

Cross Border Mergers and Acquisitions in Indian Banking Sector.

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Abstract

Mergers & Acquisitions (M&A) are a significant form of business strategy today for Indian Corporates. A large number of Mergers & Acquisitions deals are making headlines all over the world. One may wonder as to what it is that necessitates Mergers & Acquisitions deals. One may be interested in knowing the main objectives behind such deals.

Mergers & Acquisitions may take different shapes. Simply, a merger is a transaction involving two or more corporations, swapping stocks, but only acquiring firm survives. Mergers usually occur between firms of somewhat similar size and are usually friendly. Acquisition is the purchase of a company that is completely absorbed as an operating subsidiary or division of the acquiring corporation. Merger and Acquisition refers to a combination of two or more firms into one firm; it may involve acquisition or consolidation. In absorption, one firm acquires one or more other firms. In consolidation, two or more firms combine to form a new entity.

Mergers & Acquisitions activities in banking sector have started greatly after 2003 when the heat of competition mounted and the Basel II norms were implemented. Basel II norm, which requires banks to maintain a minimum of 9% Capital Adequacy Ratio (CAR), forced the banking sector to look for consolidation of smaller and weaker banks with larger banks.

Indian banks also started hunting for cross-border M & A. The State Bank of India (SBI) acquired majority stakes in Indo Monex, an Indonesian bank. And in another case SBI has acquired Mauritius based Indian Ocean in the year 2005 and Kenya based GIRO Commercial Bank in 2005.

In this paper reasons for cross-border M&As by Indian banks are discussed. There is also description of the objectives and various issues behind cross-border M&As. Finally, it gives a brief description on successful cross-border M&As in Indian banking sector.

Introduction:

Mergers & Acquisitions are a significant form of business strategy today for Indian Corporates. A large number of Mergers & Acquisitions deals make headlines all over the world. One may wonder as to what it is that necessitates these deals and what are the main objectives behind any Mergers & Acquisitions. "A merger is a transaction involving two or more corporations in which stock is exchanged, but from which only one corporation survives. Mergers usually occur between firms of somewhat similar size and are usually friendly. The resulting firm is likely to have a name derived from its composite firms.

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Acquisition is the purchase of a company that is completely absorbed as an operating subsidiary or division of the acquiring corporation”¹. Merger and Acquisition refers to a combination of two or more firms into one firm; it may involve acquisition or consolidation. In absorption, one firm acquires one or more other firms. In consolidation, two or more firms combine to form a new entity. In a merger, a stock swap is involved while in an acquisition, a cash deal is involved. Another distinction is that while mergers usually take place in a friendly environment, in may not be so in case of acquisitions. The terms merger and amalgamation are used interchangeably. Mergers & Acquisitions activity in banking sector has started mainly after 2003 the reason may be increased competition and the implementation of the Basel II norms that require banks to have minimum 9% Capital Adequacy Ratio (CAR). These factors had forced the banking sector to look for consolidation of smaller and weaker banks with larger banks.

Mergers and Acquisitions – World Banking Scenario

The trend towards banking consolidation, especially cross-border mergers and acquisitions is moving unavoidably ahead and key deals appear to indicate a fundamental shift in the evolution of mergers and acquisitions. It is the beginning of a new phase in banking structures, both in domestic and global market. Cross-border banks deals have been evolving over recent years and have now reached a take-off stage as the centre of gravity of global finances shifts to accommodate the growing wealth of China, India and the Gulf states along with other emerging economies across the world. Banking sector has played a vital role in the overall economic development of this country right from the time of nationalization.

Due to globalization the Indian banking sector has been facing keen competition from the foreign banks. “The RBI, which is equally protective of the Indian banking industry, has already sounded a note of warning to the foreign banks who expect easier entry and takeover norms by 2009”². The old and new private sector banks will be prime targets when foreign banks are allowed to launch predatory forays in Indian banking sector. The world is changing significantly and moving away from a US-centric focus. Last October China's biggest bank, Industrial and Commercial Bank of China (ICBC), in a landmark \$ 5.6 billion deal, acquired a 20 per cent stake in South Africa's Standard Bank. In India a cross-border M & A the State Bank of India (SBI) acquired majority stakes in an Indonesian bank Indo Monex. In another case SBI has acquired Mauritius based Indian Ocean and Kenya Based GIRO Commercial Bank both in 2005.

Objectives of the study:

The study plans to analyze the cross border Mergers and Acquisition in Indian Banking sector and setout following objectives.

