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Consolidation through Mergers & Acquisitions—A Rule rather than Exception

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ABSTRACT: *Consolidation means a combination of players operating in similar sector with the results being stronger than the parent entities. The word has assumed significance in the past few years not only in India but the world over as liberalization and aligning to global trends and policies are becoming mantras for all countries. In a way a process is fuelled by the need for countries and sectors to become globally competitive, mainly because the customer is becoming a "world citizen". Unlike a decade back, when the client was happy with the local products, the internet boom has opened its eyes to products (even financial products) available in advanced economy. Along within this fact comes another that the customer can access these products irrespective of the facts whether they are locally available or not. This leads to not only domestic consolidation but also global consolidation. The importance of consolidation in financial sector assumes importance since a healthy financial sector is necessary, if economies are to be equipped to meet the challenges of globalization. Merger mania is sweeping the Indian banking community. The objective of this study is to identify the dominant factors conditioning the pace of M&A activity in the Indian banking industry today and its impact for the domestic players.*

INTRODUCTION

Consolidation means a combination of players operating in similar sector with the results being stronger than the parent entities. The word has assumed significance in the past few years not only in India but the world over as liberalization and aligning to global trends and policies are becoming mantras for all countries. Thus, a way a process is fuelled due to need for countries and sectors to become globally competitive, mainly because the customer is becoming a "world citizen". Unlike a decade back, when the client was happy with the local products, the internet boom has opened its eyes to products (even financial products) available in advanced economy. Along with this fact comes another that the customer can access these products, irrespective of the fact whether the products are available locally or not. This led to not only domestic consolidation but also at global level.

The importance of consolidation in financial sector assumes importance since a healthy financial sector is necessary to equip the economies so as to meet the challenges of globalization. Merger mania is sweeping the Indian banking community. The study aimed to identify the dominant factors conditioning the pace of M&A activity in the Indian banking industry today and its impact on the domestic players. In India we have four categories of players' namely public sector banks, old private sector banks, new private sector banks and foreign banks. In the present study foreign banks are excluded because of their lesser or no impact on domestic players. On the basis of asset size we have divided banks into four groups. The first category comprises of six banks with asset size more than Rs.80, 000 crores and constitutes 50 % of the overall total assets of the industry. Second category includes 15 banks with asset size not below Rs.80, 000 crores but greater than Rs. 25, 000 crores, constitute 32% of the total assets of the industry. In the third group 15 banks were taken with asset size ranging between Rs. 10, 000 and Rs. 25,000 crores and forming 14% of the total assets of the industry. The fourth category comprises of 12 banks with asset size below Rs.10, 000 crores and constitutes only 4 % of the total assets of the industry. From this data it is evident that a few banks manage a larger proportion of total assets of the industry.

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THE CONSOLIDATION IS INEVITABLE

The consolidation in the present arena being talked about is not the merger of the weak banks in the strong banks, neither it is to protect the interest of depositors of one bank by merging it into other bank. Instead it is a merger of two banks, even two large or two strong banks to be a mega as well as strong entity which rank amongst the top 200 banks of the world. The idea is that a strong unit can absorb the shocks and survive in the difficult times. A number of issues emerge in the consolidation. High on the list are:

MEASURES OF COST REDUCTION

(1) Achievements of economies by scaling up i.e. reduction in per unit cost due to increase in the scale of operation.

(2) Economies of scope, i.e. reduction in per unit cost due to synergies in producing multiple products within the same firm. For instance a bank can sell insurance, units, mutual funds products etc. with the same branch network. In other words, a firm can leverage on its existing infrastructure to maximize opportunities for cross- sell.

(3) Risk reduction by geographic or product diversification.

4) Increased market share or market power

5) Larger firms could better access the capital market and get better credit rating.

TECHNIQUES OF REVENUE IMPROVEMENT

(1) Increased size will help firms to serve large number of customers.

(2) Product diversification can help establishing “one-stop shop” and attract new customers thereby improve earnings.

(3) Higher market share will enable the firms to increase prices (may bestow monopoly power)

(4) Increase in size will help the firms to increase the risk taking ability of its portfolio and provide higher returns.

