

LEGAL FRAMEWORK FOR M&A'S 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 deals of the same and motives behind it. An M&A is a transaction involving two or more corporations, swapping stocks, but only acquiring firm survives. M&A 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. The Indian banking sector reforms initiated in the year 1992 with deregulation of banking sector in India. The Government of India, the owner of public sector banks, has expressed its concern for strengthening these banks through selective M&A in Indian Banking sector. Indian Banking sector will have to explore inorganic growth options in order to 'Significant' challenges emanating from large sized foreign banks to be known for their advanced technology and skilled personnel. M&A 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. In article highlighting the M&A and its legal formalities required for M&A in Indian Banking Sector.

Key words : Mergers, Acquisitions, Banks consolidation & Legal issues

1.01. Introduction

Banking sector in India has witnessed a paradigm shift in the post-economic reform period. It has become strong, stable and vibrant with a dominating share in gross financial assets. Banking sector has continued to be the principal purveyor of finance and its all-pervasive intermediation has not been challenged by other financial entities. It has become more entrenched and diversified having made forays into insurance and investment banking. Banks have become tech-savvy and competitive as well. They are profitable and stable with impressive performance indices. "Indian banks represent a massive structure with over 76,696 branches of 26 nationalized banks, 14 old private sector banks and 7 new private sector banks in addition to 33 foreign banks¹". The Liberalization, Privatization and Globalization process which was started in early 1990s has brought many changes in the economic scene of the country. Mergers and acquisition (M&A) have become the principal tools for corporate restructuring. There has been a sharp increase in both the number and size of the M&A in the last two decades. M&A and restructuring have become a major force in the financial and economic environment all over the world. As David Sinclair put it: "It was once through that states too sophisticated to fight each other world make war through sport. They do not. The real international battle ground these days is the boardroom. The weapon is takeover"². Closer home, too, corporate are seriously looking at M&A's as strategic management tools, which have become ubiquitous. The use and intensity with which corporate restructuring is practiced has grown at tremendous pace since the beginning of the liberalization era, 1991, thanks to greater competitive pressures and a more liberal environment. A large number of M&A's of the 1990's are standing

examples of World Trade Organization (WTO) rule driven activities. In most of these cases, the manufacturers tried to circumvent the export restrictions, quotas and local content barriers by acquiring small to medium companies operating locally in the country of their interest.

- 1 A profile of banks, published by RBI for the year 20010-11
- 2 <http://www.tvnewscheck.com/article/52980/sinclair-eyes-market-with-interest>

1.02. Mergers and Acquisitions & Indian Banking Scenario

Banking industry became one of the fastest growing sectors after the first phase economic reforms. The Narasimhan Committee Report in August 1991 highlighted the need for the financial sector and Banking sector reforms. The report comes with a road map for banking sector reforms particularly in the area of operational flexibility and functional autonomy that enhance banking sector in efficiency, productivity and profitability. The banking sector reforms initiated in the year 1992 with deregulation of banking sector in India. Consolidation of the banking sector, it is presumed, is required to improve operational efficiency and to facilitate the emergence of globally competitive banks. In the speech on the Union Budget 2005-06 the finance minister has said. "The banking sector presents a picture of paradoxes. There are many banks in India but none among the top twenty in the world. It is universally acknowledged that the key drivers of the banking sector in the future will be competition, consolidation and convergence. Reserve Bank of India (RBI) has prepared a road map for banking sector reforms and will unveil the same. While most proposals will be implemented by the RBI on its own authority, some legislative changes would be required to be made". Here the emphasis is on competition, consolidation and convergence for the development of banking sector in India. Smaller banks in the private sector find themselves on the radar of bigger banks for acquisition. The unprecedented inflow of foreign institutional investment does not leave the capital structure of these banks untouched. Small is no more considered as beautiful, when it comes to sustainability in the long run. There is a move to merge some of the public sector banks to consolidate the banking sector. The same thing is said by Pawan Kumar former Union Minister of State for Finance in his speech in Bancon - Indian Banking Conclave 2007: "Indian Banking sector will have to explore inorganic growth options in order to 'Significant' challenges emanating from large -sized foreign banks to be known for their deep pockets, advanced technology and skilled personnel"³. "The inorganic growth is one of the best ways to compete with foreign banks. And the Consolidation is inevitable in the Indian Banking Sector as the 3 Pawan Kumar's mantra to banks – Deccan Herald Dated November 27th 2007, Page number – 14.