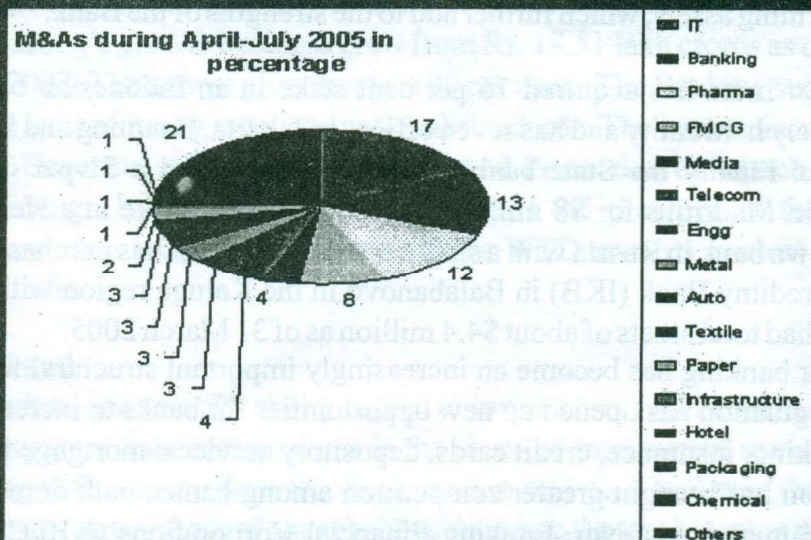
1. To study the Cross border Mergers & Acquisitions in Indian Banking sector.
2. To study the motives behind cross border Mergers and Acquisitions in Indian Banking Sector.

1. To study the Cross border Mergers & Acquisitions in Indian Banking sector.

After economic reforms in the name of globalization, liberalization and privatization, India has opened its markets for global competition. This situation has made Mergers and Acquisitions a desperate search for a survival strategy. There has been a phenomenal growth in the Indian industry in the last decade. Banking industry became one of the fastest growing sectors after the first phase economic reforms of 1991. Banking sector has played a vital role in the overall economic development of the country right from the time of nationalization. Due to globalization the Indian banking sector has been facing keen competition from the Public Sector and Foreign banks. As is well known survival of the fittest is the core theme in the global market today. An increasing number of Indian companies are going global hoping for a global existence is apparent from ASSOCHAM Eco pulse study pie chart April-July 2005.

Cross-border M&A by India Inc

(Source; ASSOCHAM Eco Pulse study)



Of 144 deals in April-July 2005, 34 are overseas deals by domestic companies. Of 34 deals, IT sector remains on top with 17%. Banking and Insurance, second with 13%. Pharma (12%), FMCG (8%), Media (4%), Telecom (4%), Engineering, Metal, Automobile, Textiles (3% each), Paper (2%) and Infrastructure, Hotels, Packaging & Chemicals (1% each). While the IT industry appears to lead the recent trend of acquiring foreign companies, traditional manufacturing companies such as cement, steel, banking are not far behind. It has also succeeded in the case of foreign banks. Banks.

Cross Border Mergers and Acquisitions by Indian Banks during 2005 - 2008.

Sl. No	Name of Bank merged	With whom Merged	Year of merger
1	State bank of India Ltd	GIRO Commercial Bank Ltd	2005
2	State bank of India Ltd	Indian Ocean International Bank Ltd	2005
3	ICICI Bank Ltd	Investitsionno-Kreditny Bank Ltd (IKB)	2005
4	State bank of India Ltd	PT Bank Indo Monex	2005

Source: Grant Thornton's Deal tracker Annual issue 2005, 2006 and 2007.

State Bank of India acquire Giro Commercial Bank of Kenya, as part of its strategy to increase presence in African continent and gradually emerge as a global banking major, and acquired 76 per cent stake in Giro Commercial Bank along with management control. SBI will increase its footfall in Africa country. Giro Commercial Bank is one of the leading banks in Kenya.

State Bank of India (SBI) holds 98% of shares of SBI International (Mauritius) Ltd. and the State Investment Corporation Ltd holds 2%. SBI International (Mauritius) Ltd. is carrying the tradition of excellent Banking services of SBI with a professional touch. It has strong fundamentals and is customer focused which is quite evident from its clientele spread over 40 countries worldwide. The Bank has a high capital base, and near zero non-performing assets, which further add to the strengths of the Bank.

State Bank of India has acquired 76 per cent stake in an Indonesian bank, PT Bank IndoMonex. IndoMonex is a closely held entity and has seven offices in Jakarta, Bandung and Surabaya. This is SBI's third overseas acquisition. Finally the State bank of India had acquired a 51-per cent stake in Indian Ocean International Bank in Mauritius for \$8 million and a 76-per cent stake in a Kenyan bank ICICI Bank has acquired a little-known bank in Russia with a single branch. The bank has purchased the entire paid-up capital of Investitsionno-Kreditny Bank (IKB) in Balabanovo in the Kaluga region with a branch in Moscow. The seven year-old IKB had total assets of about \$4.4 million as of 31 March 2005.

