ROE and ROA regression analysis and conclude that post merger returns can be predicted
depending on the base year data of the buyer and buyer characteristics dominate the prediction.

Mergers and acquisitions and bank performance in Europe considering the strategic similarities between merging banks are carried out by Yener and David (2004). The study compares pre-and post-merger performance in comprehensive sample of European Banks from 1992-2001. It also understands the strategic fit between merging companies based on similarity in resource allocation patterns measured from their balance sheet data. This would throw light on the risk profile, Marketing expenditure or efficiency. They have included various indicators of financial measure such as capital structure, Asset and liability composition, liquidity, risk exposure, financial innovation and efficiency. Weighted average ROE of merging banks two years before and after acquisition is computed and compared and it shows an improvement in the post merger period. The overall picture is large and generally efficient banks takeover relatively smaller institutions with diversity. The success of the merged entities is mainly due to the strategic fit.

2.4-4 Effect of Bank Mergers on Bank Shareholders
One of the most visited topic under bank mergers across world is impact on shareholders’ return.

Patrick and Dirk (2006) study value creation by domestic and cross border M&A transactions in the European Banking Market. The research studies the value creation for shareholders of target and acquirers. The study covers a sample of 98 bids and reveals that the shareholders of the target experience the positive returns whereas the shareholders of the acquiring company or bidders does not experience any significant gain or loss. They compare the European and cross border deals based on event study analysis.

2.4-5 Efficiency Studies
Srinivasan, Aruna(1992) revisits the studies on cost savings from US bank merger and present additional evidence on pre and post merger bank efficiency considering non interest expenses divided by net interest and non-interest revenue. Using univariate analysis 2 years prior merger and 4 years after merger they find
significant decline in average interest expenses to net interest and non-interest revenue. Jalal, Berger and Humphery (1996) add some missing information about the profit efficiency and market power effects of mergers using profit function. All 3 potential sources of increased operating profits from merger – cost efficiency, profit efficiency and market power in setting prices is evaluated and compared. They test several hypotheses regarding the pre merger conditions which contribute to efficiency and market power. Statistical analysis suggests that in US mega mergers profit efficiency has significantly improved but not cost efficiency; at the same time they increased the market power.

Stavros Peristiani (1997) carry out X-efficiency and scale efficiency of U.S. banks. The study uses the Translog flexible functional form to estimate the cost structure of the banks and measures of efficiency. Distribution Free Approach (DFA) is used to estimate the X Efficiency. The model is extensively used to analyse the cost characteristics of the depository firms. The issue is whether merger survivors enhanced the performance. Post merger scale efficiency and X efficiency are estimated for the surviving banks. The surviving banks’ X efficiency declined after 2 to 4 years after merger compared to those who have not merged. The scale efficiency improved moderately. Kevin E Rogers (2003) also studies consolidation in the US banking industry and the viability of small commercial banks using X Efficiency. Using cost and profit frontiers it is found that small banks are cost efficient but not necessarily profit efficient.

The two academic approaches to study merger gains are – Accounting ratios based approach and market based approach. Pilloff, Steven (1996) combines both approaches to find whether both accounting and market data yield consistent implications of the merger using size, location and the operating performance to estimate the abnormal return. And finds little or no significant change in the variables selected due to low target profitability, higher merger expenses etc. Abnormal returns are higher for mergers with the greatest opportunities for expense reduction.

Simon and Robert (1999) analyze mergers of publicly traded banking organizations and find that ratios of the acquirer and the target for 8 quarter is considered and compared to industry benchmark average. The study reveals that 1990s
merger in US market have resulted in either positive earnings or greater efficiency. Only one of the acquirer’s ratio is positively related to its size. Otherwise larger acquirers are more likely to be associated with a reduction in the expected performance and earning benefits of the merger.

Bank mergers are analyzed by many researchers from the production efficiency perspective. The implementation of General Agreement on Trade in Services (GATS) has removed the protection available to the banks. Traditionally it is believed that mergers and acquisitions would lead to better economies of scale (Khong, Roy & Muzafar 2000). The study examines the input efficiency and bank productivity in Malaysia using the production function and establishing multilateral output index considering the revenue, financial products offered, input cost to finally establish a ratio between input and output. The study covers a long period of 12 years from 1989 to 2000 covering all domestic and foreign commercial banks. The study reveals that the acquiring banks have higher productivity level than the industry average. The new entity exhibits the lower productivity initially as the integration of different computer platforms, corporate culture and strategies requires some time.