SPREADING OVER OF FIXED COSTS OVER A LARGER CUSTOMER BASE

New technological development has encouraged consolidation because of their high fixed costs and the need to spread these costs across larger customer base. At the same time, dramatic improvements in its speed and quality of communication and information processing have made it possible for financial service providers to offer a broader array of products and services to a large numbers of clients over wider geographic areas than had been feasible in the past.

IN MATURE MARKETS

Consolidation has been adopted to overcome under utilization capacity. In emerging markets, consolidation has been used as a means of overcoming financial distress. The government authorities have played a crucial role in the emerging markets particularly in those countries which suffered financial crisis in 1990s. The market forces have been in full play in consolidation in the mature markets where as cross border merger and acquisitions have been rare in mature markets and foreign ownership of banks in emerging markets has been significant. In contrast to developed markets, ownership structure of banks and concerns of job losses have constrained the process of consolidation in the emerging markets, suggesting that the market forces alone cannot bring about the desired level of consolidation.

RECAPITALIZATION OF BANKS IN THE VIEW OF BASEL II NORMS

Weaker banks will find it difficult to raise sufficient capital to meet Basel II norms. Consolidation of weaker banks with stronger banks is the only real alternative. The question is whether these should be market determined or driven by the government. Even the stronger local banks need to access international markets to augment capital resources but this would be difficult in the absence of size. Thus, size is critical for both survival and growth. Size and scale are critical in this capital intensive industry for survival. Size and scale are also important for growth since bigger banks with larger balance sheets and a broader customer base are better placed to tap new opportunities through appropriate investment appetite. Under existing structure of market participants, this can be achieved only through consolidation of the existing players.

STABILIZATION OF ASSET QUALITY

Small size banks with poor assets would find it difficult to survive in the long run as they need to meet the additional capital requirements. The exit route for such banks will be to get absorbed by banks with strong asset quality.

HUMAN RESOURCES MANAGEMENT THROUGH CONSOLIDATION

Different persons have different qualities. Some are expert in marketing, some in table work while others in field work. Some personals are expert in making policies. Some people have specific skills which others do not have. Maximum output or productivity can be achieved by optimizing capacity utilization and increasing the efficiency of each individual and by putting right person on a particular job. If a person is given a job of his choice or expertise, he starts loving his job profile. Then job remains no more a job for him but becomes like playing a game or singing a song. Thus there will be more opportunities for the employees and they may be offered the skilled jobs of their choice. Thus the human resources will be managed in a better way after consolidation. It will also provide more career opportunities to employees.

OTHER ADVANTAGES OF CONSOLIDATION IN BANKING INDUSTRY

There is a lot of competition for taking over of deposits/ loan accounts from one bank to other bank. This is an unhealthy competition, thus resulting in wastage of time, labour, stationary and other inputs. After consolidation, there will be substantial reduction in taking over of accounts from one bank to another bank. After consolidation, emergence as a large entity will help to develop its own system, software, lease lines, offices, buildings, residences with fully adorned and decorated with all the new facilities, techniques and comforts similar to or better than the world class banks. There will be increased number of products available to customers. Presently there are around 50 bank products available to customers. These can be doubled as per the requirements of the customers. It will be easier for the Govt. and the regulatory bodies to make on-site and off-site surveillance due to less number of banks. The guidelines and changes can also be easily and promptly implemented. The consolidation will help increasing the productivity of the banks. The closure of some of the branches and controlling offices will make the staff surplus which may be trained in a different way to absorb at potential centers. Thus the business per employee will be increased. More employee welfare schemes can be introduced. More remuneration and better facilities can be provided to the employee/officers. Floating provisions on NPA can be introduced. Banks can write off entire NPA and can become NPA free due to more net profit.

EMERGENCE OF TWO SCENARIOS

There could be two basic banking structures that could emerge. The first structure involves a big bank taking over smaller bank or a group of smaller banks, whereas in the second structure there is a merger of group of mid-sized banks to form a lager institution. The first structure is a perfect fit for the new private sector bank taking over an old smaller bank or a group of small banks. In the second structure a group of mid-size public sector banks going for a merger. The primary advantage of the first structure could be seen as the creation of a larger branch network. Whereas it could be argued that the merger of a group of small sized banks as envisaged in the second structure is still insufficient to create institutions that are regionally competitive and may require further consolidation.

FIRST STRUCTURE - CONSOLIDATION WITHIN THE PRIVATE SECTOR.

