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A Review on Recent trends in Bank Merging System in India

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Abstract
The present paper examines the impact of mergers and acquisitions on the financial efficiency of the selected financial institutions in India. The analysis consists of two stages. Firstly, by using the ratio analysis approach, we calculate the change in the position of the companies during the period 2000-2008. Secondly, we examine changes in the efficiency of the companies during the pre and post-merger periods by using nonparametric Wilcoxon signed rank test. While we found a significant change in the earnings of the shareholders, there is no significant change in liquidity position of the firms. The result of the study indicates that M&A cases in India show a significant correlation between financial performance and the M&A deal, in the long run, and the acquiring firms were able to generate value. Using data available from Thomson Financial Services Worldwide Mergers and Acquisitions database, the paper analysed M&A transactions listed in the database that were announced between January 1, 2000 and December 31, 2009, in which the target firm or acquirer was located in India, Pakistan or Bangladesh. M&A in India is a lot more active than that in Pakistan or Bangladesh. One unique feature of Pakistani M&A market is that it has a high ratio (more than 80 percent) for Pakistani firms buying non-Pakistani companies. In Bangladesh, non-Bangladeshi firms acquiring Bangladeshi companies accounted for more than 90 percent of all large M&A value.
Keywords: Cross Border Merger, Mergers and Acquisitions, Corporate Performance, India,

1. Introduction

Strategic alliances and Mergers and Acquisitions (M&A) are the dominant corporate strategies followed by organizations looking for enhanced value creation. The growing tendency towards mergers and acquisitions (M&As) world-wide, has been driven by intensifying competition. There is a need to reduce costs, reach global size, take benefit of economies of scale, increase investment in technology for strategic gains, desire to expand business into new areas and improve shareholder value. During the first wave (i.e., 1990-95), the Indian corporate houses seem to have been bracing up to face foreign competition while the second wave (i.e., 1995-2000) experienced a large presence of multinational firms**.** The third wave of M&As in India (2000-till date) is evident of Indian companies venturing abroad and making acquisitions in developed and developing countries and gaining entry abroad. The relative size of target and acquiring firm has also increased. The size differences between the bidder and target firms influence acquisition performance and large acquisitions would have a greater combination potential**.** M&As also determined, to a large extent, the nature of foreign investment in the country during this period. M&A comes in all shapes and sizes, and investors need to consider the complex issues involved in M&A. The most beneficial form of equity structure involves a complete analysis of the costs and benefits associated with the deals. Corporate restructuring including M&As have given rise to a host of important issues for business decisions, for public policy formulation and economic regulations. While business firms can grow both internally and externally, with increased global competition, it has become imperative for the business firms to grow inorganically that is externally. A look at the sectoral trends reflects that Indian financial sector is adopting inorganic strategies to grow its businesses. The Indian financial system comprises an impressive network of commercial banks (CBs), co-operative banks (CPBs), development finance institutions (DFIs) and non-banking financial companies (NBFCs). Researchers and economists have observed that due to smaller size, the Indian commercial banks may find it very difficult to compete with international banks in various facets of banking and financial services in the post 2009 scenerio. The entry of foreign banks was restricted earlier, but since 1991 a number of foreign banks have been allowed to operate in India. To enhance competition, foreign direct investment up to 74 per cent of ownership has been allowed in private banks and up to 20 per cent in nationalized banks. The banks have also been allowed to enter into insurance business either as joint venture participants or to take up strategic investment for providing infrastructure and services. Consequently, the number of foreign and private banks operating in India increased from 21 and 23 in 1991 to 33 and 30, respectively, in 2004. For the Indian financial sector organizations, one of the strategies to face the intense competition could be, to consolidate through the process of mergers and acquisitions. India is slowly but surely moving from a regime of 'large number of small banks' to 'small number of large banks' and ‘larger the bank, higher its competitiveness and better prospects of survival’ appears to be the mantra for success. However, there is little published empirical literature on the impact of M&As in India. This study is an initial attempt to fill this void. The aim of this study is to find out the impact of mergers and acquisitions on corporate performance in Indian context particularly in relation to companies of financial sector. The rest of the paper is organized as follows. Section 2 discusses the present status of M&A in India. Section 3

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elaborates the related literature. Section 4 describes the data. Section 5 discusses the impact of value creation for the merged or acquiring firms before and after merger. Section 6 concludes with avenues for future research. As the economies of the three countries continue to grow, these countries have also become important destinations for foreign direct investment (FDI). Mergers and acquisition (M&A) activities in these three countries have expanded significantly in recent years. The main purpose of this article is to provide the latest information on M&A activity in India, Pakistan and Bangladesh. Another objective of this paper is to compare the M&A activity in these three countries.

