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Beware of Mergers of Convenience

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The ICICI – ICICI Bank merger has been welcomed by many analysts who feel that universal banking is the right strategy for financial institutions. According to an editorial in the *Hindu Business Line*[3], "The development is entirely in keeping with trends worldwide. Europe has had a long tradition of universal banking and the US more recently has seen a wave of consolidation across entities in commercial and investment banking and in insurance businesses. Without doubt, synergies are to be had in such arrangements."

An article in the [4] with the caption, "Well-timed move" has mentioned: "The reverse merger makes commercial sense for ICICI and it had consciously been working towards this goal… Lately, project financing activity has dried up and sustaining growth has become difficult. Post merger, … the revenue stream will be diversified and the cyclicality can be avoided, and the banking entity will result in access to cheaper funds and access to retail deposits that are the key drivers of growth in the industry. No doubt, greater economic and operational efficiency in the form of lower cost, larger product portfolio and added reach would accrue to the new entity."

How valid is this optimism? At the outset we must remember that almost two thirds of the mergers which took place globally in the mid 1990s have failed to add value for shareholders. This is mainly because in their obsession to grow big and in their enthusiasm to close the deal, senior executives throw caution to the winds. Consequently, many of the projected synergies fail to materialise. Also, integration of the pre merger entities does not go through as smoothly as predicted due to cultural differences and turf wars. Some of the most high profile mergers of recent times, Daimler-Chrysler, Citicorp-Travelers and AOL-Time Warner have run into problems due to the slow pace of integration and difficulties in realising the anticipated synergies.

So, statements made by ICICI and ICICI Bank should be taken with a pinch of salt.
Sample some of them :-
K V Kamath, MD, "The merger is a culmination of a dream which began five years ago. The merged entity will enable us to leverage enormously on the size of our balance sheet." Press release by ICICI, "The merger would enhance value for shareholders of ICICI Bank through the large capital base and scale of operations, access to ICICI's strong corporate relationships, built up over five decades, entry into new business segments, higher market shares in various business segments…The process of integration between ICICI Bank and ICICI is expected to be smooth due to the strong synergies between the two entities."

In practice, realising synergies will be difficult. In the US, following a merger, it is common to see immediate retrenchment to trim the payrolls. It is also usual to see the closure of inefficient units. This results in major cost savings. In the case of the ICICI-ICICI bank merger however, there are no plans to retrench surplus staff. Rather, ICICI Bank is expected to go on a recruiting spree. It is also not clear whether any offices will be closed down.

The Citicorp Travelers merger has shown that cross selling is not easy to implement. People comfortable with retail banking are not necessarily good at dealing with corporate customers. The skills needed in project appraisal and those in working capital loan sanctions are quite different. So, the merged entity's plans to sell each other's products by leveraging on the combined network may not fully materialise.

Moreover, cultural differences between ICICI and ICICI Bank are significant. One is a young organization, the product of the liberalised era while the other is old, a product of the license raj. Employees of the market savvy ICICI Bank and those of the relatively conservative ICICI are not likely to see eye to eye on many matters. Also, as reported, there are major differences in compensation structure between the two organisations. So, integration of the pre merger entities may not be as easy as projected. To claim even before integration starts that it is going to be a smooth affair is highly simplistic to say the least.

Quite clearly, the reverse merger between ICICI and ICICI Bank may not be as beneficial as is thought by many. ICICI in its eagerness to grow big and spread its non performing loans (NPL) over a wider base, is probably rushing headlong into a risky deal. The right way of dealing with NPLs is through ruthless write off as John Reid of Citicorp did in the early 1990s and not through a merger. Only time will tell to what extent the merger succeeds.

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[3] October 31, 2001

[4] October 29, 2001