Economy is growing need for scale and size"⁴. One plus one makes three or some time more than three popularly referred to as Synergy. This equation is specifically applicable to M&A in the Indian banking sector in India. The key principle behind buying a bank is to create shareholder value over and above that of the sum of the two companies. In other words two banks together are more valuable than two separate banks. There are three patterns of Mergers and Acquisitions are noticeable, that is mergers and acquisitions of private sector banks with private sector banks, private sector banks with public sector banks, and public sector banks with public sector banks. This study aims at understanding the motives for mergers and acquisitions in Indian banking sector. Hence an attempt is made in this research.

1.03. Before & after liberalization period of M&A in Indian Banks.

In India the companies' Act 1956 and the Monopolies and Restrictive Trade Practices Act (MRTP), 1969 are statutes governing mergers among companies. In the Companies Act, as procedural has been laid down, in terms of which the merger can be effectuated.

Sanction of the company court is essential prerequisite for the effectiveness of a scheme of merger. The other statute regulating mergers was the hitherto monopolies and restrictive trade practices act. After the amendments the status does not regulate mergers. The regulatory provisions in the MRTP Act were removed through the 1991 amendments, with a view to giving effect to the new industrial policy of liberalization and deregulation, aimed at achieving economies of scale for ensuring higher productivity competitiveness. The next stage for the Indian banking has been setup with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%. The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. M & A encourage banks to gain global reach and better synergy and allow large banks to acquire the stressed assets of weaker banks. Merger in India banks that is between weak/unviable banks should grow faster so that the weak banks could be rehabilitated providing continuity of _____

4 Consolidation inevitable – Business Line Dated Tuesday, November 27, 2007, Page number 7 - Mr. H N Sinor, Chief Executive, Indian Bank's Association.

employment with the working force, utilization of the assets blocked up in the weak/unviable banks and adding constructively to the prosperity of the nation through increased flow of funds. In all there are 88 M&A have taken place between 1961 to April 2010.

Table 1: Bank mergers and acquisitions in India

Period	Number of Mergers and Acquisitions	Per cent of Mergers and acquisitions (%)
Pre nationalization of Banks (1961-1968)	46	52
Nationalization period (1969 – 1992)	13	15
Post reforms period (1993 – 2019)	29	33
Total number of mergers	88	100 %

Sources: (Compiled from various publications from RBI)

It indicates 1993 -2010 that only 29 M & A are taken place in post liberalisation period. It indicates that 33 per cent mergers and acquisitions have taken place between 1961-1968 it accounts for nearly more than 50 per cent of the total M&A. Indian Banking sector in India has witnessed a paradigm shift in the post economic reform period. It has become strong, stable and vibrant with a dominating share in gross financial assets.

1.04. Purpose for the Present Study

The problem area of research is “Legal Framework for M&A’s in Indian Banking Sector” it is an in-depth analysis of legal parameters of M&A in Indian banking sector. M&A in Indian Banking Sector have often been viewed as consolidation process, where a strong bank takes over a weak bank. It is basically financial integration, economic growth and financial stability. This in turn enables them to improve M&A in the Indian banking sector that leads to interbank competitions. This intends to give the beneficial effects to the spread the Indian banking sector as a whole, fostering closer convergence towards better, more efficient banking practices, deepened integration and greater breadth, depth and liquidity of the current financial markets. This study aims at understanding the legal framework for mergers and acquisitions and

also sees the impact on merged and acquiring unit. Hence an attempt has been made in this research, and so the researcher felt that there is a need for an in-depth analysis to find out the Legal Framework for M&A’s in Indian Banking Sector. This study has been carried out by covering legal aspects such as Act and their applicability in M&A process.

1.05. Methodology

A deliberate sampling technique is used for the present study. The researcher would follow deliberate sampling technique since a number of mergers and acquisitions happened in the Indian banking sector over the year 1991 to April 2019 is 29, which is very high sample. Secondly, it would be very time consuming to list down each and every mergers and acquisitions which have taken place in the given period. Since the researcher has interested to follow deliberate sampling method technique for the primary data, it has targeted number of respondents such as old bank manager, officer, customers and corporate customers of the merged banks.

