CHAPTER - I

INTRODUCTION
Chapter one would be an introduction covering the brief aspects of Mergers and Acquisition in the banking industry. The main theme of this chapter would include the aims and objectives of the research, the hypothesis which has been framed and the purpose of the research.
INTRODUCTION

India, located in South Asia, is the seventh largest, also the second most populous country in the world. Home to the Indus Valley civilization, India is known for its historic trade routes and vast empires, the country is recognized parallel for its cultural wealth and commercial as well. To shape the country's diverse culture, it is indeed the centre of amalgamation of many religions and ethnicities. After a struggle for independence that was remarkable for its largely non-violent resistance, India became a nation state in the year 1947.

1.1 INDIAN ECONOMIC SCENARIO

The gross domestic product (GDP) has been estimated to expand at 9.2 per cent in 2010-11 as compared to the growth of 7.4 per cent in 2009-10 (CMIE, 2010), while the growth in the industrial sector is expected to increase at 9.4 per cent in 2010-11, in contrast to 9.2 per cent in 2009-10. (IBEF, 2010). With a decade, since the entrance of the era of 2000s, economic growth did not show an impressive growth for the western economies. However, the fastest growing economies such as India, Brazil, China, Mexico, Russia and Indonesia have shown an unprecedented economic expansion. While, India is the second fastest growing economy in the world after China. (FICCI, 2010).

1.2 BACKGROUND INFORMATION FOR THE PRESENT STUDY

The Indian Banking – An Overview:

The Indian Banking, governed by the Banking Regulation Act of India, 1949 is broadly categorized into two viz; non-commercial banks and scheduled banks. Scheduled banks comprises of commercial banks and the co-operative banks. While commercial banks are further classified into; nationalized banks, the State Bank of India along its group banks, the regional rural banks and the private banks which comprises of the old, new domestic and the foreign
comprises of commercial banks and the co-operative banks. While commercial banks are further
classified into; nationalized banks, the State Bank of India along its group banks, the regional
rural banks and the private banks which comprises of the old, new domestic and the foreign
banks). The reforms in the financial sector resulted in nationalization of 14 banks in the year
1969, while the next stage of reforms saw 6 more commercial banks to nationalize in the year
1980. However, since the second stage of financial sector reforms the public sector banks could
not withstand the completion with the new private banks and the foreign banks. (Indian Banking
Industry, 2002). Indeed the banking sector reforms initiated in the year 1991 intended to enhance
efficiency, productivity and profitability gains. (Sarkar, S and Sensharma.R., 2010). The fo

Structure of Indian Banking System:

![Diagram of Indian Banking System]

(Kothari, R., 2010).
Scheduled Banks:

The schedule of the Reserve Bank of India Act contains a list of banks which are described as “scheduled Banks”. A bank in order to be designated as a schedule bank should have a paid up capital and reserves as described by the Act. In terms of Section 42(6) of RBI Act, 1934, the required amount was only a Rs. 5 lakhs. However, presently the RBI prescribes a minimum capital of Rs. 100 crore and its business must be managed in a manner which, in the opinion of RBI, is not detrimental to the interests of its depositors. The scheduled banks are also required to maintain of cash reserve ratio, based on its demand and time liabilities at prescribed rate. They are also known as public sector banks. A nationalized bank is one where control, management, and ownership vest in the government.

Non-scheduled Banks:

The commercial banks not included in the second schedule of the RBI Act, are known as non-scheduled banks. They are not entitled to get facilities like refinance and rediscounting of bills from RBI. They are mainly engaged in lending money, discounting and collecting bills, and agency services. RBI does not encourage the opening of non-scheduled banks.

Though the capital market size has expanded substantially since financial liberalization, the Indian financial system is dominated by financial intermediaries. The commercial banking sector holds the major share (about 60 per cent) of the total assets of the financial intermediaries, which comprise of commercial banks, urban co-operative banks, rural financial institutions, non-banking finance companies, housing banking finance companies, development financial institutions, mutual funds and the insurance sectors. (Suresh and Paul, 2010).
The Commercial Banking System in India:

Note: Figures in brackets signify the number of banks under each category. The data for public sector and private sector banks pertain to March 2009. While data on number of foreign banks and RRBs pertain to June 2009 and August 2009, respectively. At the end of March 2009, public sector and the new private sector banks operated 130 and 11 overseas branches, respectively.

Public Sector Banks:

At the end of March 2009, there were 27 public sector banks in India, comprising of State Bank of India and its six associate banks and 20 nationalized banks (including IDBI Bank Ltd.) These banks in India are regulated by statutes of Parliament and some important provisions under section 51 of the Banking Regulation Act, 1949.

Specifically, the regulations are as follows:

• Subsidiary Banks of State Bank of India regulated by State Bank of India (Subsidiary Banks) Act, 1959.

The statues also stipulate that the central government is mandated to hold a minimum shareholding of 51 per cent in nationalized banks and 55 per cent in State Bank of India (SBI). In turn, SBI will have to hold a minimum 51 per cent of the shareholding in its subsidiaries. Another stipulation is that foreign investment in any form cannot exceed 20 per cent of the total paid up capital of the public sector banks.

From 1984-1985, there have been three distinct ‘phases’ of equity infusion by the government into public sector banks. In the period up to 1992-1993, all nationalized banks were capitalized without any predetermined norm. Over the next couple of years, (up to 1993-1995), when the first phase of financial reforms were under way, some ‘weak’ nationalized banks were put on a recovery path and in the following years, the government, as owner, had to improve banks’ capital position to levels stipulated by the Basel Accords. In 2006-2007, banks were allowed to raise capital from the public through equity issues. The relevant Acts were amended to permit banks raise capital to a level not exceeding 49 per cent of their equity base. Having raised Rs. 19,600 crores up to the year 2007 from the equity market, as many as 22 public sector banks have divested government equity at levels ranging between 23.2 per cent and 48.9 per cent.
The Board of public sector banks comprises of whole time directors- chairman, managing director(s), executive directors. Government nominee directors, RBI's nominee directors, workmen and non workmen directors and other elected directors. (Suresh and Paul, 2010)

**Private Sector Banks:**

All the banks in India were earlier private banks. Private sector banking in India received a fill-up in 1994 when RBI encouraged setting up of private banks as part of its policy of liberalization of Indian Banking industry. Housing Development Finance Corporation Limited (HDFC) was among the first to receive on “in principle” approval from the RBI to set up a bank in the private sector. Private Banks play a major role in the development of Indian Banking Industry. These banks have introduced innovative products and aggressive marketing strategies. At the end of March 2009, there were seven new and 15 old private sector banks operating in India. The broad underlying principle in permitting the private sector to own and operate banks is to ensure that ownership and control is well diversified and sound corporate governance principles are observed. New private sector banks can initially enter the market with a capital of Rs. 200 crores, which should be increased to Rs. 300 crores over the following three years. No singly entity of group can have shareholding or control (direct or indirect) more than 10 per cent of paid up equity capital of the bank. The aggregate foreign investment in an Indian private sector bank cannot exceed 74 per cent and at least 26 per cent of the paid up capital should be help by resident Indians at all times. There are two distinctly observable categories among private sector banks- the new banks- aggressive, professionalized and the fastest growing, and the old private sector banks- typically smaller, with a specific regional bias and less than satisfactory performance. (Suresh and Pual, 2010)
### Table 1.1: Major Banks- Public, Private and Foreign Banks