Cross-border banking has become an increasingly important structural feature of the Indian banking sector. Further, deregulation has opened up new opportunities for banks to increase revenues by diversifying into investment banking, insurance, credit cards, depository services, mortgage financing, securitization and etc. The liberalisation has brought greater competition among banks, both domestic and foreign, as well as competition from mutual funds, Non-Banking Financial Corporations (NBFCs), post office and etc. The competition will only get intensified as large global players emerge on the scene. Increasing competition is squeezing profitability and forcing banks to work efficiently on shrinking spreads. Positive fallout of competition is the greater choice available to consumers and the increased level of sophistication and technology in banks. As banks benchmark themselves against global standards there has been a prudential norms for capital adequacy, asset classification, income recognition and provisioning. RBI has introduced Risk Based Supervision of banks against the traditional transaction based approach. Best international practices in accounting systems, corporate governance, payment and settlement systems, etc. are being adopted.

2. To study the motives behind cross border Mergers and Acquisitions in Indian Banking Sector.

One plus one makes three or more, which is popularly referred to as Synergy in merger and acquisitions. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. In other words two companies together are more valuable than two separate companies. Many of the motives behind cross border mergers and acquisitions are similar to those of purely domestic strategic alliances, while a few are unique to the cross border deals. Some such motives are discussed as follows.

1.	Opportunity for Growth	6. Diversification
2.	Access to capital and brand	7. Current Economic conditions in the home country
3.	Gaining complementary strengths	8. Acquisition of Technology
4.	Acquire new customers	9. Integrated Human Resources system
5.	Exchange rates	10. Government policy

2.1. Opportunity for Growth

Growth is the most general and important motive for cross border mergers. Merging internationally provides an immediate growth opportunity to a firm, which was once operating with a single country. There are various factors, which encourage firm to merge internationally for growth. Some banks, which are having surplus cash flows, slow growth in the domestic market or domestic markets are saturated for growth opportunity. The banking industry's growth business grew from Rs. 18.51 lakh crores as of March 2002 to Rs. 46.19 lakh crores by March 2007. The annual growth rate is 20 per cent. The Banking sector in India is robust and its standards are broadly in conformity with international standards. The issues discussed in the Ministry of Commerce and industry, Department of Industrial Policy and Promotion on March 5, 2004 on Foreign Direct Investment (FDI), Foreign Institutional Investor (FII) and the presence of foreign banks will be implemented in phase manner. It is India's commitments to the WTO towards gradual enhancement of the presence of foreign banks in India.

2.2. Access to capital and brand

Present financial markets are volatile, rising capital at lower costs will be a challenge. No doubt, a present banks deposit still enjoys a dominant position in the share of incremental savings of the household sector. The interesting thing is that every time the stock market was on a bull run, the general public has favoured the diversion of slightly larger share of household savings into the stock market than the bank deposit. On the other hand stock market attracts only 5 per cent of the money that went into bank deposit. Capital and brand name plays very important role in assess to capital market.

2.3. Gaining complementary strengths

Indian banking industry too has fallen in line with the global trend and has made a beginning with small forays into such areas as selling mutual fund units or instance polices. The Priority sector requirement for foreign banks was only 32 per cent as against 40 per cent for domestic banks. The bank that has developed a reputation for superior products in the domestic market may find acceptance from the foreign customers as well.

2.4. Acquire new customers

Foreign banks opened new outlets by offering new technology and products, delivery channels such as ATMs, Internet banking and other services. There are currently 1.1 crore demat account holders with two depositories namely NSDL & CDSL functioning in the country. In contrast, there are 30 crore customers with the banking industry. There is a huge opportunity that is waiting to be tapped. In case of credit growth could be around 22-23 per cent for the industry. "It is a function of GDP growth and if GDP growth at 8-9 per cent, credit could grow at roughly three times³". There is a huge potential of new customers in Indian market.

2.5. Exchange rates

One view on exchange rates revolves around the fact that while there seems to be a relationship exists between exchange rates and acquisition activity, there is no evidence that a change in the exchange rate improves the position of foreign acquirers relative to their host counterparts. The argument is that when the host country's currency depreciates, the host country becomes a cheaper place for any firm to do business – foreign or domestic. The relationship between foreign acquisitions and exchange rates, contending that improved capital mobility facilities equalized, risk-adjusted returns on international investment is minimized. The depreciated host country's currency increases Foreign Direct Investment (FDI) in the host country business. The

reverser also holds true, if the host currency is strong, there should be a pause in the foreign acquisition of host firms and an upward trend in the home country's acquisitions of foreign firms.

