The Impact of Bank Mergers and Acquisition in a Developing Economy with special reference to Bank of Baroda

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Abstract

This research focuses on evaluating the impact of mergers and acquisitions on the performance of the Bank of Baroda in India. Bank mergers are not a new event, but recently, in the banking sector, it has received remarkable attention. This successful merger of various banks in India grabbed many scholars' attention in the field. The question remains whether bank merging is good for the economy after the rationale behind such mergers has been hotly debated. This paper analyzes the 'favor' and 'against' views. It concludes that bank mergers in India positively affect the banking sector's health and ultimately are helpful to the Indian economy. We always argue that the merger of banks brought synergy in the banking sector's operations, primarily in customer reach. In addition, even though the management change remains challenging, it also provides economies of scale.

The study recommended that banks be more proactive in driving profit to enhance financial performance to reap the benefit of merger and acquisition bids in the Indian banking sector. Similarly, amalgamations also relieve the Reserve Bank of India (RBI). RBI can better concentrate its efforts on supervising niche banks and assist the government in more significant economic and policy issues.

Keywords: - Merger and Acquisition (M&A), Indian Economy, Banking sector, Finance.

Introduction

The Indian economy is an 'emerging' economy, but it is heading towards a 'merging' economy. Banking is one of the vital sectors of the Indian economy, one of India's fast-growing sectors. A bank is a financial institution that deals with deposits, advances, and other related services. Running a bank is just as tricky as analyzing it for investment purposes. The bank's management must consider some criteria, such as how many loans to extend, to whom it can be given, what rates to set, etc.

Banking reforms have been an ongoing phenomenon worldwide since the 1980s. Still, it has intensified recently because of globalization's impact, precipitated by the continuous integration of the world market and economies. Banking reforms involve several unique historical, economic, and institutional imperatives. In India, the reforms in the banking sector preceded the backdrop of a banking crisis due to the high undercapitalization of deposit-taking banks, weak management practices, weakness in the regulatory and supervisory framework, and the tolerance of deficiencies in the corporate governance behavior of banks.

The consolidation and recapitalization exercise in the banking industry by the Reserve Bank of India has necessitated different organizations to engage in corporate consolidation. This has sent some commercial banks to consider mergers and acquisitions as a survival strategy.

Banks work as a propeller for the entire economy of any nation that runs the economic ship; hence, there is a need to reposition it for efficient financial performance through a reform process geared toward forestalling bank distress. In India, the reform process of the banking sector is part of the government's strategic agenda aimed at repositioning and integrating the Indian banking sector into the global financial system. The sector has undergone remarkable changes in institutions, ownership structure, and operations depth and breadth. These changes have been influenced mainly by the challenges of financial sector deregulation, operations globalization, technological innovations, and the implementation of supervisory and prudential requirements that conform to international regulations and standards.

In the present scenario, the banking sector faces many challenges, such as changes in the regulatory environment, the evolution of online banking, significant financial consolidation, etc. To gain a competitive advantage, private and public banks are making intense efforts to sustain and outperform each other, making the Indian financial industry highly competitive. Banks are adopting a consolidation strategy to have an impact on the market. Mergers and acquisitions give a synergy advantage and open up various opportunities and varied challenges, which may affect the efficiency of the banks, their employees, and their customers.

In 1991, the governor of the Reserve Bank of India, Mr. Narasimham, suggested consolidating public banks to strengthen them in a report on banking reforms. It envisaged a three-tier banking structure with three large banks with an international presence at the top, eight to ten national banks at tier two, and many regional and local banks at the bottom. The government is working on the merger and acquisition plan for public sector banks to create a multitier structure with approximately four global banks and bring down the number of state-owned lenders to about 12 from 21. The merger's main objective includes building scale and strengthening the risk-taking ability. Consolidation of state-run banks with weaker state-run banks shall be carried out to enjoy synergies, yield good results, and stabilize the more ailing banks.

Statement of the problem

The complete focus of this study is to use a comprehensive approach to test whether mergers and acquisitions of Bank of Baroda, Dena Bank, and Vijaya Bank lead to improvements in performance. The topic has been raised for discussion on one more essential point: banks are the backbone of any financial sector, and their role and function are significant in fiscal stability. And for an economy like India, this is required for its buildout.