<table>
<thead>
<tr>
<th>Public</th>
<th>Private</th>
<th>Foreign</th>
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<tbody>
<tr>
<td>Allahabad Bank</td>
<td>Axis Bank (formerly UTI Bank)</td>
<td>ABN AMRO</td>
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<tr>
<td>Andhra Bank</td>
<td>Bank of Rajasthan</td>
<td>Abu Dhabi Commercial Bank Ltd</td>
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<tr>
<td>Bank of Baroda</td>
<td>Bassein Catholic Bank</td>
<td>American Express Bank</td>
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<tr>
<td>Bank of India</td>
<td>Bharat Overseas Bank</td>
<td>Antwerp Diamond Bank</td>
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<td>Bank of Maharashtra</td>
<td>Catholic Syrian Bank</td>
<td>Arab Bangladesh Bank</td>
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<td>Canara Bank</td>
<td>City Union Bank</td>
<td>Bank International Indonesia</td>
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<td>Central Bank of India</td>
<td>Development Credit Bank</td>
<td>Bank of America</td>
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<tr>
<td>Corporation Bank</td>
<td>Dhanalakshmi Bank</td>
<td>Bank of Bahrain &amp; Kuwait</td>
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<tr>
<td>Dena Bank</td>
<td>Federal Bank</td>
<td>Bank of Ceylon</td>
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<tr>
<td>IDBI Bank</td>
<td>Ganesh Bank of Kurundwad</td>
<td>Bank of Nova Scotia</td>
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<tr>
<td>Indian Bank</td>
<td>HDFC Bank</td>
<td>Bank of Tokyo.Mitsubishi UFJ</td>
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<td>Indian Overseas Bank</td>
<td>ICICI Bank</td>
<td>Barclays Bank</td>
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<td>Oriental Bank of Commerce</td>
<td>Indusiland Bank</td>
<td>BNP Paribas</td>
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<td>Punjab &amp; Sind Bank</td>
<td>ING Vysya Bank</td>
<td>Calyon Bank</td>
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<tr>
<td>State Bank of Bikaner &amp; Jaipur</td>
<td>Jammu &amp; Kashmir Bank</td>
<td>China Trust Commercial Bank</td>
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<td>State Bank of Hyderabad</td>
<td>Karnataka Bank Limited</td>
<td>Cho Hung Bank</td>
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<td>State Bank of India (SBI)</td>
<td>Karur Vysya Bank</td>
<td>Citibank India</td>
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<td>State Bank of Indore</td>
<td>Kotak Mahindra Bank</td>
<td>DBS Bank</td>
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<td>State Bank of Mysore</td>
<td>Punjab National Bank</td>
<td>Deutsche Bank</td>
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<td>State Bank of Patiala</td>
<td>Saraswat Bank</td>
<td>HSBC (Hongkong &amp; Shanghai Banking</td>
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<td>State Bank of Saurashtra</td>
<td>South Indian Bank</td>
<td>Corporation)</td>
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<td>State Bank of Travancore</td>
<td>Yes Bank</td>
<td>JP Morgan Chase Bank</td>
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<td>Syndicate Bank</td>
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<td>Krung Thai Bank</td>
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<td>UCO Bank</td>
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<td>Mashreq Bank</td>
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<td>Union Bank of India</td>
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<td>Mizhu Corporate Bank</td>
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<td>United Bank of India</td>
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<td>Oman International Bank</td>
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<td>Vijaya Bank</td>
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<td>Royal Bank of Scotland</td>
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<td>Societe Gebneral</td>
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<td></td>
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<td>Standard Chartered Bank</td>
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<td></td>
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<td>State Bank of Mauritius</td>
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<td></td>
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<td>Taib Bank</td>
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</table>

(Kothari, 2010)

### Foreign Banks:

Foreign banks are required to invest an assigned capital of USD 25 million upfront at the time of opening their first branch in India. They can operate in India in one of the following three ways: (1) through branches, (2) through wholly owned subsidiaries and (3) through subsidiaries with
maximum aggregate foreign investment of 74 per cent in a private sector bank. Hence, foreign banks can have an asset share, equity stake and FII investment in the Indian banking system. In a move to foster globalization, the RBI announced a two-phase road map for the presence of foreign banks in 2005. In the first phase, 2005-2009, foreign banks were allowed to establish wholly-owned subsidiaries in India (minimum capital requirement of Rs. 300 crores and maintain capital adequacy of 10 per cent), or spin off existing operations into a subsidiary. The second phase, due to commence in April 2009, was intended to consider extension of national treatment to wholly owned subsidiaries, dilution of stake and permitting mergers and acquisitions with private sector banks in India. These measures would also entail amendments to the Banking Regulation Act, 1949. Since this phase would have far reaching changes on the ownership pattern of the Indian financial sector, and in view of the global developments, the second phase is yet to be implemented.

Foreign banks have brought latest technology and banking practices in India. They have made Indian Banking system more competitive and efficient. The government has come up with a road map for expansion of foreign banks in India. The road map has two phases. During the first phase between March 2005 and March 2009, foreign banks may establish a presence by way of setting up a wholly owned subsidiary (WOS) or conversion of existing branches into a WOS. The second phase would commence in April 2009 after a review of the experience gained after due consultation with all the stakeholders in the banking sector. (Suresh and Paul, 2010)

**Regional Rural Banks (RRBs):**

The RRBs were created for rural credit delivery and to ensure financial inclusion. Their capital base if held by the central government, relevant state government and the commercial bank that
sponsors’ them, in the ratio of 50:15:35, respectively. Recent policy initiatives include recapitalization and amalgamation of RRBs with their sponsor banks, liberalized branch licensing and technology upgradation. In order to strengthen weak RRBs, the process of recapitalization of RRBs with eroded capital (negative net worth), as well as consolidation/amalgamation with the sponsor banks was undertaken. The branch expansion procedures for RRBs has been further simplified, subject to specific ‘financial soundness’ criteria. (Suresh and Paul, 2010).

1.3 EARLY BANKING SCENARIO:

A healthy economy deserves a sound and effective banking system and therefore the banking system should not only be hassle free but it should also be able to meet challenges led by the technology along with external and internal factors. (India Finance and Investment Guide, 2010) The performance of the Indian Banking sector has also helped the economy to a positive growth. (CII, 2010). Theoretical models have triggered empirical research to explore the relationships between banks, stock markets and economic growth. (Chakraborty, I., 2010). During, the first three decades, the banking system in India has met lot of achievements to its credit. Indeed, the banking system, is now no longer confined to just metro’s but also reached to remote corners of the country. The year 1786, was the first bank of India that was established. From this date the journey of Indian banking system can be divided into three different phases; the early phase began from 1786 till 1969, the second phase began with nationalization of Indian banks till 1991, and the third phase began with the post Financial and Banking Sector Reforms that is post liberalization. (India Finance and Investment Guide, 2010).
Phase one: Early Phase-1786-1969

The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders banks, mostly Europeans shareholders. In 1865 Allahabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came in 1935.