2.6. Diversification

Given a firm's preferred risk return position international diversification by way of acquisition improves the risk return tradeoff. It is assumed that the covariance of returns across economies even within the same industries is likely to be smaller than within a single economy. The prospective acquiring company must first decide on its desired levels of risk and return and then should it attempt to identify countries, industries and specific firms, which fall within its risk class. In acquiring an ongoing foreign concern, companies may be able to get out of tariff and non-tariff barriers.

2.7. Current Economic conditions in the home country

The Union Minister of State for Finance said that Acquisition is the right path to grow, in his speech in Bancon "Indian banking conclave 2007". Indian Banking sector will have to explore inorganic growth options in order to face 'significant' challenges emanating from large -sized foreign banks to known for their deep pockets, advanced technology and skilled personnel. He also emphasis on cross-country evidence to indicate that inorganic growth is one of the best way to compete with foreign banks. The economic conditions in the home country, such as a slump, recession or capital constraint may cause banks to concentrate on their domestic business which temporarily delaying strategic international moves. If the economic condition is in boom, cross-border acquisitions are likely to again become a means for increasing demand and levels of diversification.

2.8. Acquisition of Technology.

The technology affects the mergers in two ways. First a technologically superior firm may take acquisitions in another country in order to exploit its technological advantage. And second inferior technological firm may make acquisitions in another country to enhance its competitive position both at home and abroad. The acquirer can improve its competitive position and profitability both at home and abroad. On the other hand the acquirer firms with surplus cash but technologically inferior can obtain the necessary technology by acquiring a firm with superior technology to remain effective in the market. There are cases where a firm falls behind in the level of technological knowledge necessary to complete efficiently in its industry. If a firm is unable or unwilling to develop the required technology through research and development it may attempt to acquire a foreign firm, which is technology through research and development, so attempt to acquire a foreign firm, which is technologically more advanced.

2.9. Integrated Human Resources system

Mergers and acquisitions can help banks restructure in a way that gives them superior organizational capabilities, resulting in a sustainable competitive advantage in integrated Human Resources system. Banks will have to build around this concept a performance measurement system, a career development path and a remuneration policy. In the day to come, there is bound to be greater staff mobility between banks. Staff remuneration has to be based partly on market trends and partly on job requirements and individual bank's needs standardized uniform scales for all banks. Promotions must be decided primarily on merit and requirements of the banks concerned, ensuring at the same time that the promotion policy is objective and transparent.

2.10. Government policy

The pace of mergers and acquisitions in the Indian Banking sector has been augmenting during the last five decades. The recent developments in Europe, America and Asia indicate that the merger

activity in the banking sector is going to continue for few more years. So the Government policies regulations, tariffs and quotas play a great role in the merges and acquisition activity in a country and more significantly in cross-border deals. The Reserve Bank of India (RBI) released the roadmap for presence of foreign banks in India and guidelines on ownership and governance in private sector banks. Shri P Chidambaram, Finance Minister, Government of India, in his speech announcing the Union Budget for 2005-2006, stated that the 'RBI has prepared a roadmap for banking sector reforms and will unveil the same in the near future. It may be recalled that the Ministry of Commerce and Industry, Government of India had, on March 5, 2004 revised the existing guidelines on foreign direct investment (FDI) in the banking sector. These guidelines also included investment by non-resident Indians (NRIs) and FIIs in the banking sector. As per the guidelines the aggregate foreign investment from all sources was allowed up to a maximum of 74 per cent of the paid up capital of the bank while the resident Indian holding of the capital was to be at least 26 per cent. It was also provided that foreign banks may operate in India through only one of the three channels, namely (i) branch/es (ii) a wholly owned Subsidiary or (iii) a subsidiary with an aggregate foreign investment up to a maximum of 74 per cent in a private bank. In consultation with the Government of India, RBI has released the road map for presence of foreign banks in India to operationalise the guidelines. The roadmap is divided into two phases. During the first phase, between March 2005 and March 2009, foreign banks will be permitted to establish presence by way of setting up a wholly owned banking subsidiary (WOS) or conversion of the existing branches into a WOS.

Conclusion

Consolidation in the banking industry is inevitable, as the economy is growing need for scale and size. A lot of Cross-border banking consolidation continues, creating new challenges for being both global and local banks. The rapid pace of consolidation across the global retail banking industry is likely to continue through and beyond 2008. Large number of high-bank profile cross-border an acquisition is on rise, not all are or will be successful. Pressure on acquiring banks is intense especially in large cross border deals, because of the risk involved in moving into a new geography.

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