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Inorganic Growth Through Mergers and Acquisitions: A Study of Proposed Merger of Five Associate Banks with SBI

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***Abstract*: This paper presents a study on merger of five associate banks with SBI.**

***Keywords*: bank, mergers, acquisitions**

1. Introduction

Inorganic growth arises from Mergers and Acquisitions instead of increasing company's own business activities. Through inorganic growth, firms can gain access to new markets and seen as a faster way for a company to grow when compared to organic growth.

Mergers and acquisitions are both changes in control of companies that involve combining the operations of multiple entities into a single company. In a merger, two companies agree to combine their operations into a single entity. In an acquisition, one company purchases another company, and has the right to sell off operations, merge them into similar groups in the purchasing company, or close facilities or cancel products altogether.

One plus one makes three: this equation is the special alchemy of a merger or an acquisition. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A. This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone.

2. Proposed merger of five associate banks with SBI

State Bank of India (SBI) is an Indian multinational, public sector banking and financial services company. It is a government-owned corporation with its headquarters in Mumbai, Maharashtra. As of 2016-17, it had assets of ₹30.72 trillion (US$460 billion) and more than 14,000 branches, including 191 foreign offices spread across 36 countries, making it the largest banking and financial services company in India by assets. The bank is ranked 232nd on the Fortune Global 500 list of the world's biggest corporations as of 2016.

In the past, SBI has absorbed two other associates – State Bank of Saurashtra in 2008 and State Bank of Indore in 2010. These mergers were supposed to pay the way for an accelerated phase of consolidation involving SBI and its associates, but this has not happened. The bigger hope that a fully amalgamated SBI will set the trend for all bank consolidation is clearly misplaced. Six years after SBI absorbed the Indore bank, there has been very little merger-and-acquisition activity in the banking space, and the only deal of any significance has been between private banks – Kotak Mahindra Bank acquiring ING Vysya Bank in 2015.

The five associate banks set to merge with SBI are State Bank of Bikaner and Jaipur, State Bank of Travancore, State Bank of Mysore, State Bank of Hyderabad and State Bank of Patiala. SBI will also absorb Bharatiya Mahila Bank.

A. State Bank of Bikaner and Jaipur

SBBJ is an associated bank of State Bank of India. As of 2015, SBBJ had 1,360 branches, mostly located in the state of Rajasthan, India. Its branch network out of Rajasthan covers all the major business centers of India. In 1997, the bank entered the capital market with an Initial Public Offering of 13,60,000 shares at a premium of Rs 440 per share. For the year 2015-16 the net profit of the company was 850.60 Crore.

B. State Bank of Travancore

State Bank of Travancore (SBT), is a subsidiary of the State Bank Group, but also has private share-holders. It is the premier bank of Kerala, where it handles the majority of its business. Overall, SBT as of March 31, 2015 has a network of 1,157 branches and 1,602 ATMs, covering 18 states and three union territories. As of March 31, 2015, SBT has a total business of ₹1.61 lakh crore (US$25.23 billion), comprising total deposits of ₹91,077 crore (US$14.29 billion) and gross advances of ₹69,907 crore (US$10.96 billion). The bank has reported a net profit of nearly ₹192 crore(US$30.12 million) in the fourth quarter of the fiscal year 2014-15, compared with ₹48.6

crore(US$7.62 million) a year ago, registering a growth of 295%. For the full fiscal year 2014-15, profit came in at ₹336 crore, against ₹304 crore a year ago.