During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with The Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No. 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority. (India Finance and Investment Guide, 2010). The important regulatory steps were:

1. 1949: Enactment of banking Regulation Act
2. 1955: Nationalization of State Bank of India
3. 1959: Nationalization of SBI subsidiaries
4. 1961: Insurance cover extended to deposits. (Kothari, R., 2010)
Phase Two:

Post banking sector reforms, the government took major steps in this Indian Banking Sector. In 1955, it nationalized Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country. Seven banks forming subsidiary of State Bank of India was nationalized in 1960 on 19th July, 1969, major process of nationalization was carried out. It was the effort of the then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country were nationalized. Second phase of nationalization Indian Banking Sector Reform was carried out in 1980 with seven more banks. (India Finance and Investment Guide, 2010).

Phase Three:

This phase under the chairmanship of M. Narsimham, a committee was set up by his name worked for the liberalization policies of the banking in India and opened the doors of the foreign banks in India. (India Finance and Investment Guide, 2010). In India, the liberalization was moved by three committees, the committee to review the monetary system in India, 1985, under the chairmanship of Prof. Sukhmay Charkravarty, the committee of financial system 1991 and the committee of Banking Sector Reforms, 1998 under the chairmanship of M. Narsimham. (Nagarajan, N., 2003). To improve allocative efficiency of resources, financial stability and to maintain confidence in the financial system, the introduction of financial sector reforms were initiated as a part of the economic reform was ignited in the year 1991. (Gopinath 2007). An important feature of the reforms that took place in the regime of the Narsimham Committee, a number of foreign banks, along with private entrepreneurs have been invited to commence its
banking operations in India (Chakraborty, 2010) for instance, the Standard Chartered bank started its operations in the year 1858 while the Citi Bank opened its branch dated back in the year 1902. The Hong Kong and Shanghai Banking Corporation was functional in India since 1953. Presently, there are 29 foreign banks are operational in India, while some of the renowned foreign banks operated in India are; ABN-Amro Bank, Abu Dhabi Commercial Bank, Bank of Ceylon, BNP Paribas Bank, Citi Bank, China Trust Commercial Bank, Deutche Bank, JPMorgan Chase Bank, Standard Chartered Bank, Scotia Bank and Taib Bank. (Finance in India, 2010).

The reforms towards the industrial and trade policies was the cornerstone in India since 1990s prior to this the multiple forces of control over the private investment was the major hindrance and therefore it led to inefficient operations in the banking sector. (Ahluwalia, 1999), while the industrial de-licensing pioneered the growth in the banking sector in India. The features of the reforms introduced include (a) lowering of statutory reserve requirements; (b) liberalizing the interest rate regime, allowing banks the freedom to determine their deposit and lending rates; (c) infusing competition by allowing more liberal entry of foreign banks and de novo Indian private banks; (d) introduction of micro-prudential measures such as capital adequacy requirements, income recognition, asset classification and provisioning norms for loan classification as also exposure norms and accounting standards; (e) diversifying the ownership base of state-owned banks by enabling them to raise up to 49% of their capital from the market and (f) mandating greater disclosures in the balance sheets to ensure greater transparency and market discipline. (Dasa, A. and Ghosh, S., 2009). The impact of phase III of financial sector reforms can be seen through the following:

1. Development in financial markets
2. Regulatory role
3. The expansion of banking system
4. Growth and regulation of non-banking finance companies
5. The capital market
6. MUTUAL funds
7. Insurance Company
8. Deregulation of banking system and customer-friendly approach and
9. Overall approach to reforms

1.4 PRESENT SCENARIO OF INDIAN BANKING INDUSTRY:

The banking industry in India is one of the most vital sectors in the financial sector and thus it continues to be well regulated. The State Bank of India (SBI) is the first Indian Bank ranked 36, among the top 50 banks in the world as per the annual international ranking conducted by UK-based Brand Finance Plc, 20. (Banking, 2010). The studies pertaining to the efficiency of Indian Banking, Bhattacharyya et. al. (1997) found that Indian public sector banks indeed the best performers with improved efficiency in a deregulated environment. The expansion of banking facilities purported not only to enhance potential savings, but also to meet the credit gaps especially in agriculture and retail trade, thereby bringing large stretches of economic activity within the organized banking system. With India’s increased linkage with the world economy, India could not be expected to remain immune to the global crisis or be decoupled from the global economy. While it is true that the Indian banking sector remained largely unaffected because of its very limited operations outside India or exposure to sub-prime lending by foreign investment banks, the global crisis has affected India through three distinct channels. These channels are financial markets, trade flows, and exchange rates. The financial sector includes the
banking sector, equity markets (which are directly affected by foreign institutional investment flows), external commercial borrowings that drive corporate investments, Foreign Direct Investment (FDI), and remittances. The global crisis had a differentiated impact on these various sub-sectors of the financial sector. Given prudent regulations and a proactive regulator, the Indian banking sector has remained more or less unaffected, at least directly, by the global crisis. The imposition by the Reserve Bank of India (RBI) of a higher provisioning requirement on commercial bank lending to the real estate sector helped to curb the growth of a real estate price bubble. This is one of the few global examples of a countercyclical capital provisioning requirement by any central bank. In general, Indian banks were not overly exposed to sub-prime lending. Only one of the larger private sector banks, ICICI Bank, was partly exposed but it managed to thwart a crisis because of its strong balance sheet and timely action by the government, which virtually guaranteed its deposits. The banking sector as a whole has maintained a healthy balance sheet. In fact, during the third quarter of FY2008, which was a nightmare for many big FIs around the world, banks in India announced encouraging results. Against an absolute decline in the profitability of non-financial corporate enterprises, the banking sector witnessed a jump of 43 percent in its profitability. A ban on complex structures like synthetic securitization coupled with a close monitoring of appropriate lending norms by RBI also ensured a better quality of banking assets. The non-performing assets as a ratio to gross advances have remained well within prudential norms. Further, with an average capital risk weighted assets ratio of 13 percent, Indian banks are well capitalized and better placed to weather the economic downturn. However, the indirect impacts of the crisis have affected Indian banks quite badly. The liquidity squeeze in global markets following the collapse of Lehman Brothers compelled Indian banks and corporations to shift their credit demand from external
sources to the domestic banking sector. This move exerted a lot of pressure on liquidity in the domestic market and consequently short-term lending rates shot up abnormally. The credit crunch, coupled with the loss of confidence that followed the Lehman Brothers episode, increased the risk aversion of Indian banks and eventually hurt credit expansion in the domestic market. The magnitude of the impact of the crisis can be understood from the fact that non-food credit expansion during last five months of FY2008-2009 has declined by more than 68 percent as compared with the same period in previous financial year. (Gupta, 2010). The following table gives a snapshot of developments in the Indian banking sector during the period of 2009-10 in a comparative perspective with the earlier year/s to bring out trends in balance sheets, financial performance and profitability, and financial soundness of the sector based on data of 81 Scheduled Commercial Banks (SCBs), which includes 27 public sector banks (State Bank of India and its six associates, 19 nationalized banks and IDBI Bank Ltd.), 7 new private sector banks, 15 old private sector banks and 32 foreign banks. (Reserve Bank of India, 2010).

Table 1.2: Growth of Scheduled Commercial Banks in India at the end 2009-10.

