IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

Restructuring through Mergers- A case study on Mega Merger of Banks 2020

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Abstract:

Today, Indian Banking industry is one of the most growing and flourishing industries which is going through a remarkable change from last two decades. Banking systems of any country need to be effective and efficient as it plays an active role in the economic development of the country. Intense competition among banking industries gave an importance to mergers and acquisition as it minimizes risk, increase profits, provides better customer service with the help professional staff by providing specialized products & services and eliminates competition. This research paper provides information about the mega merger that took place on April 1,2020.

Key words: CASA, CRAR, Net provisioning, PCR, CET-1 ratios.

Introduction:

Over several decades, the existing banking structure in India has been serving the credit and banking services needs of the economy and is evolved as one of the fastest growing sectors in India. In order to cater to specific and varied requirements of different stakeholders (customers and borrowers) there are multiple layers in today's banking structure. Undoubtedly, the banking structure played a major role in the mobilization of savings and promoting economic development. Irrespective of the intense competition and challenges faced from the various multinational players, they are gaining competitive edge by acquiring or merging. Banks are witnessing changes in the regulatory environment, massive boom in off balance sheet, risk management, financial instruments, the creation of e-commerce and online banking, and enormous economic industry consolidation. All of these forces have made the Indian banking industry notably aggressive. Hence, it is important to study and observe the performance of the banks after the merger.

Meaning of 'Merger' :

A merger is an agreement that unites two existing companies into one new company. There are several types of mergers and also several reasons why companies complete mergers. Mergers are most commonly done to gain market share, reduce costs of operations, expand to new territories, unite common products, grow revenues, and increase profits—all of which should benefit the firm's shareholders. After a merger, shares of the new company are distributed to existing shareholders of both original businesses.

Review of Literature:

- According to Dr. V.Venkateswara Rao , D.Pushpa Sri in 2019 has revealed that Merger is a cumbersome process in terms of consolidating the accounts, infrastructure, management and marketing polices etc and it takes a lot of perseverance to complete the merging process. They also stated that Mergers can be beneficial if the corporate governance, structural issues related to them are resolved .
- In 2018, India- Ratings has revealed that Smaller banks such as Vijaya & Dena banks asset-liability management mismatch can be better addressed at the consolidated basis**.** Merger in public sector banks may ought to bringabout material operating efficiencies over time by decreasing combined operating costs, lower investment cost and may also strengthen the risk management practices on a consolidated basis and might set a roadmap for further consolidations in the PSB's.
- In 2016, Jyothi H. Lahotia has revealed that the merger and acquisitions is an important corporate strategy that aids the firm external growth and provides a competitive advantage.Mergers and acquisitions are being more and more utilized in today's global economy, for enhancing competitiveness via gaining greater marketplace, broadening the portfolio to lessen risks, entering into new markets and Geographic's and by capturing economics of scale.
- According to Jayashree R Kotanal has revealed in 2016 that Mergers and Acquisition is an important tool for growth and expansion in any industries and the Indian banking sector is of no exception and his study shows an impact on Mergers and Acquisitions(M&A) in the Indian Banking sector. According kotanal M&A's is important for survival of the weak banks by way of merging them in to the larger financial institution.
- In 2016, A.N. Tamragundi, Devarajappa .S has examined the effect of mergers on overall performance of selected commercial banks in India. The impact of Mergers has been examined and evaluated on three different perspectives and significant improvement can be felt in Deposits, Advances, Business and Number of personnel. Therefore, the end result indicates that mergers can help to achieve commercial performance.

Reports of various committees on Bank Mergers:

RBI and the Government of India has made several initiatives in order to strengthen the banking system since 1991. Government has appointed various committees which gave several proposals for the same purpose. Few of the committees are mentioned below

Narasimham Committee I:

The first Narasimham committee was setup by Manmohan Singh on August,1991 under the chairmanship of M.Narasimham. The committee was appointed to review the working of Financial institutions in India and to suggest measures to remodel and restructure these institutions for raising their efficiency. The following are the important recommendations given by the committee.