C. State Bank of Mysore

State Bank of Mysore is a nationalized bank in India, with headquarters at Bangalore. It is one of the five associate banks of State Bank of India. State Bank of Mysore was established in the year 1913 as The Bank of Mysore Ltd. under the patronage of Maharaja Krishna Raja Wadiyar IV, at the instance of the banking committee headed by the great Engineer-Statesman, Bharat Ratna Sir M. Visvesvaraya. During 1953, "Mysore Bank" was appointed as an agent of Reserve Bank of India to undertake Government business and treasury operations, and in March 1960, it became a subsidiary of the State Bank of India under the State Bank of India (subsidiary Banks) Act 1959. Now the bank is an Associate Bank under State Bank Group and the State Bank of India holds 92.33% of shares. The Bank's shares are listed in Bangalore, Chennai, and Mumbai stock exchanges. This bank has 976 branches and 10627 employees (June 2014) and the Bank has 772 branches (79%) in Karnataka State. The bank has regional offices in Bangalore, Mysore, Mangalore, Mandya, Hassan, Shivamogga, Davangere, Ballari, Tumakuru, Kolar, Chennai, Coimbatore, Hyderabad, Mumbai and New Delhi. The bank's turnover in the year 2013-2014 was around US$19 Billion and Profit about US$46 Million. The Bank has a record of uninterrupted profits since 1913 and has declared dividend every year since 1913.

D. State Bank of Hyderabad

State Bank of Hyderabad is a nationalized bank in India, with headquarters at Hyderabad, Telangana. It is one of the five associate banks of State Bank of India and is one of the scheduled banks in India. It was founded in 1941 as Hyderabad State Bank. Since 1956 it has been a subsidiary of State Bank of India and is now State Bank of India's largest associate bank. The Bank's head office is situated at Gun foundry Area, Hyderabad, India. SBH has over 2,000 branches and about 18,000 employees. The Bank's business has crossed Rs. 2.4 trillion as on 31.12.2015 with a net profit of Rs. 8.12 billion. The bank has performed well in the past decades, winning several awards for its banking practices.

E. State Bank of Patiala

State Bank of Patiala, founded in 1917, is associate bank of the State Bank Group. Presently, State Bank of Patiala has a network of 1445 service outlets, including 1314 branches, in all major cities of India.

3. Objectives of the study

- To investigate the pros and cons of the decision of merging of five associate banks with SBI.
- To identify the issues generated with the proposed merger.
- To analyze future growth prospects of SBI with the merger decision.
- To analyze the benefits sought by associated banks with the merger.
- To find out the major challenges of integration.

4. Methodology

The study is descriptive in nature and only secondary sources of data collection have been used for collecting the data. The data has been generated from research papers, news articles and web sources.

5. Literature review

Under this study the researcher reviewed research papers for the purpose of having an insight into the work related to Merger and Acquisitions (M&A) with special reference to SBI proposed merger with its associate banks. After going through the available relevant literature on M&A, it was found that most of the work done highlightened the impact of M&A on different aspects of the banks. A bank can achieve growth both through organic and inorganic routes. Through organic route growth may be achieved by expanding its operation or by establishing new units, and inorganic growth may be in the form of Merger and Acquisitions (M&A), Takeover, Joint venture, Amalgamation etc. Many studies have investigated the various reasons for Merger and Acquisitions (M&A) to take place, just to look the effects of Merger and Acquisitions on Indian financial services sector.

Anand Manoj & Singh Jagandeep (2008) studied the impact of merger announcements of five banks in the Indian Banking Sector on the share holder bank. These mergers were the Times Bank merged with the HDFC Bank, the Bank of Madurai with the ICICI Bank, the ICICI Ltd with the ICICI Bank, the Global Trust Bank merged with the Oriental Bank of commerce and the Bank of Punjab merged with the centurion Bank. The announcement of merger of Bank had positive and significant impact on share holder’s wealth.

Mehta Jay & Kakani Ram Kumar (2006) stated that there were multiple reasons for Merger and Acquisitions in the Indian Banking Sector and still contains to capture the interest of a research and it simply because of after the strict control regulations had led to a wave of merger and Acquisitions in the Banking industry and states many reason for merger in the Indian Banking sector. While a fragmented Indian banking structure may be very well beneficial to the customer because of competition in banks, but at the same time not to the level of global Banking Industry, and concluded that merger and Acquisition is an imperative for the state to create few large Banks.

