Project Dissertation Report on

Impact of mergers in Public Sector Banks on their Non-Performing Assets

Submitted By:

Nidhi Goel

2K17/MBA/051

Under the Guidance of:

Prof. G.C. Maheshwari

Professor

DELHI SCHOOL OF MANAGEMENT

Delhi Technological University

Bawana Road Delhi 110042

CERTIFICATE

This is to certify that the Project Dissertation Report titled **"Impact of mergers in Public Sector Banks on their Non-Performing Assets"** is an original and bona fide work carried out by **Ms. Nidhi Goel** of MBA 2017-19 batch to the best of my knowledge and was submitted to Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 in partial fulfilment of the requirement for the award of the Degree of Masters of Business Administration.

______________________	______________________
Signature of Guide	Signature of HoD (DSM)
(Prof. G.C. Maheshwari)	(Dr. Rajan Yadav)

DECLARATION

I, **Nidhi Goel**, student of MBA batch 2017-19 of Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-42, hereby declare that the project report entitled "**Impact of mergers in Public Sector Banks on their Non-Performing Assets"** submitted in partial fulfillment of the requirements for the award of the degree of Master of Business Administration, is a record of original dissertation work done by me, under the guidance and supervision of Prof. G.C. Maheshwari.

Student Name: Nidhi Goel

Roll Number: 2K17/MBA/051

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This project has enabled me to understand the various aspects of mergers and acquisitions in banking sector and its impact on their financial performance. I am thankful to all the people involved for helping me in this project.

Nidhi Goel

2K17/MBA/051

Abstract

This paper analyses the process of mergers of Public Sector Banks (PSBs) in India and studies the impact of these mergers on their Non-Performing Assets (NPAs). NPAs are loans or advances that have been defaulted for a long time (reliant upon the terms of each bank/loan). NPAs significantly affect the profitability of banks which in turn can disturb the entire economy. The public and shareholders lose faith in banking institutions which is harmful for the economy. Hence, it is important to understand how the measures taken to reduce NPAs fare in the long run.

Keywords: Mergers, Non-Performing Assets, Public Sector Banks

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Chapter I: Introduction

This section of the projects explores the objectives, hypotheses and motivation of the research. The main focus is to highlight the details about mergers in Public Sector Banks (PSBs).

1.1 Introduction

In recent times we have seen how banks have been dealing with Non-Performing Assets (NPAs) and trying to reduce them. Public Sector Banks seem to have been hit the most and we see that banks like SBI has Net NPA of Rs. 80,944 Cr and PNB has Net NPA of Rs. 35,675.12 Cr. As per a report by India News, NPA of PSBs is thrice that of the private banks as of June 2018. NPA ratio of PSBs stood at 13.88% while that of private banks stood at 4.48% at the end of Q1 FY19.

With such huge amount of NPAs, it becomes all the more important to look for ways to improve financial profitability of banks and reduce these NPAs which push the banks into abyss. There are multiple ways to improve profitability and performance, one of them being Mergers & Acquisition.

Merger is a combination of two or more companies into one company. The acquiring company, (also referred to as the amalgamated company or the merged company) acquires the assets and the liabilities of the target company (or amalgamating company). Typically, shareholders of the amalgamating company get shares of the amalgamated company in exchange for their shares in the Target Company.

There are two ways by which a company can grow; 1: internal growth and 2: external growth. The internal growth suffers from downsides like the problem of getting satisfactory finances, extended execution time of the projects, uncertainty etc. In order to overcome these problems a company can grow externally by acquiring an already existing business firm. The Banking Companies (Acquisition and Transfer of Undertakings) Acts of 1970 and 1980 provide that the Central Government, in consultation with the Reserve Bank of India (RBI), may make a scheme, *inter alia*, for the amalgamation of any nationalized bank with any other nationalized bank or any other banking institution.

including Narasimhan Committee (1998) constituted by RBI, Leeladhar Committee (2008) chaired by RBI Deputy Governor, and Nayak Committee (2014) constituted by RBI, have recommended consolidation of Public Sector Banks (PSBs) given underlying benefits/synergies.

Some of the banks that have chosen the M&A route are:

Table 1: List of bank mergers and acquisitions since 1993

Acquiring Bank	Acquired Bank	Year of Acquisition
Bank of Baroda	Vijaya Bank Dena Bank	2019
State Bank of India	Bhartiya Mahila Bank (BMB) State Bank of Bikaner And Jaipur (SBBJ) State Bank of Hyderabad (SBH) State Bank of Mysore (SBM) State Bank of Patiala (SBP) State Bank of Travancore (SBT)	2017 (Recent and Important)
Kotak Mahindra Bank	ING Vysya Bank	2014
ICICI Bank	Bank of Rajasthan	2010
HDFC Bank	Centurion Bank of Punjab	2008
Indian overseas Bank	Bharat overseas Bank	2007

Federal Bank	Ganesh Bank of Kurandwad	2006
Industrial Development Bank of India	United Western Bank	2006
Centurion Bank of Punjab	Lord Krishna Bank	2007
ICICI Bank	Sangli Bank	2006
Bank of Punjab	Centurion Bank	2005
IDBI	IDBI Bank Ltd.	2004
Bank of Baroda	South Gujarat Local Area Bank	2004
Oriental Bank of Commerce	Global Trust Bank	2004
Punjab National Bank	Nedungadi Bank Ltd	2003
ICICI Bank	ICICI Ltd	2002
Bank of Baroda	Banaras State Ltd Bank	2002
ICICI Bank	Bank of Madura	2001
HDFC Bank Ltd	Times Bank Ltd	2000
Bank of Baroda	Bareilly Co- p Ltd	1999
Union Bank of India	Sikkim Bank Ltd	1999
oriental Bank of Commerce	Bari Doab Bank Ltd	1997
oriental Bank of Commerce	Punjab Co-op Ltd	1996

State Bank of India	Kashinath State Bank	1995
Bank of India	Bank of Karad Ltd	1994
Punjab National Bank	New Bank of India	1993

However, it is necessary to understand that mergers may not always result in positive value creation for shareholders. Many mergers fail and depreciate the wealth of shareholders. This happens when the process of mergers is faulty and does not follow proper research. Consulting firms estimate that almost 2/3rd of the firms that enter M&A lead to failure which leads to divestiture at later stages (Schweiger, 2003).

1.1 Merger of SBI and Bad Loans Data

Five associates and the Bhartiya Mahila Bank became part of the State Bank of India (SBI) in 2017, propelling the country's largest lender to among the top 50 banks in the world.

State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP) and State Bank of Travancore (SBT), besides Bhartiya Mahila Bank (BMB), merged with SBI. "With this six-way mega merger, SBI has again displayed its ability to change and evolve in order to continue as the country champion among banks in India and to create enduring value," SBI said.

With this merger, the bank will join the league of top 50 banks globally in terms of assets, it added. The total customer base of the bank will reach 37 crores with a branch network of around 24,000 and nearly 59,000 ATMs across the country.

The merged entity will have a deposit base of more than Rs 26 lakh crore and advances level of ₹18.50 lakh crore.

SBI first merged State Bank of Saurashtra with itself in 2008. Two years later, State Bank of Indore was merged with it.

Table 2 lists the gross non-performing advances ratio of the banks which merged with the State Bank of India. It also lists the bad loans ratio of the State bank of India. Bad are essentially loans in which the repayment from a borrower has been due for 90days or more.

