Merger as a Corporate Strategy

An Indian Banking Perspective

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***Abstract*—Mergers and acquisitions (M&A) are becoming an integral part of the Indian business model these days as many companies resort to this measure. Merger means combining two companies, while an acquisition is the scenario where one company buys another. M&A can include a number of different transactions, such as mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions. A number of small and medium sized companies fail to withstand the tough competition of the mammoth companies. Also, lack of capital in such companies adds to the woe. That is where M&A comes to the picture. When a bigger company absorbs smaller ones, there is more scope for productivity and profitability. Though no one can guarantee that an M&A would actually be purely beneficial, it can't be denied that it is indeed a wise decision in many cases. A merged or acquired does face a lot of challenges though. This paper deals with the M&A in the Indian banking sector and specifically the recent merger of associate banks with State Bank of India.**

Keywords—mergers; integration; indian banks; state bank of india

I. Introduction

Mergers and acquisitions (hereafter called as M&A) is becoming quite a famous business strategy for companies looking to expand into new markets or territories. They also help gaining a competitive edge or acquire new technologies and skill sets. They can provide a practical business solution for companies trying to downsize and also those looking for a plausible exit route. The company can expect an increase in profits by divesting assets as it would streamline operation and also reduce cost (Geroski, et al., 1997). As companies grow, it is important that they consider Mergers and Acquisitions as part of their corporate strategy. M&A experts play their role here. They provide companies with expert advice about company restructure and the potential impact of a merger or acquisition.

There are basically two kinds of mergers and acquisitions: strategic and financial.

A financial merger or acquisition is done for financial reasons—to collect quick cash or as an investment.

Strategic mergers and acquisitions is a totally different concept. A strategic M&A is often about gaining credibility, adding intellectual firepower or changing the balance of power in a particular market. The bottom line is a strategic merger is beneficial for both the acquiring and acquired firms.

II. Sitiuations that give way to M&A as a growth strategy

M&A can be used as a growth strategy in business organizations (Sehleanu, 2014). Here are five situations in which mergers and acquisitions have proven useful as a growth strategy:

1 - Fills critical gaps in service offerings or client lists.

2 - Efficient way to acquire talent and intellectual property

3 - Opportunity to leverage synergies

There are two basic types of M&A-related synergies: cost and revenue.

Cost synergies - cutting costs by taking advantage of overlapping operations or resources and consolidating them in one entity.

Revenue synergies- alter the competitive balance of power and create opportunities to change market dynamics, sell more products, or raise prices.

4 - Add a new business model

5 - Save time and long learning curves

III. Reasons M&A falters as a growth strategy

Sometimes a solid strategy is derailed by problems in implementation or flaws in the logic or reasoning behind the strategy.

A. Culture Clash

Different firms have different cultures. But the difference in cultures can pose issues (Alexandridis & Hoepner, 2015). This is the point where "culture" must be defined not just with themes or adjectives but with specific behaviors, and with the measures and incentives that will be used to encourage those behaviors.

B. Loss of Differentiation

If we don't avoid mergers when the features and benefits that make one firm valuable are not relevant to the other brand, there will arise a problem. Instead of adding critical assets, capabilities or values, the acquired or merged firm dilutes the brand. A merger has to be done after a carefully researched brand analysis.

C. A Major Distraction

The potential for distraction is too much and most profound after the agreement I s signed. The focus now shifts to integration. The senior most employees got to remain focused on bringing about the new changes in the firm. When they get distracted, the risk becomes too much to handle.

D. Marketplace Confusion

The confusion becomes too much to handle if the only rationale for the merger is growth for growth's sake (Long & Ling, 2011)**.**

E. Loss of Brand Strength

The market place confusion results in suffering of brand strength. Brand strength is the product of a simple equation:

$$\text{Reputation} \times \text{Visibility} = \text{Brand Strength}$$

Where reputation is what you're known for and visibility is how widely you are known for it. It is quintessential to understand this equation.

Other factors include limited or no involvement from owners (Kim, 2013), theoretical valuation vs. practical proposition of future benefits, lack of clarity and execution, required capacity potential vs. current bandwidth, negotiation errors, erosion of business fundamentals, loss of key talents and so on.

Timing of merger plays a vital role. An ill-timed merger can quickly diminish the strength of both the acquiring and acquired brands (Pereira & Rodrigues, 2015).

IV. Challenges

Primary technical challenges that organizations face following M&A include: inadequate IT integration, lack of visibility, data amalgamation and compliance regulation (Area al.,). Other challenges include:

A. Communication Challenges

Communicating with employees, empowering them and creating a culture for them to thrive are all fundamental parts to integration (Pikula, 1999). Fear and lack of answers deter top management from providing the information that employees need to redirect their actions in the merged company.

B. Employee Retention Challenges

Companies must proactively work to maintain or regain employee trust to keep them and the intellectual talent they represent. Failing to keep a critical mass of the old guard may set off a domino effect the organization will be feeling for many years to come (Tiwari, 2011).

C. Cultural Challenges

Various studies conducted on the outcome of M&A's show that 30% of them fail within three years, the majority due to the disparities in organizational culture. It's difficult for a merged company to carry the culture of the previous organizations, because employees seldom replace their underlying values and beliefs in the long run. It's vital to conduct culture surveys to determine the norms within both organizations. Cultural influences have the potential to be broad and far reaching (Olsen & Roy-bonde, 2008).