In the present study we are assuming an existing new private sector bank taking over a smaller bank or a group of smaller banks. It is apparent from Table 1 that the ICICI emerged as the largest player in the private sector bank. HDFC bank could reckon as another large player. Looking at the next category of asset size between Rs.10, 000-Rs25, 000 crores, we have only 3 players namely; UTI axis bank, Federal bank, Indusind bank. Hence there is a need for the remaining banks to look at the options for growth in size. Either larger bank could absorb them or these small banks could group together and merge.

Looking at the some key performance indicators namely- return on assets, profit margin and market share and growth (Table 1), it could be seen that the returns on assets (ROA) for both ICICI bank and HDFC bank is almost same but the NIM is much higher in the case of HDFC bank and this could be due to low cost of resources. It is also interesting to note that the PAT for ICICI bank is 33% against 28 per cent of HDFC bank. How could this be a scenario, where NIM is lower and the PAT is higher for ICICI bank? This could be due to larger proportion of other income or due to large asset size. The asset size is critical for the profitability of the business and hence when the asset size is below this threshold limit, it could destroy share holders value. There are 18 banks whose share is less than one percent and for these banks it is going to be difficult to

Table 1
Market share, return on assets (ROA) and total assets of private sector banks

Private Sector as on March 31, 2011	*Marke Share (%)*	*ROA (%)*	*NIM (%)*	*Total Assets (Rs. millions)*
ICICI Bank	6.87	1.50	2.44	4736471
HDFC Bank	2.15	1.77	4.00	337909
AXIS Bank	1.30	1.68	3.04	285627
Federal Bank	0.81	1.41	3.49	606268
Indusind Bank	0.74	1.57	3.30	575961
ING Vysya Bank	0.73	1.09	2.81	470005
Karnataka Bank	0.59	0.73	2.19	363216
South Indian Bank	0.50	1.12	2.79	403701
Karur Vysysa Bank	0.39	1.56	2.79	376349
Kotak Mohindra Bank	0.24	1.83	4.31	656665
Development Credit Bank	0.29	0.68	2.83	86768
Lakshmi Vilas Bank	0.21	0.73	2.51	162436
Dhan Lakshmi Bank	0.13	1.03	1.71	146765
Catholic Syrian Bank	0.24	1.04	2.81	120471
Total	*15.18*	*1.22*	*2.33*	*9328612*

sustain the pressure in the medium to long term in the changing scenario. For example, additional infusion of funds would be required for technology advancement for providing service and meeting Basel II requirements for risk management. For this to make economically viable, the fixed cost would have to be spread over by increasing the asset size. Then the scenario that could emerge will be that each of new private sector banks, such as ICICI bank, HDFC bank absorbs 4 or 5 old private sector banks. Even some foreign banks, when they are permitted will be interested to follow this route. We can foresee that from the list of 20 odd private sector banks, not more than 5 banks will be able to survive after 3 or 4 years. Thus consolidation is an inevitable.

SECOND STRUCTURE -CONSOLIDATION WITHIN THE NATIONALIZED BANKS/PSU BANKS

A) Consolidation within the SBI group

The consolidation within the SBI group is always on the cards. The group is already in the process of integrating treasury practices. Similarly the group will be integrating risk management practices. SBI group as one entity will become a largest bank in the country in the future.

The combined entity of the SBI group is currently holding close to one third of the total market share (Table 2). SBI is already a player who is well positioned to be on the global map. It is important for the group that it doesn't lose the market share.

Table 2
Market share, return on assets (ROA) and net interest margin (NIM) of SBI and its associates.

SBI & its associates as on March 31, 2011	*Marke Share (%)*	*ROA (%)*	*NIM (%)*	*Total Assets (Rs. millions)*
State Bank of India	23.20	0.88	3.28	1335519
State Bank of Hyderabad	1.68	1.15	2.99	1183154
State Bank of Patiala	1.43	0.88	3.38	984982
State Bank of Travancore	1.27	0.67	2.82	859493
State Bank of Bikaner and Jaipur	1.13	0.99	3.61	725281
State Bank of Mysore	0.74	0.65	2.33	604036
Total	*29.46*	*1.08*	*2.98*	*5692465*

CONSOLIDATION WITHIN THE NATIONALIZED BANKS

A cluster approach could emerge in case of nationalized banks. There are five banks with asset size of over Rs. 80,000 crores. Each of the aforesaid banks could look at absorbing one bank falling in the size category of Rs.25, 000 to 80,000 crores. In addition, they could also absorb one additional bank with the size less than Rs.25, 000 crores. The ideal scenario that will emerge will be that in the long run not more than five banks will sustain among the nationalized banks. The process of M&A is comparatively easier for the nationalized banks as the controlling authority lies with the government. The some key performance indicators namely- return on assets, profit margin and market share and growth of nationalized banks is given in table 3.