Table 2: Bad Loans Ratio

	Bad loans rate (as on March 31, 2017)
State Bank of Mysore	28.76%
State Bank of Patiala	25.49%
Indian overseas Bank	24.99%
State Bank of Hyderabad	22.94%
State Bank of Travancore	18.14%
State Bank of Bikaner & Jaipur	16.47%
Bhartiya Mahila Bank	9.54%
State Bank of India (SBI)	7.15%

Source: Indian Banks' Association

1.3 Aims and Objectives the of Research

1.3.1 Aim of the Research

"The main aim of this research is to analyze the impact of mergers in Public Sector Banks on their Non-Performing Assets".

1.3.2 Objectives of the Research

- To analyze how mergers, impact financial performance of Public Sector Banks.
- To study the effect of mergers in Public Sector Banks on their Non-Performing Assets.

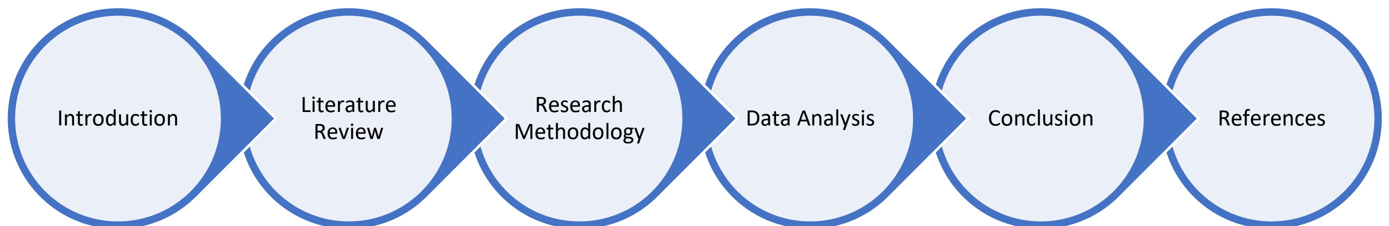
1.4 Hypothesis of Research

H0: “Mergers reduce the Non-Performing Assets and improve operating efficiency of banks.”

H1: “Mergers do not reduce the Non-Performing Assets of PSBs.”

1.5 Structure of Project

The structure of this project would be distributed over 5 chapters which are:



Chapter 2: Literature Review

2.1 Introduction

There are many strategic and financial aims that impact mergers and acquisitions. Two organizations with often different corporate personalities, cultures and value systems are brought together (Sudarsanam, 2003). The terms 'mergers' and 'acquisitions' are often used interchangeably. In lay vernacular, both are seen as the same. However, scholars have pointed out a few variances that help determine whether a specific activity is a merger or an acquisition.

A particular activity is called a merger when corporations come together to combine and share their resources to achieve common objectives. In a merger, both firms combine to form a third entity and the owners of both the combining firms remain as joint owners of the new entity (Sudarsanam, 1995).

An acquisition could be explained as event where a company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm. This may involve the purchase of another firm's assets or stock (Donald M. DePamphilis, 2008). Acquiring all the assets of the selling firm will dodge the potential problem of having minority shareholders as opposed to acquisition of stock. However, the costs involved in transferring the assets are generally very high (Ross, Westerfield, Jaffe, 2004).

There is another term, 'takeover' which is often used to describe different activities. Gaughan (2007) says that this term is very unclear. It is a broad term that sometimes refers to hostile transactions and sometimes to both friendly and unfriendly mergers (Gaughan 2007). Takeover is somewhat dissimilar than acquisition however the meaning of the later remaining the same. When the acquisition is forced in nature and without the will of the target company's management it is known as a takeover. Takeover normally undergoes the process whereby the acquiring company directly approaches the minority shareholders through an open tender offer to purchase their shares without the agreement of the target

company's management. In mergers and acquisitions scenario the terms mergers, acquisitions, takeover, consolidation and amalgamation are used interchangeably

The term 'merger' is not defined under the Companies Act, 1956 ("CA 1956"), and under Income Tax Act, 1961 ("ITA"). However, the Companies Act, 2013 ("CA 2013") without strictly defining the term explains the concept. A 'merger' is a combination of two or more entities into one; the desired result being not just the accumulation of assets and liabilities of the different entities, but organization of such entity into one business. The possible objectives of mergers are manifold - economies of scale, acquisition of technologies, access to sectors / markets etc. Generally, in a merger, the merging entities would stop to be in existence and would merge into a single surviving entity. The ITA does however describes the analogous term 'amalgamation': the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA goes on to specify certain other circumstances that must be satisfied for an 'amalgamation' to benefit from beneficial tax treatment.

2.2 Types of Mergers

2.2.1 Horizontal Mergers

Also referred to as a 'horizontal integration', this kind of merger takes place amid entities engaged in competing businesses which are at the same stage of the industrial process. A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope. These forms of merger are heavily scrutinized by the competition commission.

2.2.2 Vertical Mergers

Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the F&B business with a company engaged in farming would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move towards greater independence and self-sufficiency.

2.2.3 Congeneric Mergers

These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship. A company uses this type of merger in order to use the resulting ability to use the same sales and distribution channels to reach the customers of both businesses.

2.2.4 Conglomerate Mergers

A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.

A merger with a diverse business also helps the company to foray into varied businesses without having to incur large start-up costs normally associated with a new business.

2.2.5 Cash Merger

In a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receives cash instead of shares in the merged entity. This is effectively an exit for the cashed shareholders.

2.2.6 Triangular Merger

A triangular merger is often resorted to, for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

2.3 Motives for Mergers

Factor affecting mergers change with the changing legal, political, economic and social environments (Kaushal, 1995). Business organization literature has identified two common reasons which are derived out of mergers and acquisitions i.e. efficiency gain and strategic rationale (Neary, 2004). Efficiency gain means the merger would result into benefits in the form of economies of scale and economies of scope.

2.3.2 Operational Synergy

operational synergies refer to those classes of resources that lead to production and/or administrative efficiencies (Peck, Temple, 2002). Product related diversification or mergers are often carried out keeping operational synergies in mind. These synergies help firms bring down unit costs due to product relatedness.

2.4 Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

2.4.1 Company Law

Sections 390 to 394 of the CA 1956 (the "Merger Provisions") and Section 230 to 234 of CA 2013 govern mergers and schemes of arrangements between a company, its shareholders and/or its creditors. However, considering that the provisions of CA 2013 have not yet been notified, the implementation of the same remains to be tested. The currently applicable Merger Provisions are in fact worded so widely, that they would provide for and regulate all kinds of corporate restructuring that a company can possibly undertake, such as mergers, amalgamations, demergers, spin-off/hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

A. Procedure under the Merger Provisions

Since a merger essentially involves an arrangement between the merging companies and their respective shareholders, each of the companies proposing to merge with the other(s) must make an application to the Company Court5 having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The Court may then order a meeting of the creditors/shareholders of the company. If the majority in number representing 3/4th in value of the creditors and shareholders present and voting at such meeting agrees to the merger, then the merger, if sanctioned by the Court, is binding on all creditors/shareholders of the company. The Merger Provisions constitute a comprehensive code in themselves, and under these provisions Courts have full power to sanction any alterations in the corporate structure of a company. For example, in ordinary circumstances a company must seek the approval of the Court for effecting a reduction of

its share capital. However, if a reduction of share capital forms part of the corporate restructuring proposed by the company under the Merger Provisions, then the Court has the power to approve and sanction such reduction in share capital and separate proceedings for reduction of share capital would not be necessary.

B. Applicability of Merger Provisions to foreign companies.

Sections 230 to 234 of CA 2013 recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. Although the Merger Provisions do not permit an Indian company to merge into a foreign company, the merger provisions under Section 234 of the CA 2013 do envisage this, subject to rules made by the Government of India. However, neither is Section 234 currently in force nor have any rules been formulated by the Government of India.

