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STATUS, PROBLEMS, PROSPECTS AND CHALLENGES FOR BANK MERGERS IN INDIA

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Short Profile

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ABSTRACT:
The paper talks about the existing problems and challenges in the process of mergers of banks in India. In the era of globalization of the market of all sorts of commodities, the world is seriously thinking about the mergers of the banks, but there are lots of problems and challenges in the process. The integration of technology at the time of bank mergers creates problems for all concerned-banks, customers, partners and peers. The target bank may be technologically advanced, but the issue is, whether the current infrastructure can be scaled to meet the demands of combined entity. In fact, several bank mergers have performed lower than expected due to the inability of integrating IT as shown in the example. This, in turn, can lead to lowered customer satisfaction.

KEYWORDS
Status, Problems, Prospects and Challenges .

INTRODUCTION :

It is true that merger process makes a bank to become strong and stronger bank so as to compete in global market but various problems are involved in the process of mergers. These, problems pose serious challenges before the banks involved in mergers. Some of the challenges are:

RECOVERY OF BAD LOANS: Bad debts or the non-performing assets are an important aspect to be considered during any banking consolidation. This definitely has an impact on the performance of the companies. Post merger, it is imperative that this item of the banks is recovered as much as possible which was desired by the acquiring company at the time of going for the merger.

IT IMPLICATION: Technology is an integral part of modern banking system and it is a critical aspect in merger too. Therefore, compatibility of technology platforms of two merging banking units is to be considered carefully prior to the merger. The degree of technology overlap depends upon the IT maturity of the two organizations. The more techno-savvy the organization is, the higher is the redundancy. At the same time, a tech-savvy bank offers greater benefit to the acquirer in the form of a larger pool of technology experts. The major challenge is existing infrastructure of the acquiring bank scaling up to the degree envisaged over a span of 2-3 years. Each bank has its own data centre. By consolidating data centers, an enormous amount of costs can be saved. There could be cases where both banks have different hardware, different networks, different databases vendors, use different technologies for scanning cheques and they may not even speak the same computer language. There are several banks adopting Core Banking Solutions (CBS) and have an IT platform. In India following platform are using by most of the banks:

- FNS: State Bank of India, Allahabad Bank, Bank of Maharashtra, Central Bank of India, Indian Bank.
- Finacle : ICICI Bank, UTI Bank, Bank of Punjab, IDBI Bank, Punjab National Bank, Union Bank of India, South Indian Bank, Karnataka Bank, Bank of Rajasthan, J & K Bank, Oriental Bank of Commerce, Bank of India, UCO Bank, Bank of Baroda, United Bank of India, Vijaya Bank.
- Flexcube: HDFC Bank, Syndicate Bank, Bharat Overseas Bank, Kotak Mahindra Bank, Karur Vysya Bank, Yes Bank.

Indian banks are one of the most technologically advanced with vast networks of branches empowered by strong banking systems, and their product and channel distribution capabilities are on par with those of the leading banks in the world, says a survey by McKinsey. It also reveals that IT effectiveness at the top Indian banks is world class.

The role of Technology:

In a merger process in banking industry about 55% of synergies come from IT. According to the Boston Consulting Group, in typical integration, 20-25% of synergies are direct IT synergy, and an additional 25-30% is IT-enabled synergy, which refers to back-office operations, customer service, finance, risk management, payroll, etc.

The integration of technology at the time of bank mergers creates problems for all concerned-banks, customers, partners and peers. Hence, it is imperative for banks to address the following:

- Inventory systems
- System redundancies
- Platform compatibility
- Integration costs

The target bank may be technologically advanced, but the issue is, whether the current infrastructure can be scaled to meet the demands of combined entity. In fact, several bank merges have performed lower than expected due to the inability of integrating IT as shown in the example. This, in turn, can lead to lowered customer satisfaction.

In 2002, three large Japanese banks merged to form one financial group called Mizuho Financial Group. Though a powerful entity, the group was unable to make their systems compatible before the merger was effected. The result ATM operation froze throughout Japan, causing a lot of frustration to customers. As shown in the figure, IT integration is the most important factor influencing the success of a merger. In India, any merger had to deal mostly with operational, management and cultural issues, as traditionally banks did not have much technology. However, things have now changed with most bank being technologically advanced, implementing centralized banking solutions, and networks. There are a number of centralized banking solutions in the market and banks either have already implemented, or, are in his process of implementing those suitable for their requirements. Also, each bank has its own network architecture. Technology integration, hence, may pose a challenge for future consolidation initiatives. Considering this, the OBC-GTB deal could be termed lucky as they shared the same core banking platform (Finacle form Infosys) as also the ATM switches and hence technology issues were minimal. Though GTB had problems, there were several strengths as well - its strong branch network, robust technology infrastructure, skilled technology savvy workforce, and a wide spread ATM network. While OBC had only 180 ATMs, GTB had more than 400. Geographically as well, GTB was serving in areas where OBC had no major presence, particularly in the south. So, OBC readily got access to markets and customers where it had nil reach .