2. Present status of M&A in India

During the last decade, there has been a sharp increase in the number of mergers and acquisitions in India. India has experienced upward trend in outbound deals**.** It is expected that **i**n next decade (2010-2019), global M&A deals by Indian industries is likely to more than treble and the domestic consumption oriented businesses like telecommunication and healthcare will throw up global scale Indian companies. Even as the economic slowdown has impacted overall merger and acquisition (M&A) activity in Asia Pacific, India along with Japan and China is among the top five countries in the region with the highest number of M&A deals in the first three months of 2009. India is among the top countries in the region in terms of M&A activity in the first quarter of 2009 even as deals saw a 72 percent decline from the same period a year ago. PricewaterhouseCoopers lists India amongst the top three emerging markets to watch out for over the next 18 months, in terms of attractiveness for deals. According to global consultancy firm Grant Thornton, the total number of M&A deals announced in January 2009 stood at 18 with a total announced value of USD 970.85 million against 63 deals amounting to USD 1.66 billion in January 2008. Indian Industries announced more billion-dollar M&A deals in 2008 compared to the previous year when the markets were on a bull run. Although involving the mega $10 billion plus deals of last year, Tata Corus and Vodafone-Hutch were missing in 2008, there were however other large size transactions which kept the Indian -bankers busy. HDFC bank's acquisition of Centurion Bank of Punjab was the lone large domestic M&A deal in 2008. Marking the largest-ever deal in the Indian pharmaceutical industry, Japanese drug firm Daiichi Sankyo in June 2008 acquired the majority stake of more than 50 per cent in domestic major Ranbaxy for over Rs 15,000 crore ($4.5 billion). The deal created the 15th biggest pharmaceutical company globally, and is India's 4th largest M&A deal to date. M&A research has also peaked during the last decades and the research material on different aspects of M&As is extensive. In our paper, we have reviewed literature covering motives of M&A and specifically the impact of M&A on financial viability of the companies. Despite the empirical evidence on M&A in general, very little is known on how they have performed in financial-based industries. Therefore, our paper attempts to fill the void by evaluating the financial performance of M&As particularly of financial sector companies in India, before and after merger and to assess its impact in terms of value creation for the merged or acquiring firms.

3. Cross-border mergers and acquisitions

European economic interest groupings, or through the grant of intellectual property rights. It may also take place through the medium of joint ventures, which may be subject to Article 81 EC and to the Merger Regulation.3 Such joint ventures may take the form of a contractual partnership or a European Economic Interest Grouping. These forms of cooperation between different enterprises are clearly distinct from mergers and takeovers. Mergers involve the assets and liabilities of an acquired company being transferred to the acquiring company. They may take place by means of acquisitions or through the medium of the formation of a new company. Takeovers involve the acquisition by a company (the bidder) of sufficient shares in another company (the target) to result in the purchaser obtaining control over the other company. This is also the case with cooperation between companies. Mergers may be motivated by a number of economic considerations; they may also be motivated by a desire to reduce liability to transactions. Domestic mergers of public limited liability companies are governed by the Third Company Law Directive, which has been implemented in all the Member States. Such mergers can be carried out by means of acquisition or by the formation of a new company. The effect of such a merger is to effect a transfer of assets and liabilities with implied continuity of ownership. The consideration for the transfer consists of shares together with, if thought necessary, a cash balancing item issued and paid to the shareholders of the absorbed companies by the transferee or absorbing company. The shareholders of the company or companies which have been dissolved, become shareholders in the resulting company. The Third Directive provides for certain mechanisms to achieve this result which have been adopted for the purposes of the Cross-Border Mergers (or Tenth) Directive. The Tenth Directive appears to have certain advantages over the European Company Statute as a method of merging companies across frontiers. Thus it is applicable to mergers involving private companies, unlike the European Companies Statute. The rules which it contains governing employee participation are more liberal than these contained in the Employees Involvement Directive which accompanied the European Company Statute in some respects. In addition, the company resulting from a Tenth Directive Merger will be a company subject to a national system of law, whilst a European Company resulting from a merger will have a complex legal regime, which may give rise to uncertainties. A Member State is given an option by Articles 8 and 27 of the Third Directive not to require a general meeting of the acquired company, provided that the provisions of the Directive concerning minority protection are complied with. This rule is inapplicable where the merger takes place through the medium of the formation of a new company. There is no requirement of a qualified majority vote at the general meeting or a private company which has to approve the draft terms of a merger. However, it follows from Article 6 of the Tenth Directive that a decision[resolution] of a general meeting of such a company is required. The draft terms of the merger are required to contain particulars of the form, name and registered office of the merging companies. According to the Commission's Explanatory Memorandum, the place where the registered office is situated determines which law will be applicable to the new company, which is an important item of information as far as interested parties including creditors