2.4.2 Securities Laws

A. Takeover Code

The Securities and Exchange Board of India (the "SEBI") is the nodal authority regulating entities that are listed and to be listed on stock exchanges in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "Takeover Code") restricts and regulates the acquisition of shares, voting rights and control in listed companies. Acquisition of shares or voting rights of a listed company, entitling the acquirer to exercise 25% or more of the voting rights in the target company or acquisition of control, obligates the acquirer to make an offer to the remaining shareholders of the target company. The offer must be to further acquire at least 26% of the voting capital of the company. However, this obligation is subject to the exemptions provided under the Takeover Code. Exemptions from open offer requirement under the Takeover Code inter alia include acquisition pursuant to a scheme of arrangement approved by the Court.

B. Listing Regulations

Prior to December 1, 2015, the listing agreement entered into by a company for the purpose of listing its shares with a stock exchange prescribed certain conditions for the

listed companies which they have to follow in the case of a Court approved scheme of merger/amalgamation/reconstruction. However, on September 2, 2015, the SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations") were notified and has been effective from December 1, 2015. The Listing Regulations provide for a comprehensive framework governing various types of listed securities under the Listing Regulations, SEBI has altered the conditions for the listed companies which they have to follow in the case if a Court approved scheme of merger/ amalgamation/reconstruction has been altered. Following are the key changes that have been introduced by the Listing Regulation and table highlighting the comparison between the conditions prescribed under the listing agreement and Listing Regulation:

Sr. No	Particulars	Listing Agreement	Listing Regulation
1.	Filing of scheme with stock exchange	Listed companies have to file the scheme with stock exchange at least one month prior to filing with the Court.[8]	Listed companies have to file the scheme with stock exchange for 'observation letter' or 'no-objection'.[9]
2.	Compliance with securities law	Listed companies shall ensure that the scheme does violate or override the provisions of any securities law/stock exchange requirements.[10]	Listed companies shall ensure that the scheme does violate or override or limit the provisions of any securities law/stock exchange requirements.[11]
3.	Pre and post-merger shareholding	Listed companies have to disclose the pre and post-merger shareholding to the shareholders.[12]	The listed entity shall have to disclose the details with the stock exchange as per the disclosure requirements of stock exchange.[13]
4.	Auditor's certificate	Listed companies have to file with a stock exchange an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government in Section 211(3C) of the CA 1956.[14]	There is no corresponding provision under the Listing Regulation.
5.	Corporate actions pursuant to merger	Listed companies have to disclose to public if the listed company is proposing to undergo acquisition, merger, de-merger, amalgamation, restructuring, scheme of arrangement, spin off or selling divisions of the company, etc.[15]	Listed companies have to disclose to Stock Exchange of all the events which will have bearing on the performance/operations of the listed entity as well as price sensitive information.[16]

2.4.3 Competition Law

The Competition Act, 2002("Competition Act") replaced the Monopolies and Restrictive Trade Practices Act, 1969, and takes a new look at competition altogether. The Competition Act primarily covers (i) anti-competitive agreements (Section 3), (ii) abuse of dominance (Section 4), and (iii) combinations (Section 5, 6, 20, 29, 30 and 31). The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations") govern the

manner in which the Competition Commission of India (CCI) will regulate combinations which have caused or are likely to cause an appreciable adverse effect on competition ("AAEC") in India.

I. Anti - Competitive Agreements

The Competition Act essentially contemplates two kinds of anti-competitive agreements – horizontal agreements i.e. agreements between entities engaged in similar trade of goods or provisions of services, and vertical agreements i.e. agreements between entities in different stages / levels of the chain of production, in respect of production, supply, distribution, storage, sale or price of goods or services. Anti-competitive agreements that cause or are likely to cause an AAEC within India are void under the provisions of the Competition Act. A horizontal agreement that (i) determines purchase / sale prices, or (ii) limits or controls production supply, markets, technical development, investment or provision of services, or (iii) shares the market or source of production or provision of services, by allocation of geographical areas/type of goods or services or number of customers in the market, or (iv) results in bid rigging / collusive bidding, are presumed to have an AAEC.

on the other hand, vertical agreements, such as tie in arrangements, exclusive supply or distribution agreements, etc., are anti-competitive only if they cause or are likely to cause an appreciable adverse effect on competition in India.

II. Abuse of Dominant Position

An entity is considered to be in a dominant position if it is able to operate independently of competitive forces in India, or is able to affect its competitors or consumers or the relevant market in India in its favor. The Competition Act prohibits an entity from abusing its dominant position. Abuse of dominance would include imposing unfair or discriminatory conditions or prices in purchase/sale of goods or services and predatory pricing, limiting or restricting production / provision of goods/services, technical or scientific development, indulging in practices resulting in denial of market access etc.

III. Regulation of Combinations

The Combination Regulations are the key regulations through which the CCI regulates combinations such as mergers and acquisitions. Under Section 32 of the Competition Act, the CCI has been conferred with extra-territorial jurisdiction. This means that any acquisition where assets / turnover are in India (and exceed specified limits) would be subject to the scrutiny of the CCI, even if the acquirer and target are located outside India.

A “Combination”, for the purposes of the Competition Act means:

- an acquisition of control, shares or voting rights or assets by a person;
- an acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in similar or identical business; or
- a merger or amalgamation between or among enterprises; that exceed the ‘financial thresholds’ prescribed under the Competition Act.

2.5 Taxes and Duties

I. Income Tax Act, 1961.

The ITA contemplates and recognizes the following types of mergers and acquisitions activities:

- Amalgamation
- Demerger or spin-off; § Slump sale/asset sale; and
- Transfer of shares. The ITA defines an ‘amalgamation’ as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA also requires that the following conditions must be met by virtue of the merger, for such merger to qualify as an ‘amalgamation’ under the ITA:
- all the property of the amalgamating company(ies) becomes the property of the amalgamated company;
- all the liabilities of the amalgamating company(ies) become the liabilities of the amalgamated company; and

- shareholders holding not less than 75% of the value of the shares of the amalgamating company become shareholders of the amalgamated company.

A. Tax on Capital Gains

Section 45 of the ITA levies tax on capital gains arising on the transfer of a capital asset. Section 2(47) of the ITA defines the term 'transfer' in relation to a capital asset to include:

- The sale, exchange or relinquishment of the asset; or
- The extinguishment of any rights therein; or
- The compulsory acquisition thereof under any law; or
- In a case where the asset is converted by the owner thereof into, or is treated by him as, stock– in–trade of a business carried on by him, such conversion or treatment; or.
- Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
- Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever), which has the effect of transferring, or enabling the enjoyment of, any immovable property.
- Further, under Section 9(1)(i) of the ITA, capital gains arising to a non-resident is considered taxable in India if they are earned directly or indirectly through the transfer of a capital asset situated in India.

If a merger or any other kind of restructuring results in a transfer of a capital asset (as defined above) for a resident or a capital asset that is situated in India for a non-resident, it would lead to a taxable event.

i. Capital Gains Tax Implications for Mergers

Section 47 of the ITA sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are provided below:

- for an amalgamating company (transferor)

Section 47(vi): The transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company is exempt from tax on capital gains, provided the amalgamated company is an Indian company.73 Please note that for this exemption to be applicable to a merger, it is essential that the merger falls within the definition of 'amalgamation' provided above. Special exemptions have also been included in case of amalgamations involving banking companies.