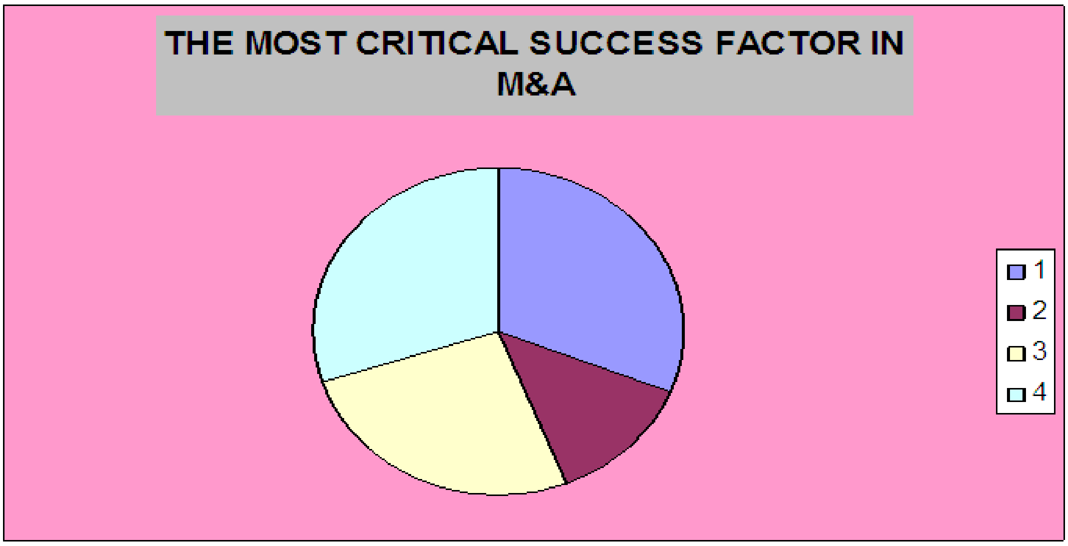
Technology Integration- What needs to be done?

Technology is a major study point when a potential merger is being evaluated. The target bank's systems and their features and functions need to be studied. The systems cost and profitability must be assessed. The acquiring bank can fully utilize business intelligence tools to determine the feasibility of target systems, post merger. The tools will also yield critical data about the system costs and profitability that will help budged operational and capital costs function more accurately after the merger.

In order to understand the best long term Return on Investment (RoI) it is critical to look at the systems of a combined entity, yet technology is not given the due importance in pre merger decisions. The result is that banks are unable to recognize the potential problems in technology integration, thus leading to unexpected expenditure and delays in achieving targets . Hence, It leadership must be involved right at the outset of the deal. Post merger, lead times could be very high; hence it's essential to perform risk assessment and skills assessment of various technologies at the initial stages.

IT integration is the most important factor influencing the success of Merger and Acquisition (M&A) as showing in the figure 1.

Figure 1: The Most Critical Success Factor in M&A



Source: Accenture survey on M&A

1.IT Integration (31%)
2.Internal M&A Merger Integration Capabilities (13%)
3.Cultural Integration (26%)
4.Management and Leadership (30%)

The Success Factors:

There are some factors that are keys to the success of technology integration. These include the following:

•IT operations and applications delivery: How well are the IT operations running and how well can they be integrated? How can applications delivery continue undisturbed?
•Program management: How well are integration and communication modalities undertaken?
•Infrastructure compatibility: Is the target's infrastructure compatible? If yes, integration is easier. If no, what steps are to be taken?
•Pre-close involvement of IT group: when is the IT group to be involved? They must enter the picture at least before the merger deal is finalized.
•Use of Specialized people and/or solutions: Is the bank using some special solutions or consultants to aid the merger and technology integration process?
•Funding of IT integration process: Is the integration activity well funded?
•Cultural integration: How well are cultural differences in IT identified? How are they being resolved?
These are all important in determining the success of the merger deal.

HUMAN RESOURCES ISSUE: Human resources are another sensitive issue in view of consolidation. Any merger leads to a good number of employees loose their job. It applies to Indian banking system also, so it is important to sort out this issue before merger.

As per study of the Indian Banking Industry by FICCI in October 2005, 88% of public and private sector banks considered HRD related issues as one of the biggest challenge in the process of consolidation, while 64% of them voted for Cultural differences as one of the confronting issues. In 2001, about 11% bank employees opted for the first-ever voluntary retirement scheme in the state-run banking industry . The consolidation drive will make more employees redundant. Besides, it will also call for large-scale redeployment of employees. Traditionally, employees in public sector banks are loath to move from one table to another of the same branch. Now the trade unions seem to be willing to allow for employees within a district. Mergers will force them to move one state to another.