V. Integration and Conglomeration

Generally speaking, there are three types of mergers: a) Vertical Integration b) Horizontal Integration c) Conglomeration. (Philosophy, 2011). They are discussed briefly as follows:

A. Vertical Integration

In its simplest form, it is the process of manufacturers merging with retailers of suppliers.

B. Horizontal Integration

Horizontal integration is when one company acquires another company that is active in the same sector. This type of integration occurs when two companies that are engaged in essentially the same product or service merger to increase and uplift their combine market value.

C. Conglomertaion

Conglomeration refers to the acquisition of unrelated companies that continue production in unrelated sectors. This can be a useful approach in spreading business risks across a wide range of areas.

VI. M&A in Indian Banking Sector

Banking sector is the most extensively regulated sector in Indian financial market. RBI, the sole regulator has the responsibility of regulating, supervising and assisting the banking companies in carrying out their fundamental activities. M&A in Indian banking sector is not new as it has been happening since ages. The predecessor of State Bank of India, the Imperial Bank of India was born out of consolidation of three Presidency Banks in 1920. There were several cases of bank failures, mergers and acquisitions that were reported in pre-independence period dating back to 19th Century. Proper regulation and control of banks and intervention by the regulator in the event of a crisis came into existence with the passing of Banking Regulation Act in 1949.

Now a days, the banks are much in favor of M&A (Kumari, 2014). Merger of Times Bank with HDFC Bank was the first of such consolidations after financial sector reforms ushered in 1991 (Devarajappa, 2012). Merger of Bank of Madura with ICICI Bank, reverse merger of ICICI with ICICI bank, coming together of Centurion Bank and Bank of Punjab to form Centurion Bank of Punjab and the recent decision of Lord Krishna Bank to merge with Federal Bank are voluntary efforts by banks to consolidate and grow are few examples (Tamrangudi, 2016).

SBI merger - Five associates and the Bharatiya Mahila Bank became part of the State Bank of India. 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 Bharatiya Mahila Bank (BMB), merged with SBI with effect from April 1, 2017. With this merger, SBI will join the league of top 50 banks globally in terms of assets. SBI first merged State Bank of Saurashtra with itself in 2008. Two years later, State Bank of Indore was merged with it.

The merged entity was expected to have a deposit base of more than INR 26 lakh crore and advances level of INR 18.50 lakh crore. The merged entity was aiming at having deposits worth INR 26 trillion and nearly INR 18.76 trillion worth advances on its books. The bank now has 23,899 branches and an employee strength of 271,765, according to a report. The total customer base of the bank has reached 37 crores with a branch network of around 24,000 and nearly 59,000 ATMs across the country.

Chairwoman, Arundati Bhattacharya stated that the transition process will be concluded in a quarter. She also mentioned that, "The combined entity will enhance the productivity, mitigate geographical risks, increase operational efficiency and drive synergies across multiple dimensions while ensuring increased levels of customer delight."

After the merger, the bank has rationalized its branch network by relocating some of the branches to maximize reach. This has helped the bank optimize its operations and improve profitability .Integration of treasuries of the associate banks with the treasury of SBI has brought about substantial cost saving and synergy in treasury operations.

VII. SBI MERGER – WHY?

It was done to decrease unhealthy competition among Public Sector Banks (PSBs). Smaller outfits will find it increasingly hard to sustain the pace of competition and regulatory mitigation norms. Heavy investments on technology and compliance are needed to change banking environment. After merger, SBI is expected to compete with the largest bank in the world, with an asset base of INR 37 lakh crore, or over $555 billion, with 22,500 branches and 58,000 ATMs. It will have over 50 crore customers. Now, Bank can better focus on defaulters.

Many people had availed multiple finances. With merger, they can be brought under one roof which makes recovery easier.

VIII. CONCLUSION

Mergers and acquisitions are being used as an important strategic tool for survival by many firms as the competition in business arena is very high. Merger is a blessing in disguise as they help revolt against threat of MNCs and they also provide a chance to compete on international scale. If you are struggling to stay afloat, a merger is the best and easiest way to stay balanced. It is economic as it cuts down the expenses by lowering cost of raw material and other requirements as the company procures a larger buying power. The range of services offered and products manufactured increases multifold. Also, a merged company has the privilege of having the best of both the organizations, which means they have a bigger number of smart minds to cope with the short comings of individual companies.

Mergers and acquisitions enable companies to work as one and thus increase their total market value. Before merging the subject, firms must first have to draw significant pre-merger plans and post-merger policies to serve their greater cause (Singh, G., & Gupta, S, 2015). The new firm must have to be fast track, highly responsive to the market's needs and customers' desires.

Like in case of SBI, enthused by the success of SBI merger, the Finance Ministry is considering clearing another such proposal in the public sector banking space by this fiscal end with a goal to create 4-5 global sized lenders. Finance Minister Arun Jaitley has on several occasions said India needs 5-6 banks of global size and scale and further consolidation in the banking sector will be done at the appropriate time.

If M&A is a part of your growth strategy, focus on the emerging culture and brand and carefully shape the new firm. And consider carefully how the merged firm will generate organic growth.

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