<table>
<thead>
<tr>
<th>Item</th>
<th>Public Sector banks</th>
<th>Private Sector banks</th>
<th>Old Private Sector banks</th>
<th>New Private Sector banks</th>
<th>Foreign banks</th>
<th>All Scheduled commercial banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>3.6</td>
<td>0.1</td>
<td>-8.1</td>
<td>7.3</td>
<td>8.2</td>
<td>8.7</td>
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<tr>
<td>Reserves and Surplus</td>
<td>20.5</td>
<td>16.8</td>
<td>10.0</td>
<td>21.0</td>
<td>14.6</td>
<td>15.9</td>
</tr>
<tr>
<td>Deposits</td>
<td>26.9</td>
<td>18.6</td>
<td>9.1</td>
<td>11.7</td>
<td>20.3</td>
<td>15.4</td>
</tr>
<tr>
<td>3.1 Demand Deposits</td>
<td>9.9</td>
<td>18.4</td>
<td>1.3</td>
<td>33.5</td>
<td>1.8</td>
<td>22.5</td>
</tr>
<tr>
<td>3.2 Savings Bank Deposits</td>
<td>18.4</td>
<td>25.8</td>
<td>14.9</td>
<td>32.8</td>
<td>15.6</td>
<td>26.2</td>
</tr>
<tr>
<td>3.3 Term Deposits</td>
<td>33.1</td>
<td>16.2</td>
<td>9.2</td>
<td>1.3</td>
<td>24.2</td>
<td>12.0</td>
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<td>Borrowings</td>
<td>65.3</td>
<td>21.4</td>
<td>56.6</td>
<td>8.1</td>
<td>77.4</td>
<td>31.8</td>
</tr>
<tr>
<td>5 Other Liabilities and Provisions</td>
<td>-21.4</td>
<td>4.4</td>
<td>-37.0</td>
<td>9.7</td>
<td>-7.8</td>
<td>15.0</td>
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<tr>
<td>Total Liabilities/Assets</td>
<td>24.6</td>
<td>17.9</td>
<td>9.3</td>
<td>12.0</td>
<td>19.4</td>
<td>15.8</td>
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<tr>
<td>1 Cash and Balance with RBI</td>
<td>-2.4</td>
<td>20.8</td>
<td>-19.4</td>
<td>32.0</td>
<td>-14.6</td>
<td>27.7</td>
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<tr>
<td>2 Balance with Banks and money at call and Short Notice</td>
<td>106.5</td>
<td>-5.4</td>
<td>32.7</td>
<td>13.9</td>
<td>46.0</td>
<td>-43.3</td>
</tr>
<tr>
<td>3 Investments</td>
<td>26.6</td>
<td>19.1</td>
<td>10.0</td>
<td>15.5</td>
<td>33.9</td>
<td>15.3</td>
</tr>
<tr>
<td>3.1 Government</td>
<td>30.6</td>
<td>19.0</td>
<td>12.4</td>
<td>10.6</td>
<td>27.3</td>
<td>13.4</td>
</tr>
</tbody>
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1.5 DE-REGULATION IN GLOBAL CONTEXT:

The experience of other countries has showed efficiency gains. Kumbhakar, et. al., 2001 in a study found the affects of profitability in Spanish banks found declined output technical efficiency however found an increasing trend in productivity growth. The most important factor for de-regulation is the impact on efficiency. A different study, in the context of Spanish banks, Lozano (1997) estimated profit efficiency using the thick frontier approach during 1986–1991 coinciding with deregulation in their banking sector, based on both standard and alternative profit function specifications. The result based on alternative profit function suggests that the profit inefficiency of Spanish savings banks, which averaged 28%, fell by 40% during 1986–1991. (Berger and Humphery, 1997). The experiences across the border have shown mixed results. The case of United States, have shown a decline in the cost productivity while this result have showed a gain from the investors point of view with high interest rate deposits. (Berger et. al., 2000). Skyu, 1998 could find that there had been improved results in Taiwan. Korea (Gilbert and Wilson, 1998), Norway (Berg et al., 1992), Turkey (Zaim, 1995), Portugal (Canhoto and Dermine, 2003) and Thailand (Leightner and Lovell, 1998). In the case of Spain (Grifell-Tatje

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<th>Securities (a+b)</th>
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<td>a) in India</td>
<td>30.8</td>
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<td>b) Outside India</td>
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<td>Overdrafts, etc.</td>
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<td>4.3 Term Loans</td>
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Source: Report on Trend and Progress of Banking in India 2009-10.
and Lovell, 1996) deregulation was found to have a negative impact upon efficiency. The studies conducted in the European context also revealed that there was relatively high profit inefficiency amongst the banks. Typically, in the Indian scenario, (Das, A. and Ghosh, S. (2006). Bhattacharyya et al. (1997) conclude that foreign banks experienced the greatest improvements in efficiency. A study based on nonparametric approach, Rammohan and Ray (2004) and Das et.al. (2005) compared various efficiency measures of Indian banks across different ownerships during post-liberalization period. The broad findings emanating from these studies were that state-owned banks performed significantly better than private sector banks on revenue maximization efficiency and the efficiency differential between state-owned and foreign banks was not significant. At the same time, Sensarma (2005) using parametric approach covering the period 1986–2003 found that state owned banks exhibited higher cost efficiency than private banks. The balance of evidence appears to indicate that inefficiency is a major source of performance inadequacies of Indian banks and both size and increasing competitiveness in the Indian banking sector have favorably impacted on efficiency. Perhaps the medium size state-owned banks are more likely to be operating at higher levels of technical efficiency and have, on an average, less non-performing loans (Chatterjee, 2006; Das & Ghosh, 2006; Kumbhakar & Sarkar, 2005).

1.6 GLOBAL FINANCIAL CRISIS AND ITS EFFECTS IN BANKING SECTOR:

One of America’s biggest investment banks, Lehman Brothers, collapsed and triggered a chain reaction of economic, financial and psychological crisis which very soon engulfed the entire globe. The year 2008-2009 turned out to be a year when hard-hit by the global financial crisis, the worldwide banking industry’s future development has been sharply drawn into focus.
Recognizing that repairing the financial system remains a key priority, the rescue measures were undertaken globally. These have contributed to an avoidance of "worst case scenarios", in particular by reducing the default risk of major banks. The "global financial crisis" of 2008, also called as global financial meltdown, global financial turmoil mainly resulted from the subprime mortgage crisis of 2007. (Gupta, A., 2010). This financial crisis the banking industry globally witnessed severe setback in terms of large income losses and write downs, however, it showed some improvement in performance in 2009. A major positive development which took place post global crisis was that during the first three months of 2010, the international claims of global banking industry rose for the first time since the third quarter of 2008. While the unprecedented monetary and fiscal stimulus measured by the central banks and the national authorities helped the banking industry to recoup capital and liquidity, the rise in asset prices that followed economic recovery in the first half of 2009 helped the banking industry return to profitability. (Reserve Bank of India, 2010).

1.7 THE WAY FORWARD:

The Indian financial sector may have come through the financial crisis of 2007 relatively unscathed. But there is much more that needs to be done. There are several challenges to financial stability and the most critical of them have been articulate by the RBI governor. In doing so, he has drawn from global experience.