Fadzlan Sufian (2006) examines bank Mergers and Acquisitions in Singapore using Non-Stochastic Frontier Window event study approach to analyze the effects on efficiency. As Singapore is the leading Financial and Banking center the study attempts to study the impact of mergers and acquisitions on Singapore Banking. Scales efficiency of the banks is studied using Data Envelopment Analysis (DEA) introduced by the Charnes, Cooper and Rhodes (1978) to measure the efficiency of Decision Making Units (DMU) that is obtained as a maximum of ratio of weighted outputs to weighted inputs. Multiple inputs and outputs are reduced to single virtual input and single virtual output by optimal weights. Following Rhodes (1998) and Avkiran (1999) five financial ratios have been chosen to analyze cost, profitability and risk (Non interest expense to total assets, Personnel expenses to total assets, Non-performing loans to total loans, ROA and ROE). The study from DEA model suggests that the merger has resulted in higher overall efficiency of Singapore banks, post merger versus pre merger. Despite that from the scale efficiency perspective the findings do not support further consolidation of banks in Singapore.
Julapa Jagtiani (2008) explore the effects of the merger on Community Banks in US banking industry as number of these banks fell by more than 3000 between 1990s and 2006. The small community banks were absorbed by the large, medium and even bigger community banks operating in the same location. They consider profitability, efficiency, and asset quality and capitalization ratios and find that merger has the potential to strengthen these community banks. Large and medium sized banks were not willing to pay higher premium to these banks where as large community banks paid higher premium.

2.4-6 Financial Performance Related Studies

Rebecca S Demsetz; Philip E Strahan (1997) explore market measures of diversification and find that the large bank holding companies are better diversified than the small bank holding companies. The risk reducing potential is offset in these large banks by the lower capital ratios. While operating at greater leverage the consolidation for diversification can be pursued. Risk will be reduced only when risky lending is reduced and capital ratios are increased. If risk increases the profitability should also increase and most of the researchers have recommended the same. They create diversification index by scaling systematic risk by stock return variance. $R^2$ is a diversification measure and stock return variance. The study provides a strong evidence of link between size and diversification and they also opine that the diversification may be strong merger drivers.

Some studies which followed combined bank efficiency measures and accounting based financial ratios to test the size efficiency. (Stephen, Larry and Kevin 2002). The study involves multi stage process analysis of small, medium and big US banks. First stage calculates alternative profit efficiency scores using the stochastic frontier approach. Second stage correlates financial ratios with the CAMELS rating. (Capital adequacy, Asset quality, Management quality, Earnings, Liquidity, Sensitivity rating). The third stage uses multiple regression analysis to determine any relationship existing between financial ratios, CAMELS rating and Alternative efficiency scores. The techniques which are used in isolation by different researchers are used in combination here. The relationship is tested by a hypothesis. For bigger banks ratios
and scores fit better and recommend the inclusion of efficiency scores in rating system of the banks by the regulators. The study proves that though the small banks are not profit efficient compared to big banks, it is definitely cost efficient.

Parametric methods are used to estimate the frontier with an explicit functional form given. These types of frontier estimation methods fall under Stochastic Frontier Estimation methods. These methods largely depend on the industry under the study as well as data availability. Most academic studies follow two distinct approaches to evaluate mergers. The first method uses the Accounting data before and after merger to identify the gain. The shortcoming is they are based on historical data and often neglect the current market value. The second approach tests the stock market reaction to the merger announcements on the share prices of targets and the acquirer separately. The stock market data may also be affected by the overall economic condition.

2.5 Literature Review - Joint Venture

A Joint Venture is an entity formed between two or more parties to undertake economic activity together. Partners contribute to equity and create a new entity to share revenues and expenses. There are various entry modes for the Multi National Companies (MNCs) to enter into new markets. There are five main choices of entry mode: Exporting, Licensing, Franchising, Joint venture, and the wholly owned subsidiary.\textsuperscript{58}

Diversification of banking activities is an initiation of RBI to restructure banking activities into related fields (Sayuri Shirai, 2001)\textsuperscript{59}. Intensified competition, market determined rates brought the spread under the pressure. Diversification of activities gives the banks a scope to earn non-interest income. The investments have also increased due to this diversification. Banks have ventured into different financial services such as underwriting, insurance (both life and non-life), investing, mutual funds, advisory services, Depository and trading services, Factoring etc.

The operational autonomy to the Indian banks through banking sector reforms have encouraged the banks to meet up the growing demand for the various financial services and products in the globalised environment. The banks have chosen various
ways to enter into the diversification mode. They include Joint ventures, corporate tie ups, setting up wholly owned subsidiary etc.

According to IRDA, ‘bancassurance’ refers to banks acting as corporate agents for insurers to distribute insurance products. Literature on bancassurance does not differentiate if the bancassurance refers to selling of life insurance products or non-life insurance products. Accordingly, here ‘bancassurance’ is defined to mean banks dealing in insurance products of both life and non-life type in any forms.