In the light of the above, the following research questions are raised-

- What effect do mergers and acquisitions have on the financial strength of the Bank of Baroda?
- What effect did the merger and acquisition of the Bank of Baroda have on the Indian economy?

The hypothesis that is tested in the course of this research are stated below-

- Merger and acquisition of Bank of Baroda, Vijaya Bank, and Dena Bank positively affect the financial strength of Bank of Baroda and the Indian economy.

Literature Review

This section has been made to review some of the journals, articles, and existing literature dealing with mergers and acquisitions. Numerous aspects of Mergers and acquisitions in the Indian banking system have been studied through research papers, articles, and books.

K. Subhashree and M. Kannappan (2018) studied mergers' purpose and various procedures in their paper. It examined different ways of amalgamation, such as purchasing shares in the open market, purchasing shares by a secret treaty, making a takeover provided to the final shareholder body, etc.

In their paper, A.N. Tamragundi and Devarajappa S (2016) analysed the impact of the merger on physical performance, financial performance of merged banks, and effects on the share price.

In his paper, Suresh Kumar (2013) has given an overview of the Indian banking system and various mergers and acquisitions post-liberalization. It incorporates the study of how the size of the Bank affects mergers and acquisitions. It also examined the efficiency and profitability parameters of the banks affected by consolidation.

Amedu (2004) and Katty (2005) analysed that mergers and acquisitions are global business terms used to achieve business growth and survival. A merger entails the combination of two firms, which subsequently form a new legal entity under the banner of one corporate name while acquiring the takeover or pursuing similar motives.

Research Methodology

For the present study, Bank of Baroda, Vijaya Bank, and Dena Bank have been selected whose merger was done in 2019, out of which two are profit-making, and one Bank is piled under NPA. Secondary data has been collected for the study. The required data for the analysis were collected and compiled from the respective banks' websites and annual reports. In addition, other required data were collected from various journals, Government officials, newspapers, and magazines.

Discussion

Over time, public sector banks have started losing their market share, currently approximately 70% of the industry. The Government of India favors the merger and acquisition of nationalized banks, and any such mergers between two public sector banking entities occur under an act that stipulates that two banks can initiate merger talks. However, the government must finalize the merger scheme in consultation with the Reserve Bank of India and be placed in parliament, which reserves the right to modify or reject the plan. The approval of parliament is mandatory even if the merger is between private and public banks.

The highlights of the economic survey 2015-16 suggested a 4R strategy - Recognition, Recapitalization, Resolution, and Reform. At the same time, the government has already introduced several schemes, laws, and policies under the first 3Rs.

Synergy has been created between the dominance of Bank of Baroda in the western and northern regions and Vijaya Bank in the southern region, plus Dena Bank's expertise in the MSME sector. The 'synergistic effect' can be explained through the merger of Bank of Baroda, Vijaya Bank, and Dena Bank.

Post-merger, the synergy effect was observed in more than 9500 branches, more than 13400 ATMs, 85000 employees, and 120 million customers, and the entity has a deposit of Rs. 8.75 lakh crore and advances of Rs. 6.25 lakh crore.

While mergers bring synergies to one side, a big challenge of managing change awaits the managers. Before the merger, the entities had distinct and unique operational guidelines, cultures, and work ethics. After the merger, a single, unified entity will be on the external front. However, internally, there are bound to be several differences within the firm in terms of the work culture, beliefs, and ethos of the consolidating entities, and it certainly takes time and effort to harmonize and integrate such diversities and differences.

The other point is that to become a more substantial bank, the unified entity might subsume the weaker banks' sickness and limitations and exploit their growth potential. Even the government's intention through several mergers, like the recent merger of ten Public sector banks into four big banks, is to get them listed on the list of global-sized banks in the Indian economy, reflecting India's aspiration to be a five trillion dollar economy by gross domestic product.

As previously mentioned, mergers and acquisitions also bring relief to the Reserve Bank of India. It concentrates its efforts on supervising niche banks and assists the government in policy and more significant economic issues. The non-performing assets with no dues also get checked through mergers. The financial stability reports of the Reserve Bank of India reveal that there has been a growth in credit creation and a decline, although minimal, in the NPAs. However, one must remember that the arrangement does not uproot the NPA problem completely.