The first challenge is 'defining and measuring' financial stability. A second challenge is determining who takes the responsibility for financial stability— will it be central banks, the banks, other regulators and the government as well? While it is recognized that 'risk
management' at all levels in the financial sector has to take precedence, the challenge remains as to where risk management amounts to 'conservativeness'. Yet another challenge is the massive and continuing reforms that should go in to create an effective and efficient 'regulatory architecture' that ensures financial stability. And finally, there is the constant tension between fiscal and monetary policies that could impair financial stability if left unchecked. (Suresh and Paul, 2010)

1.8 BANKING SECTOR REFORMS:

The Narasimham Committee I

The banking sector reforms in the 1990s in India were based on the report of the committee headed by Mr. M. Narasimham in 1991. Major recommendations of the committee were as follows:

- There should be no bar to new banks being set up in the private sector, provided they have the start-up capital and other requirements prescribed by the Reserve Bank of India.

- The government should indicate that there would be no further nationalization of banks and there should not be difference in treatment between public sector banks and private sector banks.

- The banking systems should evolve towards a broad pattern consisting of three of four large banks, including the State Bank of India which could become international in character; eight to ten national banks with a network of branches throughout the country engaged in universal banking; local banks whose operations would be generally confined to a specified region and lastly, rural banks to cater to rural areas.
There should be an assets reconstruction fund (ARF) which could take over from the banks and financial institutions a portion of their bad and doubtful debts at a discount, the level of discount being determined by independent auditors on the basis of clearly defined guidelines. The ARF, according to the committee, should be provided with special powers for recovery, somewhat broader than those contained in Sections 29-32 of the State Financial Corporation Act, 1951. The capital of the ARF should be subscribed to by the public sector banks and the financial institutions.

The banks and the financial institutions should be authorized to recover bad debts through the special tribunals and based on the valuation given in respect of each asset by a panel of at least two independent auditors.

The public sector banks with profitable operations should be allowed to tap the capital market for enhancement of their share capital. Subscribers to such issues could be mutual funds, profitable public sector undertakings (PSUs) and the employees of the institutions besides the general public.

Branch licensing should be abolished and the option of opening branches or closing of branches other than rural branches should be left to the commercial judgement of the individual banks. Further, the internal organization of banks is best left to the judgement of the management of the individual banks.

There should be phased reduction of the CRR and the SLR.

Banks should adhere to prescribed capital adequacy ratio (CAR) and should attain a CAR of 8 per cent by 1998.

A board for financial supervision should be set-up to oversee the operations of the banks.
- Banks should conform to prudential income recognition norms of provisioning against bad and doubtful debts and ensure transparency in maintaining balance sheets.
- There should be speedy computerisation of the banking industry.

According to the committee, foreign banks should be subjected to the same requirements as are applicable to India banks and RBI policies should be more liberal in respect of allowing the foreign banks to open branches or subsidiaries. Joint ventures between foreign banks and Indian banks should also be permitted particularly in regard to merchant banking, investment banking, leasing and other newer forms of financial services. Priority sector lending by banks should be reduced from 40 per cent to 10 per cent of their total credit.

The committee recommended phasing out concessional interest rates. The committee was of the view that the present structure of administered interest rates was highly complex and rigid and proposed that interest rates be further deregulated so as to reflect emerging market conditions. Premature moves to market-determined interest rates could, as experience abroad has shown, pose the danger of excessive banks lending at highly nominal rates to borrowers of dubious credit worthiness, the committee observed.

Most of the recommendations of the committee have since been implemented. Meanwhile, keeping in view the changing global scenario after the setting up of the WTO and the need for more efficient, competitive and broad-based banking sector, the government has set up another committee, once again headed by Mr. Narasimham.
The Narasimham Committee II


The major recommendations of the committee were as follows:

- **Concept of ‘narrow banking;** should be tried out to rehabilitate weak banks. If this was not successful, the issue of closure should be examined. Narrow banking, according to the committee, implies that weak banks should not be permitted to invest their funds anywhere except in government securities as these were absolutely safe and risk-free.

- Two or three large Indian banks should be given an international character.

- Small local banks should be confined to states or a cluster of districts in order to serve local trade, small industry and agriculture.

- The committee has also commented on the government’s role in public sector bank by observing that government ownership has become an instrument of management. Such micromanagement of banks is not conducive to the enhancement of autonomy and flexibility.

- Functions of boards and management need to be reviewed so that the boards remain responsible for enhancing shareholder value through formulation of corporate strategy.

- There is a need to review minimum prescriptions for capital adequacy. In this regard, the committee recommended that minimum CAR be raised to 10 per cent by 2002. Most of the banks have a CAR of 100 per cent of higher.
- The committee also felt a need to lay down prudential and disclosure norms and sound procedures for the purpose of supervision and regulation.
- There should be an integration of NBFC’s lending activities into the financial system.
- There is a need for public sector banks to speed up computerization and focus on relationship banking.
- A review of recruitment procedures, training and remunerations policies in public sector banks should be carried out.
- Threat of action by vigilance and other investigative authorities, even in the case of commercial decisions creates low morale. The committee recommended that this issue be addressed in right earnest.
- Need for professionalizing and depoliticizing of bank boards.
- The banking service recruitment boards should be abolished.

Committee on financial sector reforms-2009: The main proposals of the Raghuram Rajan committee

The Macroeconomic Framework

Proposal 1: The RBI should formally have a single objective to stay close to a low inflation number or within a range, in the medium term and move steadily to a single instrument, the short-term interest rate (repo and reverse repo) to achieve it.

Proposal 2: Steadily open up investment in the rupee corporate and government bond markets to foreign investors after a clear monetary policy framework is in place.
Broadening access to finance

Proposal 3: Allow more entry to private well-governed deposit-taking small finance banks offsetting their higher risk from being geographically focused by requiring higher capital adequacy norms, a strict prohibition on related party transactions and lower allowable concentration norms (loans as a share of capital that can be made to one party). Make significant efforts to create the supervisory capacity to deliver the greater monitoring these banks will need initially, and put in place a tough prompt corrective action regime that ensures these banks do not become public charges.

Proposal 4: Liberalize the banking correspondent regulation so that a wide range of local agents can serve to extend financial services. Use technology both to reduce costs and to limit fraud and misrepresentation.

Proposal 5: Offer priority sector loan certificated (PSLC) to all entities that lend to eligible categories in the priority sector. Allow banks that undershoot their priority sector obligation to buy the PSLC and submit it towards fulfillment of their target.

Proposal 6: Liberalize the interest rate that institutions can charge, ensuring credit reached the poor, but require (a) full transparency on the actual effective annualized interest cost of a loan to the borrower, (b) periodic public disclosure of maximum and average interest rates charges by the lender to the priority sector and (c) only loans that stay within a margin of local estimated costs of lending to the poor be eligible for PSLCs.

Levelling the Playing Field

Proposal 7: Sell small underperforming public sector banks, possibly to another banks or to a strategic investor, to gain experience with the process and gauge outcomes.
Proposal 8: Create stronger boards for large public sector banks, with more power to outside shareholders (including possible a private sector strategic investor), devolving the power to appoint and compensate top executives to the board.

Proposal 9: After starting the process of strengthening boards, delink the banks from additional government oversight, including the Central Vigilance Commission and Parliament, with the justification that with government-controlled boards governing the banks, a second layer of oversight is not needed. Further ways to justify reduced government oversight is to create bank holding companies where the government only has a direct stake in the holding company. Another is to bring the direct government stake below 50 per cent, perhaps through divestment to other public sector entities or provident funds, so that the government (broadly defined) has control, but the government (narrowly defined) cannot be considered the owner.