- Number of PSB's should be reduced through Mergers & Acquisitions which would help them to strengthen their size and operations.
- It also stressed that strong banks should be merged with banks of equivalent size either in public or private sector banks and development financial institutions or non-banking institutions.
- There should be 3 to 4 banks of International presence.
- 8 to 10 banks of national presence in the country engaged in common banking and few local banks serving the credit needs of customers in specific area/locality.
- Few Regional Rural banks which would provide finance to Agriculture and allied activities in rural and backward areas.
- No further nationalization of banks.
- It also stressed on creation of private sector banks meeting the minimum capital and other requirements and to allow foreign banks to enter into the country.
- It also recommended that the PSB's should be free and autonomous.
- Reduction of CSR & SLR rates.

Narasimham Committee II:

On 23rd April,1998 another committee was setup by P. Chidambaram under the chairmanship of M. Narasimham in order review the progress of banking reforms since 1992 and to strengthen the financial institutions. Following are the important recommendations of Narasimham committee II.

- It suggested that Merger between banks, DFI's and NBFI's should based on synergies.
- It also suggested that Mergers of PSB's ought to emanate from the control of the banks with the Government as the common shareholder playing as an ancillary function. Merger should no longer be seen as a method of bailing out weak banks.
- The committee suggested that it would be desirable to increase Capital adequacy and Provisioning norms which inturn improves their risk taking ability.
- The committee recommended for the creation of Asset Reconstruction Funds to take over bad debts as NPA's became a major concerning issue. These recommendations led to establishment of 'Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI),2002'.
- It also stressed on reviewing and amending RBI act, Banking regulation act, Bank nationalization act etc.
- It also recommended for proper classification of assets and transparency of bank accounts and various other financial institutions.
- Besides major recommendations, the committee also suggested for faster computerization, upgradation in technology along with training and recruitment of banking staff.

The Khan Committee 1997:

The committee was appointed to study the harmonization of roles of commercial banks and financial institutions. It recommended that banks and developmental financial institutions should be permitted to explore and enter into gainful merger. Further, the committee not only recommended merger between banks but also between banks and development financial institution, between strong and weak banks and between two strong banks and development financial institutions.

Verma Committee 1999:

Reserve Bank of India has appointed Verma committee on February 1999 under the chairmanship of Shri M.S. Verma in order to identify the and examine the performance of weak banks on the basis of certain criteria and to suggest a strategic plan for restructuring and strengthening of Weak Public Sector banks. Certain parameters which were essential for financially strong bank were developed to identify weak banks. Committee submitted its report on October 1999 and provided recommendations for identifying weak banks with the help seven parameters which are mentioned below.

- Capital Adequacy Ratio.
- Coverage Ratio.
- Return on Assets.
- Net Interest Margin.
- Ratio of Operating profits to average working funds.
- Cost to income Ratio.
- Staff cost to net interest income plus all other incomes Ratio.

Public sector banks were classified into three categories on the basis of the above mentioned 7 parameters.

- The banks in which all the parameters were met.
- The banks which met only few parameters.
- The banks in which none of the parameters were met .

The Committee examined the financial strength and weakness of all Public sector banks and also suggested ways for restructuring of weak banks. The working group opined that the privatisation or merger of weak banks should be a last resort. The Committee suggests for operational restructuring which could be attained by reducing the level of NPA, adopting and introducing modern technology, involving improvement and diversification of sources of income, a financial restructuring authority with an asset reconstruction fund managed by an asset management company, cost reductions through substantial reduction of staff, organisational and financial restructuring etc. The Government would also consider re-capitalisation of the weak banks to achieve the prescribed Capital Adequacy Norms

Raghuram Rajan Committee:

Rajan's 2008 report cited the "need to deregulate certain areas of the financial sector" and "focus on creating necessary institutions, and closing important gaps in regulation". He also suggested for more small private banks, disinvestments, underperforming state-run banks, the freeing of branch licensing rules, and the greater participation of foreigners in Indian financial markets. Underperforming PSU's were suggested to be sold. Committee has suggested an open-minded outlook towards merger of banks and takeovers.