Bhide and Prasad(2001)\textsuperscript{60} identify the emerging challenges in Indian banking, identify the changing facet of the PSBs. In a situation of universal banking, there could be multiple regulators covering a single entity, depending on the functions undertaken by it. In such a scenario, the risk of regulatory arbitrage or competitive concessions might prove overwhelming. The role of regulation in such circumstances should be to ensure risk mitigation, and not risk diversification. More importantly, at a time when banks and financial institutions would require higher levels of capital in the light of the pronouncements in the new Basel Capital Accord, it is possible that the banking industry might witness mergers and acquisitions to exploit cost benefits, or revenue benefits as financial entities brace to position themselves as universal banks.

While comparing Indian and Australian banks Unnithan and Swatman(2001)\textsuperscript{61} observes that progressive banks such as ANZ Bank has adopted joint ventures for increasing competitiveness and ‘one stop environment’ to the customers. Similar practice is identified with ICICI Bank in India to obtain higher growth momentum.

Jayanth Verma (2002)\textsuperscript{62} revisits the financial sector reforms and also reviews the Indian banking system solvency, need for lending autonomy, CRR-SLR liberalization etc. Commenting on the Financial Institutions in India, he observes the role reversal of these institutions and opines that they have attempted to restructure their business by following universal banking model. This model is prevalent in Europe and Germany.

Rajan and Ajay (2005)\textsuperscript{63} focus on the new directions in financial sector policy. Looking at the issues of NPA disclosure, Bank recapitalization they recommend the closure of weak banks. They observe that the role of supervisors and regulators should
ensure the market discipline. As banks become more sophisticated in their functioning, the risks they take on will become harder to measure. Nevertheless, as a rule of thumb, banks that are distressed, somehow find competence through diversification. (This is a good recipe for disaster). On the other hand, universal banking should be permissible to the best run entities, provided they can set up internal fire-walls between the various activities, and provided they fulfill the statutory requirements of each activity.

Karunagaran (2006) explores the scope for bancassurance models as a feasible source of sustainable income to the banking sector by exploiting the synergy in the context of India having the largest banking network on the one hand and lower insurance penetration and insurance density on the other hand. It concludes that going by the present pace, bancassurance would turn out to be a norm rather than an exception in future, in India and it would be a ‘win-win situation’ for all the parties involved - the customer, the insurance companies and the banks. The financial liberalization and financial innovations have drawn the worlds of banking and insurance closer together. In India, ever since espousing of financial reforms following the recommendations of First Narasimham Committee, the contemporary financial landscape has been reshaped. Banks, in particular, stride into several new areas and offer innovative products, viz., merchant banking, lease and term finance, capital market / equity market related activities, hire purchase, real estate finance and so on. Thus, present-day banks have become far more diversified than ever before. Following the implementation of Malhotra Committee’s far reaching recommendations, the insurance sector had undergone sweeping changes during the later 1990s and 2000 onwards and of which only a few developments are highlighted here. IRDA was established in the year 2000 as an exclusive Regulatory Authority for the insurance sector through the enactment of IRDA Act, 1999.

The contribution portion of joint venture partner to equity is determined by the regulations prevailing. Operating control and ownership stake is shared by a team of managers from both parent companies. Companies opt for the Joint venture as a means of expansion of their activities as they can share resources, skill sets, technology, special knowledge, expertise etc. Regulatory liberalization encourages the formation
of Joint ventures. MNCs and Local players can mutually benefit to integrate in the global market (Kale and Anand 2006)\textsuperscript{65}

Rakesh Mohan (2006)\textsuperscript{66}, recommends competition enhancing measures by Granting of operational autonomy to public sector banks, reduction of public ownership in public sector banks by allowing them to raise capital from equity market up to 49% of paid-up capital. He prescribes transparent norms for entry of Indian private sector, foreign and joint-venture banks and insurance companies. Permitting foreign investment in the financial sector in the form of Foreign Direct Investment (FDI) as well as portfolio investment, have allowed banks to diversify product portfolio and business activities.

Strategically it makes sense for the banks to expand their operations into financial services as it is relatively advantageous for the banks to cross sell these related products to the existing customer. (Richa Sharma and Nijaguna 2006)\textsuperscript{67}. Both the bank and the customer have benefits due to one stop financial service provider. The study involves qualitative technique and analyses cross selling practice in 6 PSBs and 3 private sector banks and finds significant difference in their approach, due to their philosophical difference. They opine that PSBs should focus on incentives and training, whereas the Private Banks need to focus on the control mechanism as their aggression may annoy the customers.

There is an implicit belief that all government linked financial institutions come under the safety net. While too explicit a statement of which institutions are covered and which are not may trigger off undesirable runs, it should be made abundantly clear both through words and through deeds that financial institutions will be allowed to fail. While some institutions may indeed be too big to fail, this category should be as limited as possible, and supervised extremely closely.

\textbf{2.5-1 The Related Studies in the Developed Market}

This enables the insight into the development of thought and the dimensions of the study under taken.