Mergers and acquisitions undoubtedly open funding for various budding developmental projects as financial resources get multiplied. However, it is essential to check that mergers do not hamper the healthy competition of the market and that such arrangements do not lead to cartelization of interest rates.

Post-liberalization, the banking industry in India experienced numerous mergers and acquisitions. The main objective behind many unions was to stabilize weaker banks by merging them with solid banks, increasing competition, economies of scale, synergy, advanced technology, and its integration, new products, and services.

In September 2018, the Government of India proposed merging Dena Bank and Vijaya Bank to Bank of Baroda's Management. The merged entity, i.e., Bank of Baroda, became the third-largest bank in India after ICICI Bank and State Bank of India. The merger is to absorb Dena Bank, which has sunk under non-performing assets, by the healthier banks, i.e., Bank of Baroda and Vijaya Bank, so that the merged entity may enjoy increased lending ability and widen its operations. The Reserve Bank of India has taken Dena Bank under a prompt corrective action framework because of high non-performing assets. Dena Bank is restricted from further funding and new hiring under PCA (Prompt Corrective Action) norms. The Gross NPA of Dena Bank mounted 22.4% of the gross advances as of March 31, 2018, from 16.27% on March 31, 2017. in terms of value, the gross NPA rose to Rs. 16361.44 crores from Rs. 12618.73 crores. Net NPA was also up at 11.95% from 10.66%.

Following are the financial parameters based on which individual banks and merged entities are compared:

Financial Parameters	**Dena Bank**	**Bank of Baroda**	**Vijaya Bank**	**Merged Bank of Baroda**
Total Business (Crore)	172940	1029810	279575	1482325
Gross Advances (Crore)	69920	448330	122350	640600
Deposits (Crore)	103020	581485	157325	841830
Domestic Branches	1858	5502	2130	9490
Advance Branches	38	81	57	68
Deposit Branches	55	106	74	89
Employees	13440	56360	15875	85675
Return on Assets	(2.43%)	0.29%	0.32%	(0.02%)
CRAR Capital Ratio	10%	12.13%	13.91%	12.25%
CET-1 Capital Ratio	8.15%	9.27%	10.35%	9.32%
Net NPA	11.04%	5.40%	4.10%	5.71%
CASA Ratio	39.8%	35.52%	24.91%	34.06%

Impact of Merger

On retail customer

- It seems quite possible that the new entity will add another layer of security. The customer with accounts in more than one Bank subjected to the merger will be given a single customer identity document. While the customer ID will be shared across multiple accounts with the same Bank, a different user ID can be generated for the joint holder to access only the relevant account.

- Accountholders of the merged entity had to update their new IFSC code or new account number with the Income-tax department, Insurance companies, and mutual funds, among others, and they will have to honour all electronic clearing services (ECS) mandates and post-dated cheques. According to requirements, fresh ECS mandates need to be issued and inquired.
- The Bank of Baroda was offered the applicable fixed deposit rate on the merger date. The rate, home loans, and loan agreements will remain the same as the Bank offered it before the merger for existing holders.

On Shareholders

- Bank of Baroda has decided to issue 402 and 110 equity shares for every 1000 shares held. After the swap ratio announcement, Dena Bank's share price fell by 20%, while Vijaya Bank was down by 7.25%. There was no significant change in the share price of the Bank of Baroda. As can be seen, the swap ratio proves to be fair for Dena Bank despite facing many challenges. Vijaya Bank gains nothing from the swap ratio and Favors the Bank of Baroda as their book value and adjusted book value are 8.2% and 2.2%. It is estimated that a return on equity of 10% for 2020 and 12.5% for the financial year. The earnings per share dilutive will increase by 4% from 2020 to 2021.
- Dena Bank, Bank of Baroda, and Vijaya Bank have lost 6839 crores or nearly 1 billion dollars in market valuation after the merger proposal. After the merger, the consolidated share of the merged entity became 3425 million, and its net worth amounts to Rs. 55600 crore. With these, the book value of the Bank of Baroda will be 80 rupees per share. After the swap ratio, the Bank of Baroda is valued at 1.5 times, reasonably.