Need for Study:

The present study would investigate the detail of Merger with greater focus on the Indian banking sector. The research paper will also discuss the pre and the post merger performance of banks. These mergers have important implication on the overall performance and profitability in the Indian banking sector. Therefore, it is extremely important to know the impact of these merges on the efficiency levels of banks in terms of both managerial and policy interests and their temporal behavior so as to understand how the banking industry has been reacting to these emerging challenges and which banks are performing better than others in this period of transition.

Objectives of study:

- To understand and to interpret the purpose of mergers and acquisitions.
- To study and examine the strength and weakness of the merged banks.
- To examine the effects of merger.
- To recognize banking awareness regarding mergers and acquisitions in general.
- To study the Merger of Punjab National Bank (PNB), Oriental Bank of Commerce(OBC), United Bank of India, Canara Bank , Syndicate Bank, Union Bank of India, Andhra Bank & Corporation Bank, Indian Bank & Allahabad Bank.

Research Methodology:

Data is collected from secondary source. Secondary sources comprises of Research publications, Newspapers, Data mining (exploring through internet).

Important terms:

1. CASA (Current account Savings account) ratio : A CASA combines the benefits of both a checking account and savings account, and it is indicative of a competitive market in which banks need to offer new products to win over customers.Current Account Savings Accounts (CASA) are a type of non-term deposit account. A CASA has a lower interest rate than term deposits, such as a certificate of deposit, and is therefore a cheaper source of funds for the financial institution.

The percentage of total bank deposits that are in a CASA is an important metric to determine the profitability of a bank. The CASA ratio indicates how much of a bank's total deposits are in both current and savings accounts. The ratio can be calculated using the following formula:

CASA Ratio = CASA Deposits / Total Deposits

A higher ratio means a larger portion of a bank's deposits are in current and savings accounts, rather than term deposit accounts. This is beneficial to a bank because it gets money at a lower cost. Therefore, the CASA ratio is an indicator of the expense to raise funds and, therefore, is a reflection of a bank's profitability or likelihood of generating profit.

2. CET-1(Common Equity Tier 1) ratio: CET1 is a measure of bank solvency that gauges a bank's capital strength. Common Equity Tier 1 (CET1) is a component of Tier 1 capital that consists mostly of common stock held by a bank or other financial institution. It is a capital measure that was introduced in 2014 as a precautionary means to protect the economy from a financial crisis. It is expected that all banks should meet the minimum required CET1 ratio of 4.50% by 2019.

Common Equity Tier 1 Ratio = Common Equity Tier 1 Capital / Risk-Weighted Assets.

3.CRAR (Capital to Risk weighted Asset) ratio **:** Capital to Risk weighted Asset Ratiois also known as CapitalAdequacy Ratio (CAR), is used to protect depositors and promote the stability and efficiency of financial systems around the world. The capital adequacy ratio is calculated by dividing a bank's capital by its risk-weighted assets. The capital used to calculate the capital adequacy ratio is divided into two tiers.

CRAR = (Tier 1 Capital + Tier 2 Capital)/ Risk Weighted Assets.

A bank with a high capital adequacy ratio is considered to be safe and likely to meet its financial obligations.

Tier 1 capital consists of equity capital, ordinary share capital, intangible assets and audited revenue reserves and is used to absorb losses and does not require a bank to cease operations. Tier 2 capital comprises unaudited retained earnings, unaudited reserves and general loss reserves and absorbs losses in the event of a company or winding up or liquidating.

Risk-weighted assets are used to determine the minimum amount of capital that must be held by banks and other financial institutions in order to reduce the risk of insolvency.

4. Net NPA (nonperforming asset) ratio: A nonperforming asset (NPA) refers to a classification of loans or advances that are in default or in arrears. Gross NPA represents the quality of loans granted by the banks .Gross NPA includes the assets such as sub-standard, doubtful and loss assets. Net NPA can be obtained by deducting provisions from Gross NPA.