Wall, Larry Reichert, Alan, Mohanty, Sunil (1993) study the diversification opportunities due to deregulation. Restricting banks from operating in non banking
activities led to reducing competition in US market. Development in communication, Information Technology and modern financial theory has eroded the barriers between banks and non banks. The study focuses on whether deregulating bank activities would increase or decrease banks’ risk or not, portfolio affects of combining banking and non banking activities. It analyses the historic Accounting Rate of Return (ARR) on various bank and non bank activities reported to the internal revenue service. These may be posed to higher risk and result in social costs, even the failure of individual institution may run through the banking system. Another threat is diversion of resources to the non bank activities. The analysis includes 7 industries Return on Assets volatility. He concludes that the policymakers need to focus on risk rather than mere diversification.

Rudi Vander Vennet (2002) study cost and profit efficiency of financial conglomerates and universal banks in Europe which are allowed to hold the equity stake in financial and non-financial firms. Adoption of market based or bank based functions depend upon the regulatory environment. The arguments favoring financial conglomerates are economies of scale, financial stability; diverse portfolio etc. on the other hand conflicting interests and concentration of financial activity are the main drawbacks. They examine cost and profit function in relation to profitability. The main findings are they are more cost and profit efficient than non universal banks when it comes non traditional activities.

Gleason, Mathur and Roy (2003) find positive average abnormal returns when their sub sample of banks expand abroad using joint ventures. Thus, hypothesis states that international joint ventures are value enhancing transactions and should result in positive average wealth gains. In 2006 the same authors examine international bank expansions, which are classified as banking (scale related) or non-banking (complementary) moves into developed or developing markets. The market responds favorably to expansions through joint ventures by U.S. banks, and insignificantly to expansions through acquisitions. Accounting and operating performances (for joint venture banks) and long-period holding returns (for acquisitions) show improvement in the two years following the announcement. Systematic risk declines for the overall sample, for acquisitions, and for expansions into developing countries. In general,
scale or developing expansions are better pursued through acquisitions, whereas complementary or developed expansions are best pursued through joint ventures.

Another study published in the same year by the same authors examine the acquisition and joint venture strategies of U.S. banks from 1980 to 1998 to diversify into non-banking sectors. They find that the market responds favorably to both types of expansions, with the gains being shared between acquiring banks and their targets and venture banks and their non-bank partners, respectively. Acquisitions expose acquiring banks to significant increases in nonsystematic, market, and total risk, while joint ventures result in significant decreases in the nonsystematic and total risk measures for participating banks. The results suggest that product-market expansions, in general, provide U.S. banks with value-enhancing opportunities, and that joint ventures may improve both the return and risk characteristics of the partner banks.

Corporate tie-ups are used by the organizations either to share resources or partnering sales. The banks have entered into strategic tie-ups to sell some of the financial products such as insurance and mutual funds. Some banks have floated their own Joint venture company along with a foreign partner to market their own product under their own brand name. H John, L Thompson identify growth strategies, which are external growth strategies commonly known as inorganic growth strategies. Organic (internal) growth is slow, whereas inorganic growth through mergers, acquisitions and joint venture is faster.

John and Richard identify restructuring as long term objectives and as a part of grand strategies. He opines that strategic tie ups or alliance is a less rigid arrangement as it involves no equity stake.

2.6 Motivations of the Study

The selection of financial indicators were influenced by the following studies. Sang Yong and other (2006) aim to study and provide empirical evidence on the impact of M&A and joint ventures on the value of IT and non-IT firms. Using the event study methodology, they have analyzed the effect of strategic alliance announcements on firm value in a sample of 170 firms. The results, find stronger support for positive impact on gains in firm value among non-IT firms than among IT
firms. The study focuses on all types of restructuring such as M&A, JV and strategic tie up. The Joint venture study in the present study is guided by the observation in this paper.

B Rajesh (2007) and Prabina conduct a comparative study of the acquirer and the target firms in the year of merger and the logit analysis reveals that the size of the target firms was much smaller compared to the acquirer firms. The acquirer firms have higher cash flow, higher PE ratios, higher book value, higher liquid assets, and lower debt to total assets ratio, which are statistically significant when compared to the target firms. Some evidence points out higher leverage for the target firms especially for measures of market leverage. The lesser the liquidity position, greater the probability of a firm becoming a target. The larger firms are less likely to become acquisition targets. The above study covers firms other than banks. Some of the indicators used above were referred while undertaking an analysis of targets and acquiring banks.

Donald and others have analysed long term performance of cross border bank acquisitions of US banks. They have used parameters such as ROA, ROE, CAR, Expenses to revenues, employee income, assets growth rate etc for the analysis. Timothy (2009) and others have studied the targets and motives in US banking industry. The study covers a large number of sample between 1996 to 2005. The analysis is undertaken considering certain financial indicators such as ROA, CAR, efficiency, market share etc. The similar indicators are used in the present study.