- for a foreign amalgamating company (transferor) in connection with transfer of shares in an Indian company

Section 47(via): When a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such a transfer of the capital asset i.e. shares in the Indian company, would be exempt from tax on capital gains in India for the foreign amalgamating company, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated. It may be noted that while the definition of 'amalgamation' under Section 2(1B) requires that 75% (in terms of value of shares) of the shareholders of the amalgamating company should become the shareholders in the amalgamated company, this section specifies 25% of the number of shareholders as the corresponding figure. The above provisions also indicate that an Indian company may not amalgamate into a foreign company without attracting capital gains tax liability in India.

- shareholders of the amalgamating company

Section 47(vii): Transfer by the shareholders of amalgamating company, in a scheme of amalgamation, of shares of the amalgamating company (the capital asset) as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, provided that the amalgamated company is an Indian company.75 The exemption from tax on capital gains would only be to the extent that the transfer is for the consideration for shares of the amalgamated company. If any consideration other than

shares of the amalgamated company, such as cash or bonds, was paid to the shareholders of the amalgamating company, it may be considered liable to tax on capital gains.76 If any of the conditions specified above are not satisfied (including the conditions specified in the definition of 'amalgamation'), the transfer of capital assets in a merger would be subject to tax on capital gains.

- for the shareholders/interest holders of a foreign amalgamating company in relation to indirect transfer tax

The Finance Act, 2015 has added Sections 47(viab) and 47(vicc) to the ITA by which transfer by the shareholders, in a scheme of amalgamation, of shares/interests of a foreign amalgamating company (the capital asset) that derive their value 'substantially' from Indian assets77 as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated. Capital gains tax implications for demergers. The term 'demerger' in relation to companies is defined by Section 2(19AA) of the ITA to mean the transfer, pursuant to a scheme of arrangement under the Merger Provisions by a demerged company of its one or more undertakings, to any resulting company, in such a manner that:

- All the property of the undertaking78, being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;

All the liabilities79 relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

- The property & the liabilities of the undertaking/ undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger; § The resulting company issues, in

consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

- The shareholders holding not less than 3/4ths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or its subsidiary) become shareholders of the resulting company(ies) by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- The transfer of the undertaking is on a going concern basis;
- The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf. Section 2(19AAA) of the ITA defines the term "demerged company" to mean a company, whose undertaking is transferred, pursuant to a demerger, to a resulting company.

Section 2(41A) defines a "resulting company" to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company. The ITA contains certain tax beneficial provisions in the case of a demerger. If the demerger fulfills the conditions listed above, the transfer of assets by the demerged company to a resulting company, which must be an Indian company, is exempted from capital gains tax under Section 47(vib) of the ITA. Further, in case of a demerger of a foreign company, whereby both the demerged and resulting companies are foreign, but the assets demerged include or consist of shares in an Indian company, the transfer of these shares is exempt from capital gains tax in the hands of the demerged company under Section 47(vic) of the IT Act, if the following conditions are satisfied:

- The shareholders holding at least three fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated. However, since both the demerged

and the resulting companies in the aforesaid example are based outside India, hence the provisions of the CA 1956/ CA 2013 (as the case may be) would not be applicable.

As in the case of a merger, a specific exemption provision covering demergers in an 'indirect transfer' situation i.e. Section 47(vicc) has been added by the Finance Act, 2015 whereby any transfer of a foreign company's shares, that derive their value 'substantially' from Indian assets, as part of a demerger would be exempt from capital gains tax in the hands of the demerged company if the following conditions are satisfied:

- The shareholders holding at least three fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

ii. Computation of Capital Gains

Tax Income chargeable to tax as capital gains is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset. Section 49(1) (e) provides that the cost of acquisition of assets transferred by way of a scheme of amalgamation that are covered by the exemptions under Section 47 mentioned above would be deemed to be the cost of acquisition of the assets by the amalgamating company. Similarly, Section 49 (2) provides that the cost of acquisition for a shareholder, of shares of the amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.

2.6 Indian Legal Issues involved in M&A

2.6.1. SEBI Takeover Regulations/Company Law in M&A:

Mergers are primarily supervised by the High Court(s) and the Ministry of Company Affairs. The SEBI regulates takeovers of companies that have shares listed on any stock

exchange in India. The main corporate and securities law provisions governing mergers and takeovers are:

- Sections 108A to 108I of CA56, which place restrictions on the transfer and acquisition of shares where the shareholdings of the bidder or transformer would either:
  - Result in a dominant undertaking; or
  - In case of a pre-existing dominant undertaking, result in an increase in the production, supply, distribution or control of goods and services by it.

- Section 390 to 394 of CA56, which govern the schemes of arrangement between companies and their respective shareholders and creditors, under the supervision of the relevant High Court.

- The Takeover Code, which sets out procedures governing any attempted takeover of a company that has its shares listed on one or more recognized stock exchange(s) in India. Regulation 10, 11, and 12 of the Takeover Code, which deal with public offers, do not apply to a scheme framed under the Sick Industrial Companies (Special Provisions) Act, 1985 ("**SICA**"), or to an arrangement or reconstruction under any Indian or foreign law (*Regulation 3 (1) (j), Takeover Code*).

The Takeover Code, however, does not apply to the following acquisitions:

1. Allotment of shares made in public issue or in right issue;
2. Allotment of shares to underwriters in pursuance of underwriting agreement;
3. Inter-se transfer between group, relative, foreign collaborators and Indian promoters who are shareholders, acquirer and persons acting in concert with him;
4. Acquisition of shares in the ordinary course of business by a registered stockbroker on behalf of his client, market maker, public financial institutions in their own account, banks and financial institutions as pledgees, international financial

institutions, and merchant banker or promoter of the target company under a scheme of safety net;

5. Exchange of shares received in a public offer made under the Takeover Code;
6. Transmission of shares in succession or inheritance;
7. Acquisition of shares by government companies and statutory corporations. However, acquisition in a listed public sector undertaking, through the process of competitive bidding process of the Central Government is not exempted;
8. Transfer of shares by state level financial institutions to co-promoters under an agreement;
9. Transfer of shares venture capital funds or registered venture capital investors to a venture capital undertaking or to its promoters pursuant to an agreement;
10. Acquisition of shares in pursuance of a scheme of rehabilitation of a sick company, amalgamation, merger or demerger;
11. Acquisition of shares of an unlisted company. However, if such acquisition results in acquisition or change of control in a listed company, the exemption will not be available;
12. Acquisition of global depository receipts and American depository receipts so long as they are not converted into shares carrying voting rights.

- Section 17, 18 and 19A of the SICA, which regulate schemes formulated by the Board for Industrial and Financial Reconstruction, a statutory body established under the SICA, for the reconstruction and amalgamation of "sick" companies (that is, any company which, at the end of any financial year, has accumulated losses equal to or exceeding the entire net worth). The Sick Industrial Companies (Special Provisions) Repeal Act 2003 ("**SICA Repeal**"), which repeals the SICA, has been enacted but has not yet come into force. Similarly, while the Companies (Second Amendment) Act, 2002 has introduced Chapter VIA in the CA56, which makes substantial amendments to the regime governing sick companies, these provisions are also yet to come into effect (there is no indication as to when these provisions are likely to come into force). As a result, SICA continues to be valid and binding.

There are also rules governing the acquisition of shares in an Indian company by a non-resident.

2.6.2 Due Diligence in M&As:

The purpose of the due diligence exercise is to identify any issues that may affect the bid including, but not limited to, the price of the bid. Generally, the bidder (in case of recommended as well as hostile bids) will want to determine the following about the target company:

- Its capital structure including shareholding pattern.
- The composition of its board of directors.
- Any shareholders' agreement or restrictions on the shares, for example, on voting rights or the right to transfer the shares.
- Its level of indebtedness.
- Whether any of its assets have been offered as security for raising any debt.
- Any significant contracts executed by it.
- The status of any statutory approvals, consents or filings with statutory authorities.
- Employee details.
- Significant litigation, show cause notices and so on relating to the target and/or its areas of business.
- Any other liability, existing or potential.