Net NPA ratio=Net NPA/(Gross advances- Provisions).

5.**P**rovisioning Coverage Ratio**:** Provisioning Coverage Ratio (PCR) refers to the prescribed percentage of funds to be set aside by the banks for covering the prospective losses due to bad loans. Earlier there was a bench mark Provisioning Coverage Ratio (PCR) of 70 percent of gross NPAs was prescribed by RBI, as a macro-prudential measure. Though, there is no such prescription now, it is good for the banks to go for higher PCR when they are making good profits, as building up 'provisioning buffer' is useful when non-performing assets (NPA) of a bank rise at a faster.

Provision Coverage ratio= (Equity- net NPA) / (Total assets – intangible assets).

Mega Merger 2020:

In order to boost and to make a clear path to achieve a target of $5 trillion economy, Finance Minister Niramala Sitharaman said the government is trying to create a big next generation banks and announced amalgamation of 10 public sector banks into four big banks.

After the Merger the number of Public Sector Banks in the country will come down to 12 from 27 banks. Apart from Merger the government has announced upfront capital infusion of Rs.55,250 in the PSBs capital for credit growth & regulatory compliance to support economy. PNB will get capital infusion of Rs 16,000 crore; Union Bank will get Rs 11,700 crore; Canara Bank with Rs 6,500 crore; Indian Overseas Bank Rs 3,800 crore; Central Bank of India Rs 3,300 crore; Bank of Baroda Rs 7,000 crore; Indian Bank Rs 2,500 crore and Uco Bank Rs 2,100 crore. Government has decided to merge Punjab National Bank, Oriental Bank of Commerce and United Bank; Canara Bank and Syndicate Banks; Union Bank of India, Andhra Bank and Corporation Bank; and Indian Bank and Allahabad Bank as per instructions received from Finance minister Sitharaman.

Merger became effective from April 1,2020. Merger has taken place at a time when the entire country is under the grip of COVID-19 outbreak. Experts are of the opinion that merger at this point of time may not be remain a very smooth and seamless transition. However, heads of the anchor banks have exuded confidence and do not find any problem as the process has gone as per the plan with certain modification in implementation.

Reasons for Merger:

- Big banks provide enhanced capacity to increase credit and bigger risk appetite, with national presence and global reach.
- To reduce Gross NPA level to a great extent.
- Government's intention is not just to give capital but also to give good governance.
- Government to monitor large loans to avert frauds.
- By taking into consideration the complementary nature of business of concerned banking companies, in terms of commercial strength, geographic profiles and site integration, the amalgamated entity may be able to conduct business in more efficient manner.

New banks after Merger:

Banks	Anchor Banks	PSB rank by size
Punjab National Bank (PNB), Oriental Bank of Commerce(OBC), United Bank of India	Punjab National Bank(PNB)	2nd largest
Canara Bank & Syndicate Bank	Canara Bank	4th largest
Union Bank of India, Andhra Bank & Corporation Bank	Union Bank of India	5th largest
Indian Bank & Allahabad Bank	Indian Bank	7th largest

PNB, OBC and United Bank has been merged. From the above table it is clear that the new merged bank will be the second largest PSB in the country with Rs 18 lakh crore business and second largest branch network in India.

	PNB	OBC	United Bank of India	Amalgamated bank
Total business(in crore RS)	11,82,224	4,04,194	2,08,106	17,94,524
Gross advances(in crore RS)	5,06,194	1,71,549	73,123	7,50,866
Deposits(in crore RS)	6,76,030	2,32,645	1,34,983	10,43,658
CASA ratio	42.16%	29.40%	51.45%	41.00%
PCR	61.72%	56.53%	51.17%	56.47%
CET-1 ratio	6.21%	9.86%	10.14%	8.73%
CRAR ratio	9.73%	12.73%	13.00%	11.82%
Net NPA ratio	6.55%	5.93%	8.67%	7.05%
Employees	65,116	21,729	13,804	1,00,649
Domestic branches	6,992	2,390	2,055	11,437

Canara and Syndicate Bank has been merged to become the fourth largest PSB with Rs 15.2 lakh crore business and third largest branch network in India.