Aparna.T (2002) in her article highlighted that the SBI is the largest and oldest service sector bank of India. Due to greater competitive pressures and changes in Indian economy it has felt the need to revitalize and restructure itself. SBI is planning for technology upgradation. In order to increase its income it has shifted its focus from traditional banking to retail finance and housing finance. It is State Bank of India and its associates that have developed banking habit it the country. The financial performance of banks has been satisfactory over a period of time. Total income, operating profit and net interest income showed arising trends. SBI has the largest holdings of government securities. SBI has computerized 80% of its business operations and the highest number of ATMs in the country. Housing finance is the new thrust of SBI. SBI targeted to bring down its NPAs. SBI should continue its revitalizing and reorienting process so that it can help its flag.

Sinha Pankaj & Gupta Sushant (2011) studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions (M&A) it came to the point that companies may have been able to leverage the synergies arising out of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency etc.

6. Research gap

Although a lot of work is carried out on the evaluation of the impact of M&A in the banking sector in India. But every little work has been carried out to evaluate the specific impact of proposed merger of five associate banks with SBI. This study is an attempt to critically analyze the decisions taken by State Bank of India (SBI) about the merger of 5 associate banks. The study examines the benefits reaped and challenges faced by State Bank of India due to spate of mergers. It is an attempt to analyze the challenges of integration. It focuses on the issues generated which have directly or indirectly affected the SBI.

7. Key issues and challenges of proposed merger

- It would be unwise to view such an issue only through the narrow prism of balance sheets and alleged synergies; like many developments in the financial sector, the merger of the five associate banks with SBI ought to be viewed through the proper perspective – there are positive developments but also some major negatives that must not to be glossed over.
- With this merger, it is expected that bank management will bear some critical challenges related to Staff Integration and rationalization of branches. Several employee unions are against the merger. they are unsecured of technical glitches which can be a roadblock in their operations/
- The five banks set to merge with SBI may turn out to be an expensive affair. The cost of merging the associates would outweigh the benefits in the short term as the bad loans mount at units. SBI was expected to bear Rs 3500 crore on account of harmonization of employee pension plans when it merges the associate banks with it. India's largest lender is expected to complete the merger of associate banks with itself by 2017. The pension obligations may be higher than earlier estimates while the doubling of NPA ratios in associate banks over the last few quarters would add further strain on the parent after merger with poorer asset quality.
- Gross NPAs at SBI's subsidiaries have more than doubled to 13.2% as on September end from 6% in March, as associates have been aligning their bad loan recognition norms in line with the parent. This translates to a 23% rise in SBI's consolidated NPAs just from the associates. “We therefore continue to believe that the initial financial impact of the merger will be negative on SBI and material synergy benefits may only accrue over long term.
- Some of the teething troubles encountered during the first two mergers in the SBI group with State bank of Saurashtra in 2008 and State bank of Indore in 2010 have not yet been fully ironed out. For instance, the merger of the Saurashtra and Indore banks with SBI proved to be so expensive that a former chairperson of the bank went on record to say that it would not be prudent to merge more than one associate bank during a financial year.
- But harnessing these post-merger benefits will not be an easy task. For one, the associate banks will not come into the SBI fold with clean balance sheets; the five banks have a higher share of restructured loans than SBI, while the levels of their non-performing assets are comparable. There will also be common borrowers, which will bring with it its own set of problems.
- Another biggest challenge for the new entity will relate to human resources issues. The combined strength of all associate bank employees is estimated at around 70,000, or a third of SBI’s 2,10,000 -strong personnel. The problem of integrating the staff is likely to be cumbersome. There are bound to be questions over seniority and given the public sector character of the banks, the courts might intervene. Pension liabilities will also surge. But with time and the cooperation of staff unions these issues can be overcome. But if you look at the other side it might not be beneficiary for the employees because factors like experience, promotions, and hikes come into picture. Now currently SBI is dwelled with lots of debts in terms of non-performing asserts whereas banks like SBH, SBP are in profits. So, there will be an extra burden on these child banks if the amalgamation takes place.
- There is no evidence that a merger today will be any less expensive than those in the past. Yet, the government has thought it fit to nudge SBI and the five associate banks to merge, a process likely to be completed during the current financial year.