1.05.01. Reference Period

The researchers study covers the period from 1991 to April 2019. During this period, the Indian banking sectors have gone in for various forms of restructuring reforms. This is also the I phase when RBI put some restrictions on Indian banking sector started mainly after 1993 which is considered first phase in Indian banking sector and second phase 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), had forced the banking sector to look for consolidation of smaller and weaker banks with strong banks. The data analysis is a very important step in the entire research process. The researcher would collect all secondary data information regarding M&A’s in Indian Banking sector involved in the research and edits the data. Only legal information and details which are important to lead towards the objectives would be picked up.

1.06. Legal Framework for M&A’s in Indian banking sector

1.06.01. Banking Regulation act 1949 : Nationalized banks are corporate bodies established by the Banking companies. These are predominantly owned and controlled by the Central Government under section 44A Voluntary Amalgamation of Banking Companies. Section 44A of the Banking Regulation act 1949 provides for the procedure to be followed in case of voluntary mergers of banking companies. A careful reading of the provisions of section 44A on banking regulation act 1949 shows that the high court is not given the powers to grant its approval to the schemes of merger of banking companies and Reserve bank is given such powers. Further, reserve bank is empowered to determine the Market value of shares of minority shareholders who have voted against the scheme of amalgamation. Since nationalized banks are not Banking Companies and SBI is governed by a separate statute, the provisions of section 44A on voluntary amalgamation are not applicable in the case of amalgamation of two public sector banks or for the merger of a nationalized bank/SBI with a banking company or vice versa. Therefore a banking company can be amalgamated with another banking company only under section 44A of the Banking Regulation Act 1945.

1.06.02. Industries (development & Regulation) Act 1951: The applicability of the above Act in the case of merger is very limited. An application under Section 391 of the Companies Act, initiating a merger process cannot be preceded with where permission of the High Court has been granted under Section 18FA of this Act to appoint anyone to take over the management of the industrial undertaking on the application of the Central Government for the purpose of running

or restarting it. However, the Central Government may review its order at the request of the parties to proceed with the scheme of merger. There is no necessity to get new license since the license of the amalgamated company since the takeover includes licenses also

1.06.03. Companies Act 1956: Section 391 to 394 of the Companies Act, 1956 deals with Compromises, Arrangements and Reconstructions and other related issues through schemes of arrangements approved by the High court. Under section 44A of the banking Regulation Act, 1949 two banking companies can be amalgamated voluntarily. Under section 396 of the act, central government may amalgamate two or more companies in public interest. As per sub-section (13) of section 38 of the SBI act, banking institution is defined as under "banking institution" includes any individual or any association of individuals (whether incorporated or not or whether a department of government or a separate institution), carrying on the business of banking.

1.06.04. Securities Contract (Regulation) Act 1956: The Securities Contracts (Regulation) Act, 1956 of the provisions of the Act, the business of dealing in securities cannot be carried out without a license from SEBI. Any Stock Exchange which is desirous of being recognized has to make an application under Section 3 of the Act to SEBI, who is empowered to grant recognition and prescribe conditions including that of having SEBI's representation, the maximum three members on the Stock Exchange and prohibiting the Stock Exchange from amending its rules without SEBI's prior approval. This recognition can be withdrawn in the interest of the trade or public. SEBI is authorized to call for periodical returns from the recognized Stock Exchanges and make enquiries in relation to their affairs.

1.06.05. Income Tax Act 1961: Under section 72(1) of the Indian Income Tax Act 1961, where there has been an amalgamation of a banking company referred to in clause of the section 5 of the Banking Regulation Act with a specified bank the accumulated loss and unabsorbed depreciation for the amalgamating company shall be deemed to be loss or as the case may be allowance for deprecation of the amalgamated company for the previous year in which the amalgamation was effected and the provision of the Income tax Act 1961, relating to set off and carry forward of loss and allowance of depreciation shall apply accordingly. Involuntary M&As would be given tax breaks under the Income Tax Act with the Finance Minister, proposing insertion of a new clause to provide for set off of losses of a banking company against profit of a banking institution under a scheme of amalgamation.