	Canara Bank	Syndicate Bank	Amalgamated bank
Total business(in crore RS)	10,43,249	4,77,046	15,20,295
Gross advances(in crore RS)	4,44,216	2,17,149	6,61,365
Deposits(in crore RS)	5,99,033	2,59,897	8,58,930
CASA ratio	29.18%	32.58%	30.88%
PCR	41.48%	48.83%	45.15%
CET-1 ratio	8.31%	9.31%	8.81%
CRAR ratio	11.90%	14.23%	13.06%
Net NPA ratio	5.37%	6.16%	5.76%
Employees	58,350	31,535	89,885
Domestic branches	6,310	4,032	10,342

Merger of Union Bank of India, Andhra Bank and Corporation Bank will create India's fifth largest PSB with Rs 14.6 lakh crore business and fourth largest branch network.

	Union Bank	Andhra Bank	Corporation Bank	Amalgamated bank
Total business(in crore RS)	7,41,307	3,98,511	3,19,616	14,59,434

Gross advances(in crore RS)	3,25,392	1,78,690	1,35,048	6,39,130
Deposits(in crore RS)	4,15,915	2,19,821	1,84,568	8,20,304
CASA ratio	36.10%	31.39%	31.59%	33.02%
PCR	58.27%	68.82%	66.60%	64.56%
CET-1 ratio	8.02%	8.43%	10.39%	8.94%
CRAR ratio	11.78%	13.69%	12.30%	12.59%
Net NPA ratio	6.85%	5.73%	5.71%	6.09%
Employees	37,262	20,346	17,776	75,384
Domestic branches	4,292	2,885	2,432	9,609

Indian Bank and Allahabad Bank has been merged. The new amalgamated bank will be seventh largest with Rs 8.08 lakh crore business.

	Indian Bank	Allahabad Bank	Amalgamated bank
Total business(in crore RS)	4,29,972	3,77,887	8,07,859
Gross advances(in crore RS)	1,87,896	1,63,552	3,51,448
Deposits(in crore RS)	2,42,076	2,14,335	4,56,411
CASA ratio	34.71%	49.49%	42.1%
PCR	49.13%	74.15%	61.64%
CET-1 ratio	10.96%	9.65%	10.30%
CRAR ratio	13.21%	12.51%	12.86%
Net NPA ratio	3.75%	5.22%	4.48%
Employees	19,604	23,210	42,814
Domestic branches	2,875	3,229	6,104

Interpretation:

1. After the merger we can see that the Capital, Advances of banks have been increased when compared to banks performing individually.
2. Allahabad Bank and Indian Bank will have the lowest net NPA (non performing assets), while boasting the highest provisioning coverage and strongest CASA (current account and savings account) ratio
3. Greater synergies are possibly to accrue from the merger of Syndicate Bank with Canara Bank as each have similar cultures and geographical presence with higher provisioning and capital ratios.
4. The combined entity of Union Bank will see improved provisioning and capital ratio after merger with Andhra Bank and Corporation Bank.

5. PCR ratio after merger in all banks are more when compared to Net NPA which is a good indicator.
6. CRAR ratio after the merger of Indian bank & Allahabad bank is 12.86%, Union bank, Canara bank & Syndicate bank is 12.59% , Corporation bank & Andhra bank is 13.06% which is above the average as per RBI guidelines and is a good indicator.
7. The combined entity Allahabad Bank and Indian Bank will have the highest CET-1 ratio.

Pros and Cons of Merger:

Why merger is good?