are concerned. The question arises as to what constraints, if any, may be imposed on the place of the head office (which may well be that of the real seat from which central control is exercised), when the real seat doctrine is applied to the resulting company, or to one of the other companies participating in the merger. If the decision of the European Court in the Daily Mail case is still regarded as good law, the view might be taken that the resulting company could not move its real seat to another Member State. A similar view might well be taken where one of the other participating companies has its real seat in a Member State adopting the real seat doctrine. There is some doubt as to whether the European Court would overrule Daily Mail. However, the approach taken in this case seems illogical, and contrary to much of the European Court's jurisprudence on the free movement of goods and persons. It also appears to be the case that participation in an international merger must be regarded as an exercise of the right of free movement, and cannot be referred by national laws restricting this right. As is the case with an SE, a cross-border merger will generally require employee participation to be dealt with either by a process of negotiation, or through the medium of the standard rules contained in point (b) of the Annex to the Employee Involvement Directive, which is made applicable to companies resulting from cross-border mergers by Article 16(3)(b) of the Cross-Border Mergers Directive. Like the creation of an SE, a crossborder merger may not be registered unless an agreement or agreements for employee participation has been concluded or if such an agreement has not been concluded within the prescribed period of six or twelve months from the establishment of the special negotiating body, the competent organs of each of the participating companies decide upon the application of the standard rules for participation. This conclusion follows from Article 16(3) of the Cross-Border Mergers Directive, which makes reference to Article 12(2) of the SE Regulation. Negotiations which take place may end with an agreement on employee participation, which may increase or reduce participation rights. The standard rules procedure may be applicable if the negotiations do not succeed, or if the relevant organs of the participating companies opt directly for the application of the standard rules on employee involvement without any prior negotiation process, or of the special negotiating body and the managerial organs of the participating companies so agree. The application of the standard rules is dependent on the attainment of a 33⅓ per cent threshold in respect of the number of employees in the merging companies who have rights of participation. As is the case with an SE, the negotiation process entails the setting up of a special negotiating body. Such a body will contain in respect of a particular Member State, one seat per portion of employees employed in that state which equals 10 per cent of a fraction thereof, of the number of employees employed by the participating companies and concerned subsidiaries in all the Member States considered together.22 The negotiation process may be expensive and somewhat protracted, but it is necessary to use it in order to increase or reduce participation rights. If such rights are to be reduced it follows from Article 3(4), paragraph 1 and first indent of the Employee Implement Directives to which Article 16(3)(a) of the Cross-Border Mergers Directive makes reference, that the special negotiating body has to act by a qualified majority in certain circumstances. It normally takes decisions by an absolute majority of its members, provided that such a majority represents an absolute majority of its employees. It has to abide by a qualified majority to reduce participation rights. Such a majority represents the votes of two-thirds of the members of the special negotiating body representing two-thirds of the employees, and must include the votes of members representing employees employed in at least two different Member States. This qualified majority is only required to reduce participation rights if at least 25 per cent of the total number of employees of the participating companies have such rights. In addition, a special negotiating body may, according to Article 16(4)(b) of the Cross-Border Mergers Directive, acting by the same qualified majority as that mentioned above, decide not to open negotiations or to terminate negotiations already opened, and rely on the rules on participation which are in force in the Member State where the registered office of the company resulting from the merger will be situated. This option is not available in accordance with the procedure applicable to the state. As has been pointed out above, the Cross-Border Mergers Directive appears to create a more satisfactory regime for cross-border mergers than does the European Company Statute. Takeovers enjoy tax advantages over the use of an SE effecting a merger as a method of effecting a cross-border merger under the Tenth Directive: merging companies are subject to transfer taxes on assets which are inapplicable in the case of a takeover. It is thought that agreed takeovers may prove to be more popular than Tenth Directive Mergers, especially where United Kingdom or Irish companies which wish to acquire companies in other Member States are concerned. However, British companies wishing to merge with companies in other Member States may sometimes find it necessary to make use of the new procedure. A DTI consultation on the implementation of the Cross-Border Mergers Directive was launched in March 2007. According to Article 19 of the Directive, Member States are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 15 December 2007. Takeovers are often thought of as producing economic benefits, especially by means of replacing less productive or efficient management by more efficient managers. The mere threat of a takeover bid is said to be a spur to efficiency. However, there is room for doubt whether takeovers always have beneficial effects. Public takeover bids have been subject to regulation in the Member States to provide for disclosure, transparency and a satisfactory procedure such that the shareholders can decide on the merits of the bid. In the past, self-regulation has been predominant in the Member States in this area, and has involved enforcement by the national stock exchange or another non-governmental body. The City Code on Takeovers and Mergers is the oldest example of such self-regulation, and dates from 1968. However, the Panel will be in a different position following the implementation of the Thirteenth Directive on Takeovers in the United Kingdom. Takeovers have been subject for some time to statutory regulation in Belgium, Germany, France and Spain. The tendency to such regulation will increase as the result of the implementation of the requirements of the Thirteenth Directive, which is intended to be one of the most important instruments of economic reform furthering European competitiveness. Barriers to takeover bids of various kinds are common in the Member States. These include the use of vote less shares or shares having multiple voting rights, the consideration of all voting rights in a special class of shares (e.g. the priority shares familiar in the Netherlands, or the use of pyramidical ownership structures as in Italy. In addition to