It is evident from table 3 that returns on assets of Punjab National Bank, Canara Bank, Bank of Baroda, Indian Overseas Bank, UCO Bank and Corporation Bank was more than one per cent whereas the ROA of other bigger banks namely Union Bank of India and Andhara Bank was close to one per cent. Similarly banks like Syndicate Bank, Bank of Baroda and Bank of India were leading in terms of total assets. Even the market share of some big nationalized banks viz. Punjab National Bank and Canara Bank was more than five per cent.

CONSOLIDATION OF BANKS: STATISTICAL OVERVIEW

The actual figures relating to deposits, advances, income and profits of public sector and nationalized banks during 2009-10 to 2011-12 are given in tables 4 & 5.

Table 3
Market share, return on assets (ROA) and net interest margin (NIM) of nationalized banks.

Nationalised banks as on March 31,2011	*Marke Share (%)*	*ROA (%)*	*NIM (%)*	*Total Assets (Rs. millions)*
Punjab National Bank	5.57	1.02	3.09	1829346
Canara Bank	5.38	1.19	3.21	1249642
Bank of Baroda	4.78	1.24	2.56	4473215
Bank of India	4.78	0.72	2.26	3845355
Central Bank of India	3.53	0.55	3.06	880174
Union Bank of India	3.21	0.95	2.17	3741602
Syndicate Bank	2.41	0.26	2.35	2297997
Indian Overseas Bank	2.61	1.06	2.05	1635604
UCO Bank	2.31	1.08	2.66	873879
Oriental Bank of Commerce	2.22	1.31	3.36	1414192
Indian Bank	2.09	0.52	2.52	2196482
Allahabad Bank	1.85	0.67	2.48	1781302
Bank of Maharashtra	1.69	0.65	2.12	729053
Corporation Bank	1.64	1.19	3.21	4581940
Andhara Bank	1.53	0.85	3.00	1824681
United Bank of India	1.43	0.69	2.27	1804984
Vijay Bank	1.28	0.79	2.77	2622114
Dena Bank	1.24	0.70	2.58	1020104
Punjab & Sind Bank	0.87	0.66	2.14	957640
Total	*50.42*	*1.39*	*3.32*	*39759306*

It is visualized from Table 4 that total deposits of public sector banks increased from Rs 36920194 crores to Rs 50020134 crores from 2009-10 to 2011-12. Similarly total advances which stood at Rs 27010187 crores in 2009-10 touched Rs 38783125 crores in 2011-12. Even the total income and net profits showed a rising trend.

Table 4
Actual figures of total deposits, advances, income and net profits (Rs Crores) of public sector banks during the period (2009-10 to 2011-12).

	2009-10	*2010-11*	*2011-12*
Total Deposits	36920194	43724487	50020134
Total Advances	27010187	33044329	38783125
Total Income	3548758	4140994	5350979
Net Profits	431614	449008	495138

Source – Statistical tables relating to banks in India (RBI)

Table 5
Actual figures of total deposits, advances, income and net profits (Crores) of nationalized banks during the period (2009-10 to 2011-12). Rs 38783125 crores

	2009-10	2010-11	2011-12
Total Deposits	25839338	31265862	35969893
Total Advances	8281248	9503797	10867544
Total Income	2102860	2750313	2864321
Net Profits	330378	341802	342413

Source- Statistical tables relating to banks in India (RBI)

It is observed that total deposits and advances of nationalized banks were Rs 325839338 crores and Rs 8281248 crores respectively in 2009-10 which rose to Rs 35969893 crores and Rs 10867544 crores in 2011-12 (Table 5). It is further seen from table 5 that net profits of nationalized banks increased marginally during the period 2009-10 to 2011-12.

The average figures relating to deposits, advances, income and profits of a public sector and a nationalized bank during 2011-12 before consolidation is given in table 6 and after consolidation is presented in table7.