1.06.06. Monopolies and Restrictive Trade Practices Act, 1969 ("MRTP Act"): 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.

1.06.07. Securities and Exchange Board of India (SEBI) Regulations 1991: Section 3 of the Securities and Exchange Board of India (Substantial and Takeover) Regulation 1994 provides that Chapter III of the Regulations (relating to takeovers) will not apply to the acquisition of shares pursuant to a scheme of amalgamation under Sections 391 and 394 of the companies Act, 1956 and to the acquisition of shares pursuant to a scheme framed under the Sick Industrial Companies

(Special Provision) Act. This regulation applies to the companies registered under the Companies Act 1956, as well as to corporations established by Act of Parliament by virtue of listing agreements. It is for this reason that corresponding new banks increasing capital by issue of shares to the public are required to comply with SEBI regulations in spite of the fact that other provisions of the companies Act in regard to issue of shares etc. do not apply to the corresponding new banks. The position in respect of acquisitions and mergers of any banking institutions whose shares are listed at the Stock Exchanges will be required to comply with all the relevant regulations of SEBI.

1.06.08. Depository laws 1996: The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by making securities freely transferable subject to certain exceptions. Dematerialization of the securities in the depository mode and providing for maintenance of ownership records in a book entry form. It will also streamline the settlement process.

1.06.09. Competitions Act, 2002: The purpose for which Competition Act, 2002 was enacted is to regulate business combinations in the form of mergers, acquisitions and alliances. Chapter II containing Section 5 and 6 of the Competition Act 2002 primarily deals with the subject of combination that is mergers, acquisitions and alliances. The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises. The acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods, or provision of a similar or identical or substitutable services.

1.06.10. High Court Approvals: Approvals of the High courts of the states in which registered offices of the acquiring and the acquired companies are situated are required.

1.06.11. Listing Agreement: Listing means admission of securities to dealings on a recognized stock exchange. The securities may be of any public limited company, Central or State Government, quasi governmental and other financial institutions/corporations, municipalities, etc. According to Securities and Exchange Board of India (SEBI) inserted Clause 24(f) in the Listing Agreement w.e.f. June 4, 2003, the company shall file any scheme/ petition proposed to be filed before any court or Tribunal under section 391, 394, and 101 of the Companies Act, 1956, with the Stock Exchange, for approval, at least a month before it is presented to the Court or Tribunal'.

1.06.12. Compulsory Amalgamation of banks under section 45(4) of the banking regulation act: RBI may prepare a scheme of amalgamation of a banking company with other institution (the transferee bank) under sub-section (15) of section 45. Banking institution means any banking company. A compulsory amalgamation is a pressed into action where the financial position of the bank has become weak and urgent measures are required to be taken to safeguard the depositor's interest. Section 45 of the Banking regulation Act, 1949 provides for a bank to be reconstructed or amalgamated compulsorily' i.e. without the consent of its members or creditors, with any other banking institutions as defined in sub section(15) thereof. RBI can apply to the central government for suspension of business by a banking company and prepare a scheme of reconstitution or amalgamation in order to safeguard the interests of the depositors.

1.07. Findings:

- Helps to revive weak banks.
- Protect interest of common shareholders & Help rural area and agricultural area customers.
- M&A increases efficiency & M&A will be market driven and based on profitability.
- M&A would make greater economic and commercial sense in Indian Banking Sector.
- M&A will help in improving functioning like up gradation of branch banking.
- There is necessity to draw up policies to accommodate surplus staff by evolving some schemes like VRS etc.,
- It may not lead to rationalization of work force & Legal hassles are the major problem in M&A

1.08. Conclusion

Acquisition is the right path to grow, Indian Banking sector will have to explore inorganic growth options in order to face 'significant' challenges emanating from large –sized foreign banks known for their deep pockets, advanced technology and skilled personnel. It is a best ways to compete with foreign banks and Indian Public sector Banks. M&A will offer the so many benefits to strengthening the ongoing Core Banking operations; M&A's will create a big platform to bring a single window system of banking and survival of banking industry in the global village. Once the mergers and acquisition process is completed, the Reserve Bank of India and the Government of India seriously consider the challenges in respect of quality of customer service, legal formalities and motives of M&A.

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