Mansour (2008) and others have listed few considerations for banks mergers. They are improving service, product expansion, asset base, multiple channels and brand creation, managerial skill etc. the study covers only national banks of UAE and is based on survey. The Likert's scale was used in the questionnaire to understand the response of the top management on the above mentioned considerations. Similar attempt to explore the top management's opinion on bank mergers is included in the present study.

Gutknecht and others (1993) observe the type of acquisition affects the employee morale in three chosen companies for the study of which two were manufacturing firms and one was service company. In bailout acquisition though there
Chapter-II

Review of Literature

is a sense of relief initially, it is only short lived as the lay off and down sizing begins to reduce cost. Hence the researchers address the question, “Can a corporate ownership change result in sustained or improved morale of its survivors?” The survey was administered to the supervisors, middle managers, and administrators of the acquired companies. The survey focused on perceived changes in morale in the face of perceived changes in work load, job satisfaction, opportunities for advancements, company productivity and job security.
PART II

2.7 A Review of M&A Trend in Indian Banking Sector

Rajesh and others identify that India had been a late starter in the M&A process due to unfriendly regulations and restrictive laws. Globalization and liberalization of the Indian economy with the onset of 1990s have paved the way for consolidation towards the end of the decade. During the decade, many business groups have undertaken restructuring process to face competition. The data presented in the study is compared with the banking mergers in the below table.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total M&amp;A</th>
<th>Banking Sector M&amp;A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974-79</td>
<td>167</td>
<td>Nil</td>
</tr>
<tr>
<td>1980-84</td>
<td>171</td>
<td>Nil</td>
</tr>
<tr>
<td>1985-89</td>
<td>204</td>
<td>6</td>
</tr>
<tr>
<td>1990-94</td>
<td>882</td>
<td>6</td>
</tr>
<tr>
<td>1995</td>
<td>450</td>
<td>Nil</td>
</tr>
<tr>
<td>1996</td>
<td>541</td>
<td>2</td>
</tr>
<tr>
<td>1997</td>
<td>636</td>
<td>2</td>
</tr>
<tr>
<td>1998</td>
<td>730</td>
<td>Nil</td>
</tr>
<tr>
<td>1999</td>
<td>765</td>
<td>1</td>
</tr>
<tr>
<td>2000</td>
<td>1477</td>
<td>1</td>
</tr>
<tr>
<td>2001</td>
<td>1367</td>
<td>1</td>
</tr>
<tr>
<td>2002</td>
<td>1224</td>
<td>1</td>
</tr>
<tr>
<td>2003</td>
<td>2306</td>
<td>1</td>
</tr>
<tr>
<td>2004</td>
<td>1069</td>
<td>2</td>
</tr>
<tr>
<td>2005</td>
<td>1237</td>
<td>1</td>
</tr>
<tr>
<td>2006</td>
<td>1141</td>
<td>2</td>
</tr>
<tr>
<td>2007</td>
<td>NA</td>
<td>3</td>
</tr>
<tr>
<td>2008</td>
<td>NA</td>
<td>1</td>
</tr>
<tr>
<td>2009</td>
<td>NA</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: compiled from various source

In the post reform period the mergers and acquisition activity increased considerably whereas the banking sector did not experience much change. The merger developments are tracked in the following table. Then a brief explanation of all the mergers are presented chronologically.
Chapter-II

Review of literature

TABLE 2.7-2 Merger Phase in Indian Banking 1961 to May 2008

<table>
<thead>
<tr>
<th>PERIOD</th>
<th>NO. OF MERGERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre nationalization of banks (1961-1968)</td>
<td>46</td>
</tr>
<tr>
<td>Post reform period (post 1991)</td>
<td>21</td>
</tr>
<tr>
<td>Forced mergers</td>
<td>13</td>
</tr>
<tr>
<td>Voluntary mergers</td>
<td>5</td>
</tr>
<tr>
<td>Convergence of financial institution to banks</td>
<td>2</td>
</tr>
<tr>
<td>Total number of mergers</td>
<td>80</td>
</tr>
</tbody>
</table>

*Source: Compiled from various publications of RBI

Box 2.7-1 The Profiles of the Targets and Acquirers

<table>
<thead>
<tr>
<th>Number of Public Sector targets</th>
<th>Number of Public Sector acquirers (7 banks in 12 cases)</th>
<th>Number of private Sector acquirers - new generation banks (4 banks in 6 cases)</th>
<th>Total number of mergers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>All 12 acquisitions were fiat driven</td>
<td>All 6 acquisitions were business driven</td>
<td>1</td>
</tr>
<tr>
<td>Private targets</td>
<td>11</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Targets from Un-scheduled and Co operative banks and others</td>
<td>7</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Number of private Sector acquirers- Old generation Banks</td>
<td>This acquisition was fiat driven.</td>
<td></td>
</tr>
</tbody>
</table>

The above box indicates that the last few decades have witnessed the failure of only one PSB, while PSBs absorbed all weak banks. New generation Private sector banks pioneered the business driven mergers.