On Employees

The March bank will have 85675 employees after the merger. Employees may not lose their employment as guaranteed by the government. Dena Bank and Vijaya Bank employees must adopt the New York culture of the Bank of Baroda. All three banks have a similar core banking system to help the employees work without difficulty. Many employees may get transferred due to the rationalization of branches, as there may be overlapping branches in the same vicinity. The merged bank will provide all their existing retirement facilities and other considerations.

Challenges in Merger

There may be many common cities where all three banks have branches. Therefore, rationalization of such branches needs to be carried out to reduce overheads. In comparison, they handle the employees, and their transfer may be burdensome. The combination of personnel with different cultures from Dena, Vijaya, and Vadodara could cause some friction.

Considering the merged Bank's employees, all three will continue their employment in the merged bank, accounting for 85675 employees. In the case of private banks, laying off the access workforce for cost-cutting is the option, but public sector banks have no choice but to continue with the total employees.

The main task of the merger will be its business growth prospects and rapid growth of credit. It will be interesting to experience how this corporate-focused Bank utilizes its network and moves in the direction of retail.

The convergence of numerous data centers that manage over 100 lakh customers of all three banks will be a significant challenge. In theory, Technology integration is easy to achieve. Still, in practice, it will require much hard work, just like getting a new account code for customers and communicating that will not be simple. The total number of branches of all three banks accounts for nearly 9489; approximately 10% of these branches are overlapped. Replacing chequebooks will be difficult for the merged entity—Integrating NEFT, net banking, RTGS, etc.

Benefits of Merger

- All three banks are on the same elemental banking system, making it easier to carry out the operations without difficulty. The employees will also be able to adapt to the working culture.
- The merged entity will benefit from network sharing, deposits at a low cost, subsidiaries, a large customer base, vast market share, operational efficiency, and various products and services.
- The merger will help Bank of Baroda widen its network as the customer base will increase and tilt towards the retail front.
- After the merger, Bank of Baroda will be the second-largest Bank in assets.
- The merger will lead to cost, product, and technology efficiencies and will be easy to manage**.**

Conclusion

The study finds that mergers and acquisitions of the banks in India, a developing country that consolidates different entities' competencies, culture, and shortcomings, are likely to be a boon for the nervous system of the banking sector and the economy. A merger helps enhance performance by offsetting the weaknesses of a bank. As witnessed in the merger of Bank of Baroda, Dena Bank, and Vijaya Bank, bank mergers also increase technological tools. The synergy that rises together through merging also helps in customer reach, operations tools, technology, and diversified business for each merging Bank. This altogether helps build a more robust financial sector. Some banks used mergers as strategic tools for expanding their horizons, and they continue to do so. In addition, merging and acquisition render massive potential in India's rural markets, which India's central banks have not yet explored.

Suggestions

The government needs to improve the implementation part of the insolvency & bankruptcy code, and it is essential to point out this. Moreover, the IBC needs to strengthen its recovery mechanism. Mergers are a course of action for banks to resolve the non-performing assets menace and various committees associated with the issue. Even the Reserve Bank of India and the Government seem to take more curative measures than preventive ones. So there is a need for a better mechanism that provides banks easy access to the most sought-after experts on productive avenues so that they do not get stuck in loss-making assets at the first instance and banks get the support and authority to get it resolved as soon as possible if any such thing happens.

In the case of public sector banks, more autonomy must be given to the Reserve Bank of India and the Board of such Banks. Since the government is the primary stakeholder in such Banks, the Reserve Bank of India finds it difficult to exercise control because the public sector banks are ultimately answerable to the government, not the RBI. Also, they do not want government decisions imposed on them because the boards of the public sector banks must have the authority to decide on issues like mergers.

The government should not merge a weak bank with a strong bank as it will hamper the valuation of a substantial bank's shares and degrade the quality of its assets. The strong Bank should be merged with another strong bank to compete well with foreign banks.

The thrust should be to improve the quality of products and services of public sector banks compared to privately owned banks so they will not lose their market share in the banking industry.

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