these legal barriers to bids, de facto barriers exist in some countries, for example the strong position of the banks in relation to the control of German listed companies. Hostile takeovers have become a frequent phenomenon in the United Kingdom; the position has been different in Germany, where there have been certain legal and factual barriers to hostile bids. The United Kingdom City Code has severely restricted certain defenses. Thus, General Principle 7 provides that at no time after a bona fide offer has been communicated to the Board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might become imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company without the approval of the shareholders in general meeting, which should effectively result in any bona fide offer being frustrated, or in the shareholders being denied the opportunity to decide on its merits. Furthermore, rule 21 of the Code provides that during the course of an offer, or even before the board has reason to believe that a bona fide offer might be imminent, the board must not without the approval of a general meeting, take any steps to increase the share capital, sell, dispose, or acquire assets of a material amount, or enter into contracts other than in the ordinary course of business. The regulation of takeover bids in different Member States deal with similar issues relating to the conduct of the bid, such as pre-bid obligations, disclosure of the details of the bid, rules prescribing the period for acceptance of the bid, and obligations which have to be complied with after the offer has expired, for example, communication of certain particulars to the supervisory authority. Mandatory bids are provided for in all the countries included in the Commission Staff Working Document Report on the implementation of the Directive on takeover bids, published in 2007. The mandatory bid rule provides that if a person acquires control over a company, he or she is obliged to make a full takeover bid for all the remaining securities of the company at an equitable price. The thresholds for control vary in the different Member States.

4. Conclusion

The Takeover Directive has some positive features, for example the provisions of Articles governing the disclosure of defences and the general principles contained in Article 3. However, the use of the options permitting Member States not to apply the neutrality or breakthrough rule, and of the provision for reciprocity in Article 12(3) has done little to encourage the belief that the Directive has created a market for corporate control in the European Union. The Commission has stated its intention to clearly monitor the way in which the Directive's rules are applied and work in practice. It will analyse the reasons why Member States are so reluctant to endorse the fundamental rules of the Directive. The Commission has added40 that in the light of the evaluation, the revision of the Directive scheduled for 201141 may if necessary be brought forward. It seems somewhat doubtful whether this will happen in practice. Privatization and deregulation of the key industries will continue to attract FDI in the region. Consolidation of companies in manufacturing and telecommunication industries will continue in the future. Many foreign firms will continue to invest in the region because of the vast pool of inexpensive labor and its large domestic market. Because of these reasons, the M&A opportunities in India, Pakistan and Bangladesh will be expected to expand again in the future. However, potential investors should examine the following issues before expanding their M&A activity in South Asia. Investors should consider the implications of cultural differences between an acquiring firm and a target company. Assessment should also be done to reveal corporate culture gaps and potential for cultural clashes. A strategy and implementation plan for cultural integration must be developed for any M&A activity in India, Pakistan and Bangladesh. Before acquiring a target form in the three countries, an investor must determine the proper value of the target with the assistance of an investment banker or certified public accountant. In India, Pakistan, and Bangladesh, the reliability of assets and earnings data of a target firm must be audited and certified by a reputable public accounting firm. Once an investor decides to acquire a firm in the region, the acquiring company should also develop detailed plans for post-merger integration for other areas including production, finance, marketing and information systems. In conclusion, increased M&A activities in India, Pakistan and Bangladesh will provide many opportunities and challenges for potential investors from Asia, Europe, North America and the Middle East in the future.With the series of M&A taking place in financial sector in India more than half of the merging firms showed improved financial performance in the post-merger time period as compared to the pre-merger period. Our study produced several interesting findings. First, earning available to shareholders and debt to equity ratio showed a significant change in pre and post-merger financial position of the companies. Second, contrary to our expectations, we found the change in the return on net worth, liquidity position and profit before tax to total income of the companies to be not statistically significant. Overall, the result of the study indicates that in most of the M&A cases, in the long run the acquiring firms were able to generate value creation in one or the other form, that is higher cash flows, cost cutting and greater market power, however in spite of improved financial performance sixty-four per cent of cases showed increased debt to equity ratio. It is also significant to note that profit before tax in all the merging cases has shown a positive trend for both financial sector companies.

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