Public Domain

Information on a target that is in the public domain and is accessible to the bidder includes its:

- Constitutional documents;
- Annual reports and annual returns filed with statutory authorities, giving information on shareholdings, directors and so on.
- Quarterly and half-yearly reports, in the case of listed companies (in accordance with the standard listing agreement prescribed by the SEBI).

A listed company must inform the stock exchanges of important decisions taken by its board of directors.

2.6.3 Contractual Issues in M&As:

While economic and business reasons may be the factors behind both M&As, contractual and legal formalities involved are rather different. Share sale and purchase/acquisition agreement, asset and business transfer agreements, representations and warranties, indemnity, non-compete and non-solicitation, confidentiality, governing law, post completion matters and indemnities are significant agreements and clauses to effectively execute M&As.

2.6.4 Intellectual Property Law and M&As:

In case of M&A of companies, all the assets of the transferor company including intellectual property assets such as patents, copyrights, trademarks and designs vest in the transferee. Where the transferor company owns the intellectual property assets, such assets are transferred to the transferee company under the scheme of arrangement.

Unregistered trademark/copyright is transferable as any other right in a property under the scheme of arrangement framed under section 394 of CA56. In case of registered trademarks/copyrights and patents, the transferee company has to apply to the respective Registry for registering its title pursuant to the order of the High Court sanctioning the scheme.

The transmission/transfer of the trademark/copyright rights in the license may be permitted in an instance where the licensor himself assents to such transfer of a license subsequent to a merger.

2.6.5 Exchange Control Issues:

The Foreign Direct Investment ("FDI") regime in India has progressively liberalized and the Government of India recognizes the key role of FDI in economic development of a country. With very limited exceptions, foreign entities can now invest directly in India,

either as wholly owned subsidiaries or as a joint venture. In an international joint venture, any proposed investment by a foreign entity/individual in an existing entity may be brought in either through equity expansion or by purchase of the existing equity.

Where the transfer of shares is by way of sale under a private arrangement, by a person resident in to a person resident outside India the price of the shares will not be less than the ruling market price in case of shares listed on a stock exchange or the value of the shares calculated as per the guidelines issued by the erstwhile Controller of Capital Issues and certified by a Chartered Accountant. In either of the cases the sale consideration must be remitted into India through normal banking channels. Lastly, to affect the transfer, a declaration in the form FC TRS should be filed with an authorized dealer along with the a consent letter indicating the details of transfer, shareholding pattern of the investee company after the acquisition of shares by a person resident outside India showing equity participation of residents and non residents, certificate indicating fair value of shares from a chartered accountant or in case of a public listed company copy of the broker's note and an undertaking from the buyer to the effect that he is eligible to acquire shares in accordance with the FDI policy.

2.6.6 Monopolies and Restrictive Trade Practices Act, 1969 ("MRTP Act") and Competition Act, 2002 ("CA02"):

The MRTP Act aims towards controlling monopolistic, restrictive and unfair trade practices, which curtail competition in trade and industry. Monopolistic trade practice includes a trade practice unreasonably preventing or lessening competition in the production, supply or distribution of any goods or in the supply of any services. Sections 108A to 108I incorporated in CA56 restrict the transfer of shares by body or bodies corporate under the same management holding 10% or more of the subscribed share capital of any company without intimating the Central government of the proposed transfer.

The Competition Commission can investigate any combination, which is a merger or acquisition where any of the following apply:

- The parties jointly have assets exceeding INR 10 billion (about US$ 227 million) or turnover of more than INR 30 billion (about US$682 million) in India, or assets of US$ 500 million (about EUR 413 million) or turnover of more than US$ 1.5 billion (about EUR 1.2 billion) in India or outside India.

- The group to which the company will belong after the acquisitions and the company jointly have assets exceeding INR 40 billion (about US$ 909.6 million) or turnover of more than INR 120 billion (about US$ 2.7 billion) in India, or assets of US$ 2 billion (about EUR 1.7 billion) or turnover of more than INR 120 billion (about US$ 2.7 billion) in India, or assets of US$ 2 billion (about EUR 1.7 billion) or turnover of more than US$ 6 billion (about EUR 5 billion) in India or outside India.

- The bidder already has direct or indirect control over another enterprise engaged in the production, distribution or trading of a similar, identical or substitutable good or service, and the acquired enterprise and this other enterprise jointly have assets exceeding INR 10 billion or turnover of more than INR 30 billion in India, or assets of US$ 500 million or turnover of more than US$ 1.5 billion in India or outside India.

- The enterprise after the merger or acquisition has assets exceeding INR 10 billion or turnover of more than INR 30 billion in India, or assets of US$ 500 million or turnover of more than US$ 1.5 billion in India or outside India.

While investigating the combination, the Competition Commission must examine whether it is likely to cause, or causes, an adverse effect on competition within the relevant market in India. The Competition Commission has 90 days from the date of publication of details of the combination by the parties to pass an order approving, prohibiting or requiring modification of the combination, or to issue further directions. If

it does not do this, the combination is deemed approved. There is no obligation to suspend the combination while the investigation is taking place.

2.6.7 Tax Implications in M&As:

Amalgamations and Demergers attract the following taxes: -

- *Capital Gains Tax* – Under the IT Act, gains arising out of the transfer of capital assets including shares are taxed. However, if the resultant company in the scheme of amalgamation or demerger is an Indian Company, then the company is exempted from paying capital gains tax on the Transfer of Capital Assets.
- *Tax on transfer of Share* – Transfer of Shares may attract Securities Transaction Tax and Stamp Duty. However, when the shares are in dematerialized form then no Stamp duty is attracted.
- *Tax on transfer of Assets/Business* – Transfer of property also attracts tax which is generally levied by the states.
    - Immovable Property – Transfer of Immovable Property attracts Stamp Duty and Registration fee on the instrument of transfer.
    - Movable Property - The transfer of Movable Property attracts VAT which is determined by the State and also Stamp Duty on the Instrument of transfer.
- *Transfer of tax Liabilities* –
    - Income Tax – The predecessor is liable for all Income Tax payable till the effective date of restructuring. After the date of restructuring, the liability falls on the successor.
    - Central Excise Act – Under the Central Excise Act, when a registered person transfers his business to another person, the successor should take a fresh registration and the predecessor should apply for deregistration. In case the predecessor has CENVAT Credit, the same could be transferred.
    - Service Tax – As regards service tax, the successor is required to obtain fresh registration and the transferor is required to surrender his registration certificate in case it ceases to provide taxable services. The

provisions regarding transferring the CENVAT credit are similar to the Central Excise provisions.

- Value Added Tax – Usually statutes governing levy of VAT specify for an intimation of change of ownership and name to the relevant authority, but these statutes do not provide any specific guidelines with regard to the transfer of tax credit. The obligation of the predecessor and the successor is joint and several.

There is a growing need to bring a change in the present law but a coordinated approach should be taken while bringing amendments in the CA56. The change is required to provide for maximum elasticity and to provide equal opportunities to economic players in the global market. This would also help in bringing Indian law in consonance with the law regarding mergers in other countries.

Chapter 3: Research Methodology

3.1 Research Problem

Hypothesis –

H0: "Mergers reduce the Non-Performing Assets and improve operating efficiency of banks."

H1: "Mergers do not reduce the Non-Performing Assets of PSBs."