Table 6
Average figures of total deposits, advances, income and net profits (Crores) of per public sector bank and per nationalized bank before consolidation during 2011-12.

	Per Public Sector Bank	*Per Nationalized Bank*
Total Deposits	1923851	1893152
Total Advances	1491658	571976
Total Income	205806	15075
Net Profits	19043	18021

Source- Statistical tables relating to banks in India (RBI)

Table 6 depicts total deposits, advances, total income and net profits per public sector bank and per nationalized bank before consolidation. The total deposits per public sector bank and per nationalized bank stood at Rs 1923851 crores and during Rs 1893152 crores, respectively whereas their total net profits were to the tune of Rs 19043 crores and Rs 18021 crores, respectively. Now assume that State Bank subsidiaries are merged with SBI and other nationalized banks are merged with each other and number is reduced from 19 to 8, then figures will be shown as under.

Table 7
Average figures of total deposits, advances, income and net profits (Crores) of per public sector bank and per nationalized bank after consolidation during 2011-12.

	Per Public Sector Bank (9)	*Per Nationalized Bank(8)*
Total Deposits	5557792	4496236
Total Advances	4309236	1358443
Total Income	594553	358040
Net Profits	55015	42801

Source- Statistical tables relating to banks in India (RBI)

It is observed from Table 7 that after consolidation, total deposits, advances, total income and net profits per public sector bank and per nationalized bank have shown a rising trend. The total deposits per public sector bank and per nationalized bank increased from Rs 1923851 crores to Rs 5557792 crores. Likewise, total advances per public sector bank and per nationalized bank are on the increase. Even the total income has increased from Rs 205806 crores to Rs 594553crores after consolidation. Similar trend was followed in terms of net profits and it increased to Rs 42801 crores after consolidation. It is very clear that after merger each nationalized bank will have an average business of around 5700000 crores and will earn a net profit of more than 42801 crores instead of present average business of approximately 1900000 crores and profit of 18021 crores.

IMPLICATIONS

1. The international scenario being dominated by larger banks, it is important that India too should have a fair number of large banks, which could play a meaningful role in the emerging economies; India has only one larger bank whereas China and Brazil has five and six banks, respectively.
2. It is observed that in all major economies, banking industry underwent some sort of restructuring process. The economy which delayed this process led to stagnation. That's why; the consolidation process should be given prime importance keeping in view, the long term prospects of the economy.
3. The major advantage perceived from bank consolidation is the ability to withstand the pressure of emerging global competition, to improve the performance of the banks, to effectively absorb the new technologies and demand for sophisticated products and service, to arrange funding for major development products in the realm of infrastructure, telecommunication etc. which requires huge financial outlays and to streamline human resource functions and skills in the tune with the emerging competitive environment.
4. A diagnostic performance evaluation study would reveal important aspect of divergence in the performance of all the domestic banking institutions. A high degree of variation is found in the performance of various groups of banks. Since, public sector banks accounts for a large share of banking assets and their lower performance ratio reflect the entire banking industry, it is considered important that suitable consolidation process may be initiated at the earliest, so that, the efficiency gain made by a large number of banks of other groups will be properly reflected which could lead a positive impact on the image of banking.
5. Consolidation can also be considered critical from the point of view of quantum of resources required for strengthening the ability of banks in the assts creation. It indicates that the restructuring of Indian banking may not be viewed from the point of particular group rather it can be evolved across the banks groups
6. Indian banks have the unique character in displaying similar characteristics of performance despite consisting of different size and ownership. This trend further substantiates the scope of consolidation across the bank groups.

CONCLUSION

Thus the process of consolidation in Indian banking is a must. The regulatory authority, the CEO of most of the banks and other authorities have been pointing out that in the next couple of years the banking industry will see a number of banks planning merger and acquisitions. The banks should be of an ideal size and strength to offer competitive pricing of the product and to sustain in a competitive banking atmosphere. It is obvious that only large banks can offer the lowest cost for lending of funds and also providing diversified services. Not only this, they can also afford the huge expenditure to be incurred for transportation and an ongoing technology up gradation. They will be ready to face any future unforeseen challenges which may arise and appear in future. The issue of credit risk, market risk and operational risks will also be addressed as consolidated entity will be able to meet all the parameters of international standards. The consolidation of banks will be a win- win situation for all the parties.

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