2.7-1 Description of Fiat Driven Merger Post 1991

This part presents the brief description of the bank mergers occurred post 1991.
2.7-1.1 New Bank of India Merger with Punjab National Bank
New Bank of India was merged with PNB as on 4th September 1993. This merger was initiated by the RBI to save the weak bank. New Bank of India was a public sector bank and the acquirer was also a Public Sector Bank. 78

2.7-1.2 Bank of Karad Ltd Merger with Bank of India
Bank of Karad was merged with Bank of India as on 20th July 1994. This merger was initiated by the RBI to save the weak bank. Bank of Karad was private sector bank and the acquirer was the Public Sector Bank.

The Bank of Karad was placed under liquidation at the instance of the Reserve Bank by the High Court of Bombay by its ad-interim order dated 27th May, 1992. The offer submitted by Bank of India was accepted for Rs.52.00 crores after careful consideration by all concerned. 79

2.7-1.3 Kashi Nath Seth Bank Merger with State Bank of India
In pursuance of Government of India and Reserve Bank of India, SBI took over Kashi Nath Seth Bank Ltd as on 1st January 1996. The branches added to SBI’s existing branches (8800) were 12. In this merger too acquirer was PSB and the target was private sector bank. 80

2.7-1.4 Punjab Co-op Bank Ltd and Bari Doab Bank Ltd Merger with Oriental Bank of Commerce 8-4-1997
One co-operative Bank and another private bank was taken over by OBC as per the notification issued by the Government of India, dated 8th April 1997. In this merger too the acquirer is a Public Sector Bank. The merger of these two banks added 10 branches to the existing branch network of OBC(820). This merger was also initiated to protect the interest of the stakeholders. 81

2.7-1.5 Sikkim Bank Ltd Merger with Union Bank of India
Sikkim Bank was a non-scheduled bank which was merged with Union bank of India following the moratorium issued by the RBI. This merger was also initiated to protect the interest of the depositors. This was the only merger between two PSBs post nationalization.

69
2.7-1.6 Bareilly Corp. Bank Ltd Merger with Bank of Baroda
Bank of Baroda acquired Bareilly Corp. Bank Ltd as on 3rd June 1999. BOB added 63 branches of BCBL to its existing network of 2550 Indian branches. BOB also added Rs. 326 crore deposits and Rs. 78 crore advances to its balance sheet.\(^\text{82}\)

2.7-1.7 Benaras State Bank Merger with Bank of Baroda
This merger was dated 20th July 2002. BoB gained 105 branches across the country following this merger. It now has a branch network of over 2,500. Benaras State Bank had authorized capital of Rs 1.20 billion, the bank has a paid-up capital of Rs 620 million which has been wiped out by accumulated losses of Rs 799.6 million in 2000-01. It posted a net loss of Rs 133.8 million last year.\(^\text{83}\) Benares State Bank was the second UP-based bank to be merged with BoB over the last few years.

2.7-1.8 Nedungadi Bank Merger with Punjab National Bank
This merger dated 1st February 2003 involved Public sector acquirer Punjab National Bank (PNB) has taken over Kozhikode-based private bank Nedungadi Bank Ltd (NBL). This was the seventh merger of another bank with PNB in the 107 years of its existence. Century-old NBL was the oldest private sector bank in Kerala. The merger added 183 branches to the then existing network of 3800 branches of PNB\(^\text{54}\). The NBL had concentrated investor group of stock brokers. Due to the merger the bank will be set free and PNB will have access to South Indian market. With this merger, PNB expected to have a total of around 4,000 branches across the country. This merger is being used as a bail out strategy. NBL’s net worth had wiped off due to accumulated losses.\(^\text{55}\)

2.7-1.9 South Gujarath Local Area Bank Merger with Bank of Baroda
South Gujarath Local Area bank was a small and new Bank established in the year 2000. Due to weak financial performance the bank was absorbed by BOB following the cabinet notification. The merger was dated 25th June 2004.\(^\text{86}\)
The performance of SGLABL which has its registered office at Navsari, Gujarat, has deteriorated in all major parameters, namely deposits, investments, advances and profitability.

Reason for merger was management failure of South Gujarat Local Area Bank. SGLAB had even failed to meet the regulatory reserve ratios. At the time of merger the target bank had 7 branches and 76 employees.  