The premise of this research is to test whether the mergers done in PSBs have been able to reduce the NPAs of the merged entities or have the mergers failed. Major emphasis is to understand the impact of merger on financial performance of the banks and comment on the ideology of merging banks for better synergy.

3.2 Research Design

Research design is defined as a context of methods and techniques chosen by a researcher to combine various components of research in a logical way so that the research problem is proficiently handled.

The design of a research topic is used to explain the type of research. There are three main sections of research design: Data collection, measurement, and analysis.

Types of Research Design

A researcher must have a clear understanding of the various types of research design to select which type of research design to implement for a study. Research design can be broadly classified into quantitative and qualitative research design.

Qualitative Research Design: Qualitative research is implemented in cases where a relationship between collected data and observation is established on the basis of mathematical calculations. Theories related to a naturally existing phenomenon can be proved or disproved using mathematical calculations. Researchers rely on qualitative research design where they are expected to conclude "why" a particular theory exists along with "what" respondents have to say about it.

Quantitative Research Design: Quantitative research is implemented in cases where it is important for a researcher to have statistical conclusions to collect actionable insights. Numbers provide a better perspective to make important business decisions. Quantitative research design is important for the growth of any organization because any conclusion drawn on the basis of numbers and analysis will only prove to be effective for the business.

Further, research design can be divided into five types –

1. Descriptive Research Design: In a descriptive research design, a researcher is solely interested in describing the situation or case under his/her research study. It is a theory-based research design which is created by gather, analyze and presents collected data. By implementing an in-depth research design such as this, a researcher can provide insights into the why and how of research.

2. Experimental Research Design: Experimental research design is used to establish a relationship between the cause and effect of a situation. It is a causal research design where the effect caused by the independent variable on the dependent variable is observed. For example, the effect of an independent variable such as price on a dependent variable such as customer satisfaction or brand loyalty is monitored. It is a highly practical research design method as it contributes towards solving a problem at hand. The independent variables are manipulated to monitor the change it has on the dependent variable. It is often used in social sciences to observe human behavior by analyzing two groups – effect of one group on the other.

3. Correlational Research Design: Correlational research is a nonexperimental research design technique which helps researchers to establish a relationship between two closely connected variables. Two different groups are required to conduct this research design method. There is no assumption while evaluating a relationship between two different variables and statistical analysis techniques are used to calculate the relationship between them.

Correlation between two variables is concluded using a correlation coefficient, whose value ranges between -1 and +1. If the correlation coefficient is towards +1, it indicates a

positive relationship between the variables and -1 indicates a negative relationship between the two variables.

4. Diagnostic Research Design: In the diagnostic research design, a researcher is inclined towards evaluating the root cause of a specific topic. Elements that contribute towards a troublesome situation are evaluated in this research design method.

5. Explanatory Research Design: In exploratory research design, the researcher's ideas and thoughts are key as it is primarily dependent on their personal inclination about a particular topic. Explanation about unexplored aspects of a subject is provided along with details about what, how and why related to the research questions.

3.2.1 Justification for using research design

Since the research objective is to investigate, describe and measure phenomena at a particular point in time, descriptive & quantitative research design is best suited for this research.

3.3 Data Collection

There are two forms of data collection and information gathering techniques prevalent in the research environment:

- **Primary Data Collection:** Collecting data for the first time and for the specific purpose of research. This data is fresh and is collected by various methods such as surveys, interviews, focus groups, observation techniques, etc.

- **Secondary Data Collection:** This data is already present in the market and was collected by some other person for a different purpose. It is historical in nature and is available through multiple sources.

3.3.1 Justification – Secondary Data

This research is based on understanding and analyzing financial data of past years, and the only way to collect it is through banks' official websites, hence secondary data has been used in this research.

Chapter 4: Data Findings & Analysis

This section explores the financial data collected of two PSB mergers i.e. Indian overseas Bank and Bharat overseas Bank Merger (2007) and IDBI Bank and The United Western Bank Ltd Merger (2006). The data has been analyzed for pre-merger and post-merger

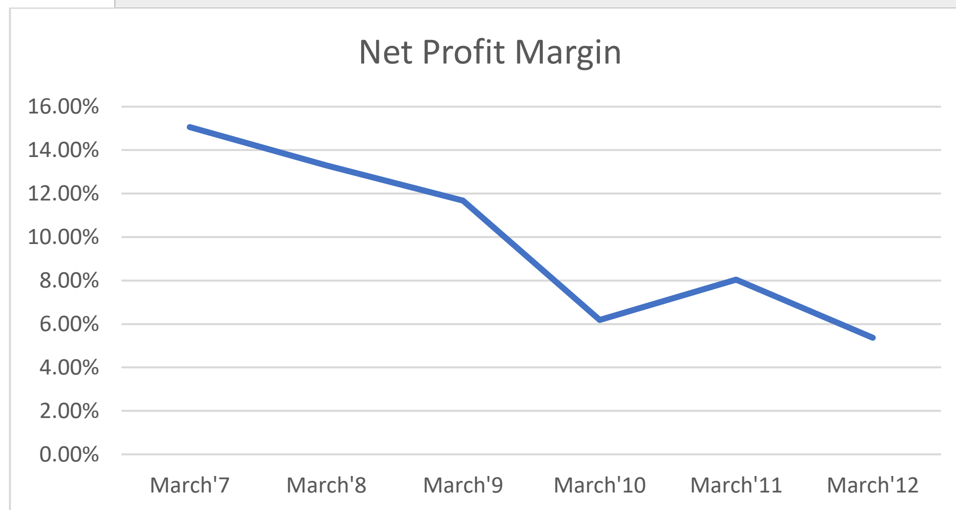
performance in terms of NPAs. The post-merger analysis has been done from the year of merger to the next 5 years to understand the implication of merger on the bank.

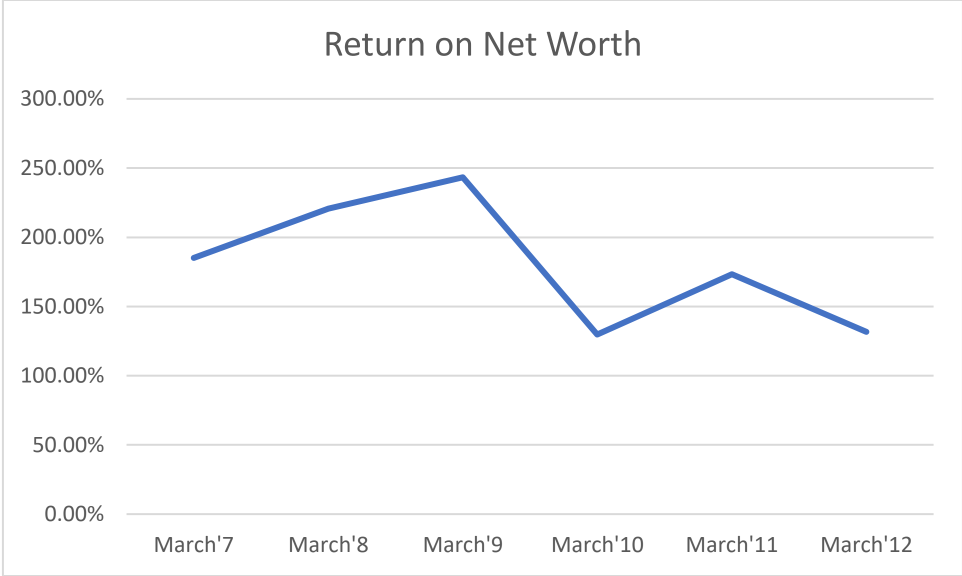
4.1 Indian overseas Bank and Bharat overseas Bank Merger (2007)