Proposal 10: Be more liberal in allowing takeovers and mergers, including domestically incorporated subsidiaries of foreign banks.

Proposal 11: Free banks to set up branches and ATMs anywhere.

Proposal 12: Allow handling company structures, with a parent holding company owning regulated subsidiaries. The holding company should be supervised by the Financial Sector Oversight Agency, with each regulated subsidiary supervised by the appropriate regulator. The holding company should be well diversified is it owns a bank. The holding company structure is showing in the following figure:
Creating More Efficient and Liquid Markets

Proposal 13: Bring all regulation of trading under the Securities and Exchange Board of India (SEBI).

Proposal 14: Encourage the introduction of markets that are currently missing, such as exchange traded interest rate and exchange rate derivatives.

Proposal 15: Stop creating investor uncertainty by banning markets. If market manipulation is the worry, take direct action against those suspected of manipulation.

Proposal 16: Create the concept of one consolidated membership of an exchange for qualified investors (instead of the current need to obtain memberships for each product traded). Consolidated membership should confer the right to trade all the exchange’s products on a unified trading screen with consolidated margining.

Proposal 17: Encourage the setting up of ‘professional’ markets and exchanges with a higher-order size, that are restricted to sophisticated investors (based on net worth and financial knowledge), where more sophisticated products can be traded.

Proposal 18: Create a more innovation friendly environment, speeding up the process by which products are approved by focusing primarily on concerns of systemic risk, fraud, contract enforcement, transparency and inappropriate sales practices. The threshold for allowing products
on professional exchanges (see Proposal 16) or over the counter markets should be lower so that experimentation can take place.

Proposal 19: Allow greater participation of foreign investors in domestic markets as in Proposal 2. Increase participation of domestic investors by reducing the extent to which regulators restrict an institutional investor’s choice of investments. Move gradually instead to a ‘prudent man’ principle where the institutional investor is allowed to exercise judgement based on what a prudent man might deem to be appropriate investment. Emphasize in providing access to suitable equity linked products to the broader population as part of the inclusion agenda.

Creating a growth friendly regulatory environment

Proposal 20: Rewrite financial sector regulation with only clear objectives and regulatory principles outlined.

Proposal 21: Parliament, through the finance ministry and based on expert opinions as well as the principles enshrined in legislation, should set a specific remit for each regulator every five years. Every year, each regulator should report to a standing committee (possibly the standing committee on finance), explaining in its annual report the progress it has made on meeting the remit. The interactions should be made public. In addition, to ensure there are more direct checks on the regulator in a system that is less rule-bound, the committee recommends Proposal 22.

Proposal 22: Regulatory actions should be subjected to appeal to the financial sector appellate tribunal, which will be set up along the lines of, and subsume, the securities appellate tribunal.

Proposal 23: Supervision of all deposit-taking institutions must come under the RBI. Situations where responsibility is shared, such as with the state registrar of cooperative societies should gradually cease. The RBI will have to increase supervisory capacity to take on this task. The
committee recognizes that this involves constitutional issues but nevertheless recommends a thorough overhaul of the system of shared responsibility.

Proposal 24: The Ministry of Corporate Affairs (MCA) should review accounts of unlisted companies, while SEBI should review accounts of listed companies.

Proposal 25: A Financial Sector Oversight Agency (FSOA) should be set up by statute. The FSOA’s focus will be both macro prudential as well as supervisory; the FSOA will develop periodic assessments of macroeconomic risks, risk concentrations, as well as risk exposures in the economy; it will monitor the functioning of large, systemically important and financial conglomerates; anticipating potential risks, it will initiate balanced supervisory action by the concerned regulators to address those risks and will address and defuse inter-regulatory conflicts.

Proposal 26: The committee recommends setting up a working group on financial sector reforms with the finance minister as the chairman. The main focus of this working group would be to shepherd financial sector reforms.

Proposal 27: Set up an office of the financial ombudsman (OFO), incorporating all such offices in existing regulators, to serve as an interface between the household and industry.

Proposal 28: The committee recommends strengthening the capacity of the Deposit Insurance and Credit Guarantee Corporation (DICGC) to both monitor risk and resolve a failing bank, instilling a more explicit system of prompt corrective action (see Proposal 3) and making deposit insurance premia more risk-based.

Creating a Robust Infrastructure or Credit

Proposal 29: Expedite the process of creating a unique national ID number with biometric identification.
Proposal 30: The committee recommends movement from a system where information is shared primarily amongst institutional credit providers on the basis of reciprocity to a system of subscription, where information is collected from more sources and a subscriber gets access to data subject to verification of ‘need to know and authorization to use’ of the subscriber by the credit bureau. This will also require rethinking the incentives of providers to share information and a judicious mix of payments as well as mandatory requirements for information sharing will have to be developed.

Proposal 31: Ongoing efforts to improve land registration and titling—including full cadastral mapping of land, reconciling various registries, forcing compulsory registration of all land transactions, computerizing land records and providing easy remote access to land records—should be expedited, with the centre playing a role in facilitating pilots and sharing experience of best practices. The committee also suggests the possibility of special law courts to clear the backlog of land disputes to be examined.

Proposal 32: Restrictions on tenancy should be re-examined so that tenancy can be formalized in contracts, which can then serve as the basis for borrowing.

Proposal 33: The powers of SRFAESI that are currently conferred only on banks, public financial institutions and housing finance companies should be extended to all institutional lenders.

Proposal 34: Encourage the entry of more well-capitalized ARCs, including ones with foreign backing.

Proposal 35: The committee outlines a number of desirable attributes of a bankruptcy code in the Indian context, many of which are aligned with the recommendations of the Irani Committee. It suggests and expedited move to legislate the needed amendments to company laws.
1.9 GROWTH OF BANKING THROUGH MERGER AND ACQUISITIONS:

Mergers and acquisitions are a regular and much noted feature in the present global corporate environment. Among the primary motives behind mergers identified by the literature are a firm's need to improve market coverage, enhance profitability, expand production without price reduction, acquire capacity at reduced prices, enhance economics of scale of operations, diversification. (Jervis, 1997). M&A activities can also be demanding factor for enhance shareholders' return, profitability as pointed out by Jervis, 1997 and also for efficiency gains. The same has also been supported by a wide range of literature in the succeeding chapter on review of literature. However, the relative motive for such activity would differ from firm to firm and from one economy to another. Merger and acquisitions is an important means of corporate growth during the post independence period, but became a vital means of growth during the phase of early nineties and therefore there has been a sharp increase in the merger related activities. Mergers and Acquisitions indeed are most widely seen in market based economies. They are found in the case of not only commodity-producing corporate entities but also of financial services providers, including commercial banks. M&A have grown phenomenally in recent years post liberalization policies in the early nineties. (Vasudevan, A., 2007). During the ends of 1920s, 1960s, 1980s and 1990s there were successive merger waves that were witnessed globally. Much of the earlier activities on merger was confined not only to North America and Great Britain, but also engulfed all the major industrial countries of the world. And, there had been an increased percentage of cross-border acquisitions. What have been the causes of these great bursts of merger activity? What have been their effects? (Gugler, K. et. al. (2003). Most banks would encourage mergers for efficiency improvements through cost reductions Mergers banks are capable of improving their operating costs by rationalizing the branch network of the
merging banks, reducing back office operations and common services and achieving higher economies of scale in information technology, brand recognition and other fixed assets (Campa, et. al., 2006).