For Banks:

- With innovative products and services and with an accepted level of efficiency Small banks can reach to international standards.
- A better and optimum size of the organization would help PSBs to offer more and more products and services and help in integrated growth of the sector.
- Public sector banks which are geographically concentrated, can expand their coverage beyond their outreach.
- Merger helps in improving the professional standards.
- Unhealthy and intense competition among public sector banks will reduce.
- In worldwide, the Indian banks will gain greater recognition and higher rating.
- The volume of inter-bank transactions will come down, resulting in saving of time in clearing and reconciliation of accounts significantly.
- This will also reduce unnecessary interference by board members in day to day affairs of the banks.
- Mergers can diversify risk management.

For Customers:

- Customers can have access to wider range of products and services at a lower cost.
- The enhanced capacity will also increase the reach of banks to rural and ill-served areas.
- Introduction of new technologies and feature will be uniformly available to all customers.

For Bank Employees:

- The wide disparities between the staff of various banks in their service conditions and monetary benefits will narrow down as they will be under single umbrella.
- Bargaining strength of bank staff will become more and visible and staff may look forward to better wages and service conditions in future.

For economy:

- Reduction in the cost of operating banking business.
- Technical inefficiency minimizes.
- The size of each business entity will add strength to the Indian Banking System in general and Public Sector Banks in particular.
- Indian Banks can manage their liquidity position(both short term and long term) without any difficulty.
- Consolidation among the banks will result in economies of scale in their operations in the form of savings and higher profits.

- A greater number of posts of CMD, ED, GM and Zonal Managers will be abolished, which saves crores of Rupee.

For government:

- The burden on the central government to recapitalize the public sector banks will come down considerably.
- Mergers will also assist in meeting stringent norms below BASEL III, particularly capital adequacy ratio.
- If we look into regulatory perspective, monitoring and controlling of less number of banks will be easier.

Cons of merger:

- Experts are of the opinion that merger during outbreak of COVID-19 may not remain a really smooth and seamless transition.
- Problems to regulate and harmonize top leadership in institutions and the unions comes into picture.
- Mergers results in shifting/closure of many ATMs, Branches and controlling offices, and it is not economical to keep so many numerous banks concentrated in various areas, notably in urban and metropolitan areas.
- On an account of Merger there will be immediate job losses on one side and hamper or stoppage of further recruitment on the other. This may worsen the unemployment situation further and may create law and order problems and social disturbances.
- Mergers will result in clash of distinct organizational cultures. Conflicts may arise in the area of systems and processes too.
- There will be a big jolt in the entire banking industry when a big bank books huge loss or crumbles. Its repercussions are to be felt everywhere.
- Merged organizations have different perspectives regarding to Compliance, risk consistency and different culture so it creates a negative impact on the profitability of the organization.

Findings & Suggestions:

- The study ignores the effect of viable differences in the accounting methods adopted by different banking companies.
- The factors which effect the Merger performance may not be same for all companies.
- The Government should not go for consolidation as a means of bailing out of weak banks. The robust banks should no longer be merged with susceptible banks, because it may have destructive affect upon the asset quality of the more potent banks.

Conclusion:

Growth is an important aspect for any organization. The Indian banking sector and the economy have confronted various challenges and problems and have made mergers and acquisitions activity not an unknown phenomenon in Indian banking industry. Merger is a highly potential tool for growth and expansion in banks. Merger is a good idea. However, this should be done with right a bank for the right reasons. With the help of mergers and acquisitions, the banks can achieve significant growth in their operations, minimize their expenses to a substantial extent and also competition is decreased due to the fact merger eliminates competitors from the banking industry and can even be tricky given the challenges banks face, including bad loan problem that has plunged many public sector banks in an unprecedented crisis and can also create variety of problems which can cause great damage if the process of merging is not executed properly hence, it has to be implemented in a careful manner. Government of India and RBI have undertaken several measures and reforms in the Indian banking sector, as well as quite a few successful mergers and acquisitions, which have helped it, to grow manifold. Comparatively in short time, the Indian banking system has earned numerous outstanding achievements as the World's largest and the most diverse democracy in banking industry. One good example of Successful merger is HDFC & Centurion bank whose financial performance has increased after merger. Hopefully the merger of above 10 banks into 4 should reap benefits in future.

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