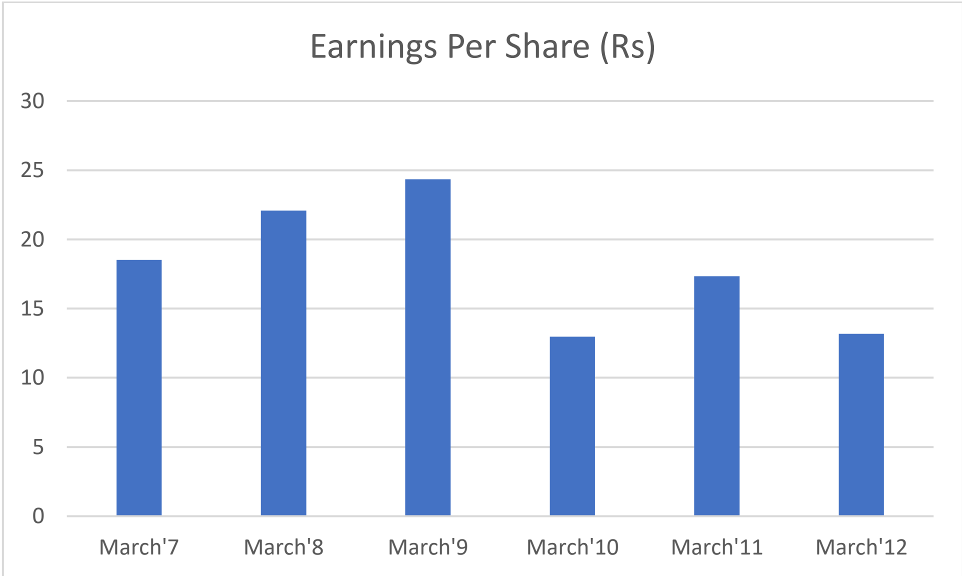
4.1.1 Financial Analysis

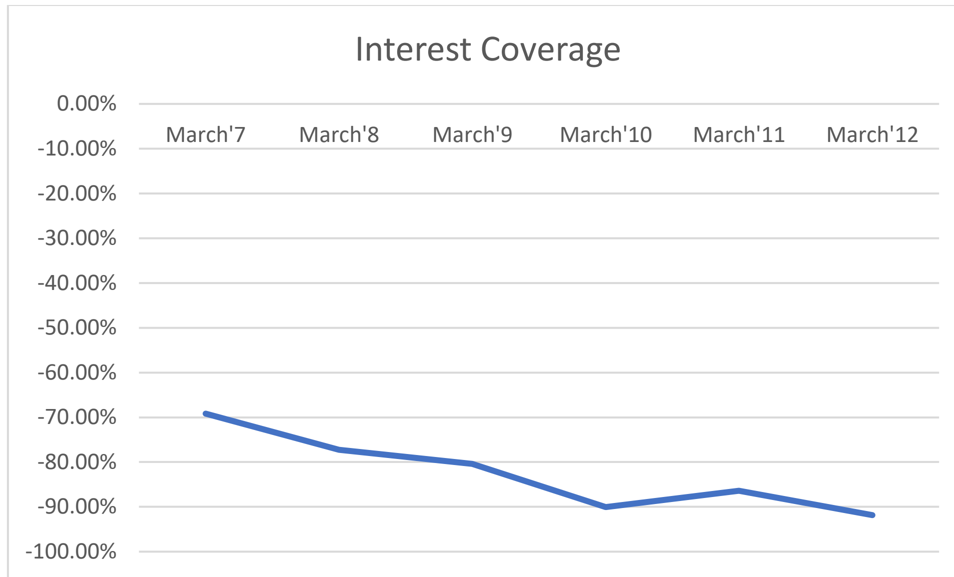
Financial Ratio	March'12	March'11	March'10	March'9	March'8	March'7 (Pre-Merger)
Net Profit Margin	5.37%	8.05%	6.18%	11.68%	13.29%	15.06%
Return on Net Worth	131.76%	173.34%	129.77%	243.35%	220.69%	185.10%
Debt-Equity Ratio	132.39	287.07	238.47	220.01	186.76	150.77
Earnings Per Share (Rs)	13.18	17.33	12.98	24.34	22.07	18.51
Return on Assets	1.00%	0.60%	0.54%	1.11%	1.18%	1.23%
Cash to Total Assets	15.41%	6.77%	7.56%	9.11%	10.16%	10.93%
Debt Ratio	191.49%	92.66%	92.19%	88.99%	89.12%	87.21%
Interest Coverage	-91.84%	-86.41%	-90.01%	-80.42%	-77.27%	-69.17%

	March'07	March'08	March'09	March'10	March'11	March'12	CAGR
Gross NPA	1120.21	996.95	1923.41	3611.08	3089.59	3920.07	**28.47%**




Return on Net Worth
300.00%
250.00%
200.00%
150.00%
100.00%
50.00%
0.00%
March'7
March'8
March'9
March'10
March'11
March'12


Earnings Per Share (Rs)
30
25
20
15
10
5
0
March'7
March'8
March'9
March'10
March'11
March'12



The financial performance of Indian overseas Bank has been on a decline since the merger. EPS and Debt-Equity Ratio briefly increased for some time but declined eventually.

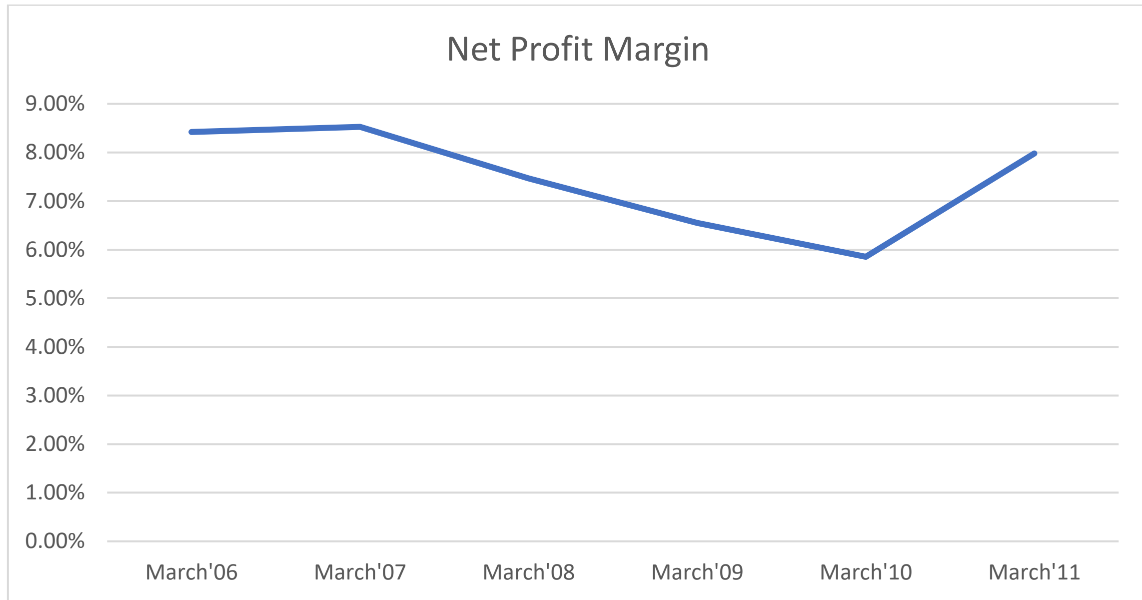
The NPA too grew by a CAGR of 28.47% which is very high. The contributing factors may have been more than just the merger, but the eventual conclusion is that the merger could not help reduce NPAs.