2.7-1.10 Merger of Global Trust Bank Ltd (GTB) with Oriental Bank Of Commerce (OBC)
This merger was dated 14th August 2004 following the weak financials of the GTB. OBC stood as a very strong bank with higher profitability and zero NPA at the time of merger. Oriental Bank of Commerce stands to gain about Rs 950 crore including Rs 300 crore in tax benefit. The Delhi-based bank OBC, expected to increase profit and 30% growth in business at Rs 80,000 crore following the merger. In addition, OBC was to gain from 100 branches and 275 ATMs of GTB, which would start functioning as OBC outlets. OBC gained easy access to the South Indian market.

OBC estimated that it would cost the bank Rs 200 crore if it has to open 100 odd branches and 275 ATMs. Moreover, OBC added one million depositors of GTB mainly belonging to high-income group, under its fold. The Delhi-based bank's branch network increased to 1,350 branches and about 400 ATMs after the merger with GTB, while the balance sheet size (deposits and loan advances) would increase by 18 per cent to Rs 65,000 crore.  

2.7-1.11 Ganesh Bank of Kurandwad Merger with Federal Bank
On 2nd September 2006, a private bank, Ganesh Bank of Kurundwad was merged with Federal Bank. Reserve Bank of India had suspended the operation of the bank. It was an old private bank established in 1920, headquartered at Kurundwad, Maharashatra. The acquirer is Kochi based private bank, Federal bank. The bank had a network of 32 branches and its operations were concentrated in Sangli and Kolhapur in Maharashatra and Belgaum in Karnataka. Prior to the merger, Federal Bank had 20 branches in Maharashatra. Takeover cost of Federal bank was only about Rs 10-15 crore as it was a
very small bank. The merger helped Federal Bank to step up its agriculture and retail portfolio. After the merger Federal Bank had 536 branches.\textsuperscript{91}

2.7-1.12 **Bharath Overseas Bank (Bh.OB) Merger with Indian Overseas Bank (IOB)**

Indian Overseas Bank acquired Bharat Overseas Bank by buying out other shareholders of Bh.OB. Four banks -- Bank of Rajasthan (16 per cent), ING Vysya Bank (14.66 per cent), South Indian Bank (10 per cent) and Karnataka Bank (8.67 per cent) sold their stakes aggregating 49.33% in Bh.OB to IOB at a price of Rs 155 per share.

IOB, which was the single largest shareholder in Bh.OB, had proposed in February 2007 to acquire Bh.OB by increasing its stake from 30 per cent to 100 per cent and had offered an exit price of Rs 155 to the other shareholders. This had added 91 branches and IOB’s branch size and increased its total to 1500 branches, making it 9\textsuperscript{th} largest bank.\textsuperscript{92}

Bh.OB's profitability was under pressure from 2004, so its merger with a bigger bank was a preferred option. The buyout cost of the remaining 70 per cent of stake was Rs. 170 crore.

2.7-2 **Description Of Voluntary Merger**

This part of the report presents the brief description of the business driven mergers occurred post 1991.

2.7-2.1 **Bank of Madura Merger with ICICI Bank**

ICICI Bank, a leading private sector bank was the acquirer of Bank of Madura. The merger was dated 10\textsuperscript{th} March 2001. The pre-merger status of Bank of Madura was as follows: it had liabilities of Rs.4, 444 crore, equity market capitalization of Rs.100 crore and equity volatility of 0.69. This reflects a hope that the products and processes of ICICI Bank will rapidly improve the value of assets of BoM in order to compensate. In addition, the merged entity had to rapidly raise roughly Rs.800 crore of equity capital to obtain a 10% buffer between assets and liabilities.\textsuperscript{93}
Chapter-II

For the first time both the acquirer and the targets were private banks in the post reform period. Bank of Madura was 57 year old private bank at the time of merger. After the merger ICICI bank had 389 branches. The deal was struck based on ‘all stock no cash basis’. Two shares of ICICI Bank were exchanged for one share of Bank of Madura.  

2.7-2.2 Times Bank Merger with HDFC Bank

Times Bank merged with HDFC Bank on 26th Feb 2000. Both the merging banks were young private sector banks barely 5 years old. HDFC Bank had 4 lakh retail accounts while Times Bank brought with it 2 lakh retail accounts to the table at the time of the merger. This would take little longer to integrate. HDFC Bank was known to target the top-end corporate while Times Bank was more mid-market oriented. All 650 people from Times Bank were absorbed. It was the first time the target bank was in good health. The settlement was done by swapping the shares in the agreed ratio of 1 share of HDFC Bank for every 5.75 shares of Times Bank Ltd.

2.7-2.3 Bank Of Punjab Merger with Centurion Bank

On October 1st 2005 the merger of Bank of Punjab and Centurion Bank was effective and RBI approved the same. Both the banks were new generation private sector banks. At the time of this merger out of 30 private banks top 5 private banks owned 65% of the assets. Competition was intensifying, hence Bank of Punjab and Centurion Bank chose the merger path for growth. Bank of Punjab merged into Centurion Bank and the new entity was named as Centurion Bank of Punjab. The swap ratio was 4:9. For every 4 shares (of Rs.10) held at Bank of Punjab, 9 shares of Re.1 were exchanged. The financials of the bank post merger was expected to improve and the bank was positioned as one among the top ten private banks. Both banks complement their branch network as one was well spread in South India (Centurion Bank) and the other in Northern parts.