1.10 MERGER AND TAKOVERS-DEFINATION:
Mergers and takeovers or amalgamation, result in the combination of two or more companies into one, wherein, the merging entities lose their identities by being absorbed in the merged activity. No fresh investment is made through this process. However, an exchange of shares takes place between the entities involved in such a process. Generally, the company which survives is the buyer which retains its identity and the seller company is extinguished. (Ramaiya, 1977).

1.11 HISTORICAL EXPERIENCE OF M&A ACTIVITY WITH REFERENCE TO INDIA:
The shift in the case of the financial sector regime took place in an effective sense only from 1992-93 banking sector reforms initiated by Narasimham committee. This report further gave impetus by yet another committee headed by M. Narasimham on banking system reforms in April 1998. Whatever mergers had taken place after the regime shift, they were all dictated by the consideration that financially weak banks should not be allowed to fail and should be merged with financially strong banks. Consolidation of banks took place in the 1950s and the 1960s was a fall out of the acceptance of the recommendations of the Travancore-Cochin Banking Inquiry Commission (1956). Accordingly, unviable banks were to be weeded out, which, in effect, meant either closure of weak banks or amalgamation was accelerated when two scheduled banks failed
in 1960. The experience of the 1950s and 1960s showed that preservation of banking stability was considered vital by the central bank of the country in order to ensure that confidence in banking is secured. But, then there were mergers, no acquisitions. It must be kept in view that all the commercial banks during this period were in private hands. And the mergers were prompted by official initiatives. They were, however, not led by an economic reasoning behind concepts such as the economies of scale and economies of scope. (Vasudevan, 2007)

1.12 MERGERS IN THE INDIAN BANKING SECTOR:
The Indian Banking sector is the corner stone for the economic development of India witnessing a tremendous change. The players in this sector drive through with an intense completion of M&A to ensure an enhanced and prospective growth. (Mathew and Raju, 2002). The reasons behind to adopt M&A is due to the increasing needs to achieve economics of large scale and therefore some of the realistic include, the voluntary merger of HDFC Bank Ltd with the Times Bank in the year 2000, followed with ICICI Bank with Bank of Madura in the year 2001 and in the year 2005, the Centurion Bank again voluntarily merged with the Bank of Punjab subsequently now it is known as Centurion Bank of Punjab (CBOP) HDFC Bank in the year 2008 voluntarily merged with the Centurion Bank of Punjab not only to expand it size but also to gain the benefits of scope of economics. To gain the motive to expand its size, the Centurion Bank of Punjab voluntarily merged with Lord Krishna bank in the year 2006, while with the same motive, the year 2007 showed the merger of ICICI bank with Sangli bank. Post liberalization saw a phenomenon of forced merger with the motive to restructure weak banks for instance, the year 1993 saw consequently two mergers, one being the merger of Punjab National bank with the New Bank of India and the second being Bank of India with the Bank of Karad
Ltd., State Bank of India, one of the leading banks of India, took over Kashipath Seth Bank in the year 1995, while the year 1997 witnessed again two mergers one being Oriental bank of Commerce merger with Punjab Co-operative Bank Ltd. and Bari Doab Bank Ltd. The era of 2000’s also witnessed merger scenarios with the same motive as, for instance, the Bank of Borada with Beneras State Bank Ltd. while Punjab National Bank merged with Nedungadi Bank Ltd. in the year 2003 while the year 2004, had seen consecutively two mergers, one being the Bank of Borada with South Gujrat Local Area Bank and the Oriental Bank of Commerce merged with Global Trust Bank. On a similar motive, the year 2006 also witnessed two more mergers, the Federal bank with the Ganesh Bank of Kurandwad and the IDBI Bank with the United Western Bank. The year 2007 witnessed only one merger which was compulsory merger with the motive to restructure the weak bank and therefore the Indian Overseas Bank merged with Bharat Overseas Bank. (Kaur and Kaur, 2010). The following table gives a birds overview of merger that took place post liberalization in India.

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<th>Target Bank</th>
<th>Motive of merger</th>
<th>Type of Merger</th>
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<td>1993</td>
<td>Punjab National Bank</td>
<td>New Bank of India</td>
<td>Restructuring of Weak Bank</td>
<td>Forced Merger</td>
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<td>1993</td>
<td>Bank of India</td>
<td>Bank of Karad Ltd.</td>
<td>Restructuring of weak bank</td>
<td>Forced Merger</td>
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<td>1995</td>
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<td>Kashinath Seth Bank</td>
<td>Restructuring of weak bank</td>
<td>Forced Merger</td>
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<td>Restructuring of weak bank</td>
<td>Forced Merger</td>
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<td>2000</td>
<td>HDFC Bank Ltd.</td>
<td>Times Bank</td>
<td>To achieve scale and scope economies</td>
<td>Voluntary Merger</td>
</tr>
<tr>
<td>2001</td>
<td>ICICI Bank</td>
<td>Bank of Madura</td>
<td>To achieve scale and scope economies</td>
<td>Voluntary Merger</td>
</tr>
<tr>
<td>2002</td>
<td>ICICI Bank</td>
<td>ICICI Limited</td>
<td>To achieve scale and scope economies</td>
<td>Voluntary Merger</td>
</tr>
<tr>
<td>2002</td>
<td>Bank of Baroda</td>
<td>Benaras State Bank Ltd.</td>
<td>Restructuring of weak bank</td>
<td>Forced Merger</td>
</tr>
</tbody>
</table>
2003 | Punjab National Bank | Nedungadi Bank Ltd. | Restructuring of weak bank | Forced Merger
---|---|---|---|---
2004 | Bank of Baroda | South Gujarat Local Area Bank | Restructuring of weak bank | Forced Merger
2005 | Centurion Bank | Bank of Punjab | To achieve scale and scope economies | Voluntary Merger
2006 | Federal Bank | Ganesh Bank of Kurandwad | Restructuring of weak bank | Forced Merger
2006 | IDBI Bank | United western Bank | Restructuring of weak bank | Forced Merger
2006 | Centurion Bank of Punjab | Lord Krishna Bank | Expansion of size | Voluntary Merger
2007 | ICICI Bank | Sangli Bank | Restructuring of weak bank | Forced Merger
2007 | Indian Overseas Bank | Bharat Overseas Bank | Restructuring of weak bank | Forced Merger
2008 | HDFC Bank | Centurion Bank of Punjab | Expansion of size and benefits of scope economies | Voluntary Merger

Source: Compiled from Report on Trend and Progress of Banking in India, RBI, Various Issues.

1.13 NEED OF THE STUDY:

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 research is to probe into the various motivations for mergers and acquisitions in the Indian Banking sector. Thus, literature is reviewed to look into the various motivations behind a banks’ merger/acquisition event. This thesis is also an attempt to synthesize the literature on the effects of bank M&A activity and try to learn from the experiences of consolidation. Most of the studies carried out in this area have focused on the effect of mergers on the performance of the banks. The performance indicator in most studies has been one of the following: Shareholders’ wealth effects by means of event studies, the measurement of improvements in efficiency gains and impact on profitability (ratios). The recent wave of bank mergers has thus raised concern with shareholder’s return, efficiency gains and profitability. The results of this thesis will provide that the bank mergers do results in an increase return in the context of shareholders, efficiency and
profitability from the sample of bank mergers during the period of 1993-2008-09. Also this thesis will give the reader a scope to understand the various policy developments that took place in the Indian Banking Sector vis a vis Mergers in the Indian Banking Sector.