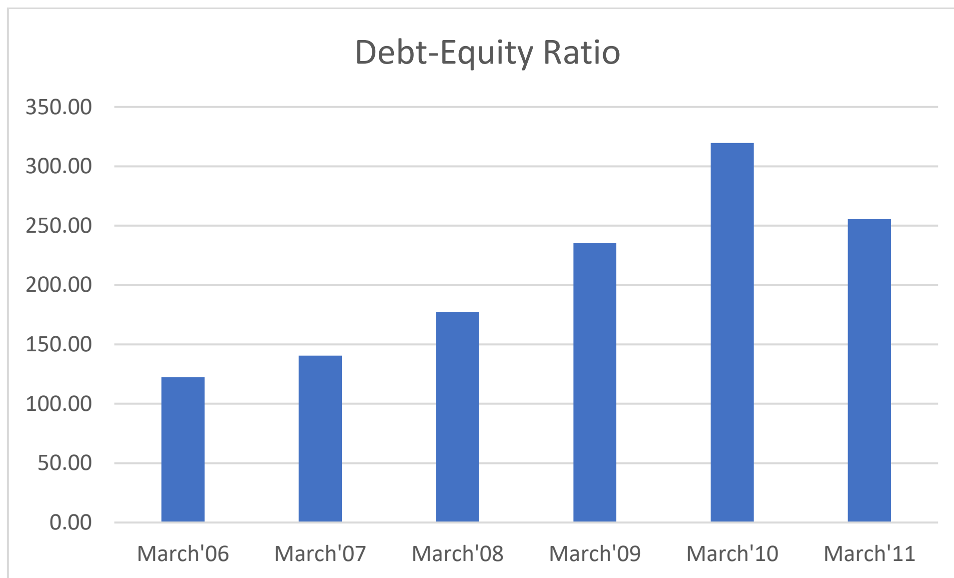
4.2 IDBI Bank and The United Western Bank Ltd Merger (2006)

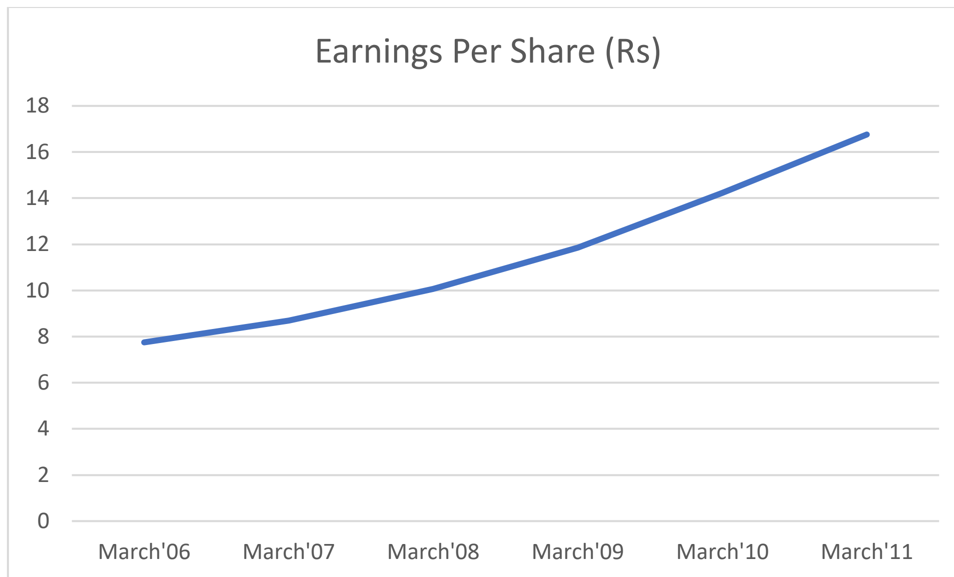
4.2.1 Financial Analysis

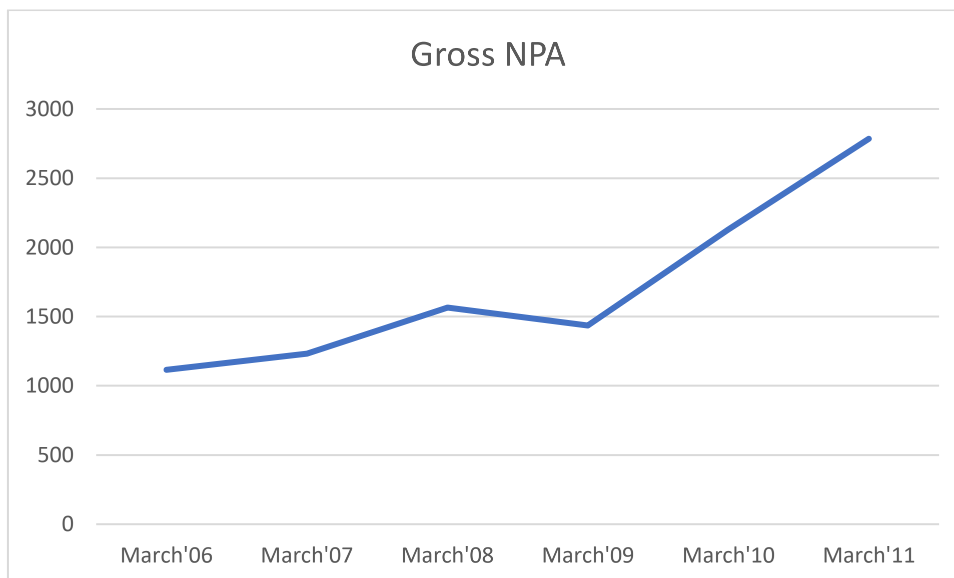
Financial Ratio	March'11	March'10	March'09	March'08	March'07	March'06 (Pre-Merger)
Net Profit Margin	7.98%	5.85%	6.55%	7.46%	8.53%	8.42%
Return on Net Worth	216.28%	152.07%	121.36%	282.07%	229.31%	186.27%
Debt-Equity Ratio	255.42	319.56	235.14	177.54	140.51	122.36
Earnings Per Share (Rs)	16.76	14.23	11.85	10.06	8.7	7.75
Return on Assets	0.85%	0.48%	0.52%	1.59%	1.63%	1.52%
Cash to Total Assets	8.26%	6.30%	6.58%	6.81%	6.79%	6.06%
Debt Ratio	92.28%	92.98%	92.02%	86.74%	84.26%	83.03%
Interest Coverage	-88.44%	-92.07%	-91.67%	-90.09%	-88.92%	-88.78%

	March'06	March'07	March'08	March'09	March'10	March'11	CAGR
Gross NPA	1115.52	1231.86	1564.68	1435.69	2129.38	2784.73	**20.08%**









After the merger, the financial ratios improved, however, the debt increased which is not good for the bank. The gross NPA too grew at a CAGR of 20.08% which again highlights that reduction of NPA could not be achieved by merging the banks.

Chapter 5: Conclusion & Recommendations

By analyzing the financial data, we come to a conclusion that merging of public sector banks does not necessarily reduce their non-performing assets and hence mergers should not be done with the motive of NPAs in mind.

our H0 hypothesis stands rejected and we accept the H1 hypothesis that says, mergers of PSBs do not result in reduced NPA.

To reduce NPA, following recommendations can be used:

- Creating awareness, and curbing unproductive borrowings through regulation.
- Multiple level of approvals to sanction massive loans. There should be transparent mechanism and disclosure regulations.
- Banks and sanctioning officials must be held accountable for the decisions. Appropriate action and communication, legal system, collaboration and coordination between authorities will lessen NPA.

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