8. Benefits of the proposed merger

- Despite some issues, there are undeniable benefits from mergers within the SBI group. The avowed aim is to take SBI, already India’s largest bank, into the league of the world’s biggest banks. At present, no Indian bank figures in the global list of top 50 large banks. The latest round of mergers will bring SBI, with assets worth $550 billion, within striking distance of that list. On the domestic front, the merged entity will tower over other banks and will be at least four times bigger than its nearest rival. The merger will result in a "win-win situation" for the bank and its associates–SBI's reach and network will multiply, efficiency will likely increase with the rationalization of branches, there will be a common treasury pooling and there will be proper deployment of skilled resources.

- Besides, the associate banks and their customers will also benefit. An enhanced scale of operations and the rationalization of common costs will result in big savings.

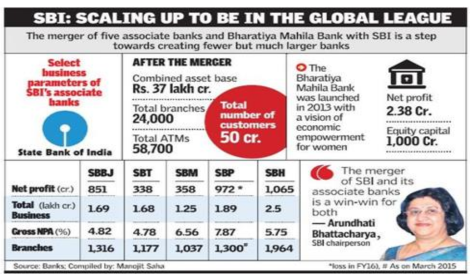

Fig. 1. SBI: Scaling up to be in the global league

- After the amalgamation it can withstand the strong competition from private sector banks and can accumulate more resources to channelize trained manpower across its branches. Secondly in terms of cost cutting, instead of setting up new branches, it can utilize the already existing branches of its child banks.

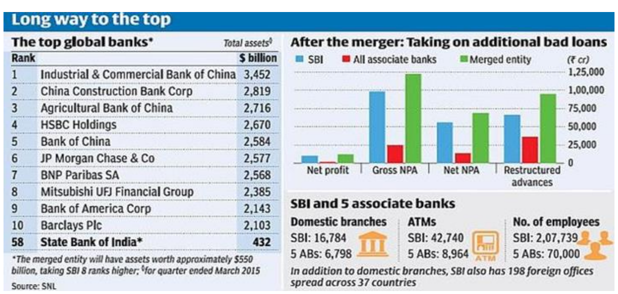

Fig. 2. Top global banks and merger

- The bigger the bank, the better is the diversification of its asset portfolio and there are lesser chances that the bank will fail in the long.
- The merged entity will be able to tap into cheaper funds more easily and it will also be able to rationalize the branches all over the country to cut down on the operations cost.
- Since SBI is upgrading processes to improve customer service, the customers of the merged smaller banks will get a better deal in loan rates after the merger.
- A country will grow economically if infrastructure sector grows properly. This needs funds from the banks, the combined employees' base will cross the 3 lakh base and that is huge in terms of employment. Moreover, it will also be feasible as diverse talent will come into the largest commercial bank of country.

9. Findings

- Merger with associate banks will have long term synergy benefits which will outweigh near term challenges. However, the biggest challenge is integration of employees. The SBI will have to create and expand its present structure to ensure smooth operations of the merged entity. A combined treasury could perform better. The lower cost of deposits will boost margins.

How they stack up — As of March 2016 (in ₹ crore)

Name	Deposits	Advances	Total
State Bank of Hyderabad	1,39,300	1,14,000	2,53,300
State Bank of Patiala	1,05,800	85,900	1,91,700
State Bank of Bikaner & Jaipur	93,300	74,700	1,68,000
State Bank of Travancore	1,00,400	67,000	1,67,400
State Bank of Mysore	70,200	55,400	1,25,600
Total	**5,09,000**	**3,97,000**	**90,6000**

Fig. 3. Banks details

10. Conclusion

The merger of five associate banks with State Bank of India (SBI) will create a much bigger entity in the Indian banking sector and will enable the giant to make one step closer to the list of among the top global banks. The merger would make SBI a global-sized bank and would be amongst the top 50 lenders in the world, with an asset base of Rs. 37 trillion or over $555 billion. After the amalgamation it can withstand the strong competition from private sector banks and can accumulate more resources to channelize trained manpower across its branches. In terms of cost cutting, instead of setting up new branches, it can utilize the already existing branches of its child banks. The scale of merger is mind boggling and SBI has rightfully started a lot of mapping and home work to address the gaps.

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