1.14 METHODOLOGY OF THE STUDY:

Two measures will be looked into this thesis: Financial Performance and Efficiency improvements. The data are in the form of financial statements that are extracted from either published newspaper, the bank’s website through its published Annual Reports and databases of Capitaline and Prowess. Financial accounts derived are from the period of 2000-01 to 2008-09. The selected period would allow a better illustration on the performance of the individual banks.

The pre-merger and post-merger averages for a set of key financial ratios were computed for 3 years prior to, and 3 years after, the year of merger completion (or the year of approval when the time of merger completion is not available). The merger completion year was denoted as year 0.

For the years prior to a merger, the key financial and efficiency ratios of the acquiring firm alone are considered. Post the merger, all the key ratios for the combined firm are taken. The post-merger performance was compared with the pre-merger performance and tested for significant differences, using paired “t” test. Instances where there have been only cash acquisitions are excluded from this study, to ensure comparability of results across the sample. (Mantravadi and Reddy, 2008).

The main instrument of supervision in this study is based on CAMELS model (for domestic banks) and CACS model (for foreign banks) and aim to achieve the analysis of key financial factors, such as capital, earnings and liquidity and bank’s solvency. (Suresh and Paul, 2010)
Financial Ratios

Financial ratios are the useful indicator of the firm’s performance and financial health. Most of the ratios are computed by the financial statements (Balance Sheet, P/L A/C and Cash flow Statement) of the companies. Ratios convert these financial statements in such a simple and understandable way that a normal person can easily understand the financial position of that particular organization. These ratios are used to analyze the trends within the same industry and usage of these ratios also helps us to compare the results with competitors and industry benchmarks. As a highly important analytical tool financial ratios help the financial analysts to take decisions in order to improve the liquidity, profitability, financial structure, leverage and interest coverage etc. When the financial ratio figures over a period of time are compared, then this method sometimes called inter-company or trend analysis. By using this method the owner of the business can identify trends, good and bad, and then adjust accordingly. The owner also compares the ratios with other industries in order to look at the industry trends (a cross company analysis). (Kemal, 2011).

In this study following key performance indicators have been used:

**Efficiency Ratios:**

- Operating efficiency = \( \frac{\text{Total operating expenses}}{\text{Total assets}} \)
- Cost of funds = \( \frac{\text{Total interest expenses}}{\text{total deposit and non-deposit borrowings}} \)
- Efficiency(cost – income)ratio = \( \frac{\text{Non-interest income}}{\text{Net total income}} \)

**Liquidity Ratios:**

- Credit – asset ratio = \( \frac{\text{Total credit extended}}{\text{Total assets}} \)
- Short term investment-T.A ratio = \( \frac{\text{Investment in money market instruments and other short-term assets}}{\text{Total assets}} \)
- Cash to total deposits
- Cash to T.A = \( \frac{\text{Cash and bank balances}}{\text{total deposits}} \)
- Cash and bank balances including call money/T.A

**Risk ratios:**

- Equity multiplier = \( \frac{\text{Total assets}}{\text{equity}} \)
- Equity Ratio = \( \frac{\text{Equity}}{\text{Total assets}} \)
- Capital Adequacy ratio = \( \frac{\text{Total capital}}{\text{Risk weighted assets}} \)
Profitability:
ROE = Net Profit/Equity
ROA= Net Profit/Total Assets
Profit Margin= Net Profit/ Total Income
Asset utilization= Total Income/Total Assets
Interest cost to asset ratio= Interest expenses/Total assets
Earnings per share= Net profit/ number of equity shares

1.15 RESEARCH HYPOTHESIS:

Considering the limited research on mergers and acquisitions in Indian Banking industry, the present study has been aimed at reviewing the financial performance and efficiency improvements of firms going through mergers in Indian banking industry, in the post-reforms period. The study has further attempted to investigate and test if there are any significant deviations in the results achieved by mergers in different banking sectors in India, by analyzing sub-samples representing banking sector.

The null and alternate hypotheses are:

0: H Liquidity of Bank improves after merger.
1: H Liquidity of Bank does not improves after merger
2: H Risk of Bank improves after merger
3: H Risk of Bank does not improve after merger
4: H Profitability of Bank improves after merger
5: H Profitability of Bank does not improve after merger
6: H Efficiency of Bank Merger improve after merger
7: H Efficiency of Bank Merger does not improve after merger
1.16 SOURCE OF DATA:
Information is compiled from books, newspapers, peer reviewed journals, industry portals, government agencies, monitoring industry news and developments, and through access to paid databases viz., EBSCO, SCIENCE DIRECT, EMERALD, SAGE ONLINE JOURNALS, PROQUEST, ECONOMIC AND POLITICAL WEEKLY, JSTOR, ELSEVIER and RBI WEBSITE. For retrieving data for financial performances of the merged companies the databases viz., CAPITALINE, INDIA STAT, ORBIS, EUROMONITOR, MINTEL REPORTS and COMPANY ANNUAL REPORTS have been used for this thesis.

1.17 SAMPLE OF THE STUDY:
The sample of this thesis would be complete list of merged banks in India from the year 2000-01 to 2008-09.

1.18 DATA ANALYSIS
Once the data is collected it needs to be analyzed. Data analysis is a very important step in the entire research process. The entire research activity can be a failure if the data analysis is not done properly so as to reach the objectives framed for the research. The process for analyzing the data starts with data editing, coding and data entry and lastly data analysis (Cooper and Schindler, 2006).

The researcher would collect all secondary information regarding mergers of the banking industry involved in the research edits the data. Only those financial information and details which are important to lead the objectives has been picked up. Secondly, the researcher would input all the relevant data in the Excel sheet. Data entry has been done on all the key performance indicators which are chosen to be analyzed for the acquiring firm. The main place
of the data entry would be an Excel Spreadsheet where the data has been entered, stored and analyzed for further use. This data has been analyzed at the researcher convenience for the study through SPSS and different statistical tools will be employed for the research. The main tools are; Mean, SD, Correlation, t-test etc. and result will be drawn accordingly and the results have been represented through bars and diagrams.

1.19 OBJECTIVES OF THE STUDY:

1. To identify the potential motivational force behind Mergers and Acquisitions in Indian Banking Industry.

2. To critically examine the impact of Mergers and Acquisition in the Indian Banking Industry through three parameters: Wealth Creation, Efficiency gains and Profitability measures (ratios).

3. To compare the performance of pre and post merger effects through Efficiency gains and Profitability measure (ratios).

4. To make suggestions in the light of the conclusions emerging from the study for the improvement of performance of the banks in India.

1.20 LAYOUT OF THE STUDY:

Chapter 1 Introduction
   Bibliography and References

Chapter 2 Literature Review
   Bibliography and References

Chapter 3 Methodology
   Bibliography and References

Chapter 4 Results & Analysis of Selected Banks in India

Chapter 5 Conclusions
   Bibliography and References
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