2.7-2.4 Lord Krishna Bank Merger with Centurion Bank of Punjab

The merger of two private sector was announced on 29th August 2007. Merged entity was expected to reach 361 branches, 12 extension counters and combined balance
sheet size would be Rs 15,080 crore. The target was Kerala based private sector bank and the acquirer was also the fast growing new generation private sector bank. The share exchange ratio was 7 equity shares of Re.1 of Centurion Bank of Punjab for every 5 shares of Rs.10 of Lord Krishna Bank.99

2.7-2.5 Sangli Bank Merger with ICICI Bank
Sangli Bank, which was merged into ICICI Bank in April 2007, had around 190 branches spread around different urban and rural centers in Maharashtra. This merger helped ICICI Bank to extend its presence across these centers and now all the branches of Sangli Bank will function as ICICI Bank. The merger of Sangli Bank was conducted through an all stock deal where the shareholders of Sangli Bank received 100 shares of ICICI Bank for every 925 held. ICICI Bank had to issue around 3.45 million fresh shares for the merger equivalent to about 0.4% of its existing issued equity share capital. Going by the market value of ICICI Bank share (Rs 876.70 per share), the deal size is pegged over Rs 302 crore.100

ICICI Bank planned to leverage Sangli Bank’s network of over 190 branches and existing one lakh customers and 1,850 employees in urban and rural centre for its rural and small enterprise banking operations, which are some of the key focus areas for the Bank. ICICI Bank expects its rural banking business to constitute 15% of total assets in the next few years. The amalgamation will also supplement ICICI Bank’s urban distribution network.101

2.7-2.6 Centurian Bank of Punjab Merger with HDFC Bank Ltd
On May 2008 another voluntary merger between two leading private sector banks came into existence. The acquisition of Centurion Bank of Punjab (CBoP) was at a cost of Rs 9,510 crore and it is one of the largest merger in the financial sector in India. CBoP shareholders got one share of HDFC Bank for every 29 shares held by them. This was HDFC Bank’s second acquisition after Times Bank.102
2.8 Identification of Research Gap

From the above review, it can be observed that no conclusive study has taken place on the merger performance of Indian banks. A lot of studies have taken place on US bank mergers on varied topics such as shareholder wealth effects, risk and return, strategic fit, merger motives/reasons, efficiency gain analysis, predicting post merger returns, competition and pricing effects etc. Even European banks have seen many mergers but some of the literature reviewed opine that much of the studies have not taken place in this area. As for as Indian banks are considered more studies have taken place on reforms and liberalization and its impact on competition, performance and we can also find comparative studies amongst different ownership banks. Relatively a very few studies have been found on Indian bank mergers. The international evidence on merger may not suit the Indian banking as the structure and focus of Indian banks is entirely different from the developed markets. Most of the researchers (Berger - Jayadev) are skeptical about the consultants' views on merger gains as they always tend to overestimate the gains of the merger. Some of the merger related studies in the Indian context have explored post merger efficiency (Adrian, Geetha, Tom), shareholders return effects (Jayadev, Rudrasen) and they have also not identified much of merger related studies in Indian banking.

Since the bailout merger dominate the Indian bank mergers the study focuses on the comparison between voluntary and bailout mergers. Even before the reforms (1960-1990) the 55 mergers which took place were not market driven mergers (Adrian, Geetha, Tom 2006). The market driven mergers are gradually increasing as the competition is increasing. The policy makers are favoring the mergers between PSBs and the various committees appointed by RBI and the government to recommend the structural changes in the Indian banking sector has also recommended the consolidation. In the midst of these developments the challenges faced by the Indian banks are size, products/service portfolio, technology, efficiency in terms of cost-profit and also regulatory compliance.
There are a lot of literature on Mergers and acquisitions in the area of banking but none of them focus on the comparison of the business gains of forced and voluntary mergers. As identified by the many authors the cross selling through joint ventures and strategic tie-ups is a diversification strategy adopted by the Indian banks. This area is still unexplored. Hence this study focuses on the joint venture and tie up exercise by the Indian Banks, the reasons and the outcomes of the joint venture. A number of aspects distinguish this research from the previous studies. Firstly this study explores recent merger activities and joint ventures by the Indian banks, secondly this research compares the bailout takeovers/mergers and voluntary mergers. Thus it explores both the expansion oriented restructuring exercises undertaken in the post 1991 period. Peculiarity of the Indian banking structure motivates this special comparison.
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