As per an ILO report on "The employment impact to mergers and acquisitions in the banking and financial services sector' statistics show that the number of employees laid off could reach 300,000 in few years. It is very important for both parties before coming to an agreement to examine carefully how customers are treated, how the employees are treated and how the bank started concentrating on human issues. Banks mulling mergers must follow the advice given by Jeffrey Sonnenfeld, the human resources guru , "Take at least as much time as you spend with your financial analysts and spend it with your employees. People care about where they work, make them a strategic partner." Different policies, procedures, and culture of two merging companies create stress for the employees. The employees may suffer because of job dislocation, service disruption, etc, HR can handle this kind of situation by playing a strategic role during the deal Employees may agree to these changes based on public interest and look for long-term is the oriental bank of Commerce, a public sector bank, acquiring a employee interest along with the bank's interest, i.e., expanding its branch network in the South and up gradation of technology.

According to the ILO report, M&A is "invariably accompanied by announcements of job reductions, sometimes on a massive scale." It is a well-known fact that whenever bank mergers take place there will be a downsizing. Two Berlin banks, Deursche Bank and Disconto-Gesellschaft, merged in 1929. At that time, they downsized the total staff by one fourth. More than 1.3 lakh finance jobs disappeared from Western Europe in the 1990. Twelve thousand jobs were eliminated in the merger between Chemical Bank and Chase manhattan in 1995. So far at least three lakh finance jobs have disappeared from Europe and the US because of the M & A .

Priority of each bank is different. In case of similar priorities, not much effort will be required and the merger will be good. Cost savings being the common goal of two banks moving towards a merger, the first step they will take after the merger is to adopt the downsizing strategy and the second is cut down their costs. Before implementing the strategy the banks have to adopt a suitable policy to hold on to their best people. They should also agree on which area they should concentrate and how to retain the efficient staff in that specialized area. In 2004, the Bank of America acquired Fleer Boston Financial and spread across 5,700 retail branches serving 35 million customers in 29 states. In every US bank one out of every ten dollars deposited is from the Bank of America. Good aspect of bank mergers is that long-term prospects are positive for full-time equivalent positions. Expansion of employment and rise in real wages occurred because of two major integrations, i.e., brokerage houses and trust companies within the banking sector.

Banks should show confidence in its staff, keep them updated on the merger details before finalizing the deal. Otherwise, it has negative impact on the employees, such as low productivity during the transition period. The details about the merger must be informed to them before finalizing the deal. It will be a shock if employees hear it all of sudden and from other sources. The HR department should be realistic. Another risk is that some good and loyal people may leave during the transition because of culture change. Therefore, HR personnel have to play the catalyst role and provide some breathing space to employees to readjust themselves to the new work culture and perform better in a few months.

1 Downsizing: According to an ILO report, bank mergers affects profitability, increase complexity owing to "reduced job security, increased workloads, anxiety and stress". The report mentioned the shortcomings in dealing with employees, which may affect the overall operations and employee morale. The ILO analysis asserts that "merger implementation involves sensitive management and personnel issues with a far reaching impact on workers' rights" and suggests that there should be a proper communication between the employees and workers throughout the process .

2 Role of HR: HR personnel play a vital role before a banks' merger. Timely communication not only reduces attrition but also succeeds in retaining loyal and talented employees. The banks should address the concern of the affected employees to ensure that they are paid adequate compensation. Generally, branch consolidation takes about three years to make the transition smooth and manageable for both employees and customers . The banks merging have to take frequent feedback from both customers and employees to retain their confidence throughout the integration period. Meeting the employee of both banks and discussing the issues frankly helps in retaining the talented staff.

More than the protection of compensation and benefits, people looks forward to a respectful co-existences, challenging role and responsibilities, significant leadership and a hospitable work ambience, etc. Hence, integration of talents and compensation in the post merger period may not be a cause for much concern for the banks. The following are some of the most common reactions displayed by employees who are involved in a M&A:

1. Loss of identity;
2. Lack of information and anxiety;
3. Survival becomes an obsession;
4. Lost talent; and
5. Family repercussions

3 World-Wide Job Cuts on Mergers:

Mergers are 'invariably accompanied by announcement of job reductions, sometimes on a massive scale." The report cites, conservative estimates indicating that at least 130,000 finance jobs have disappeared in Western Europe as a result of mergers & acquisitions during the 1990s. Employment levels fell by about 5% in the United States during 1984- 1994 resulting from mergers. Chemical Bank - Chase Manhattan merger in 1995 triggered 12,000 job losses, while Bank of America acquisition by Nations Bank in 1998 included lay off 18,000 workers in 2002 .

British banks "reduced their employees by 150,000 and shut a quarter of their total network of branches" between 1990 and 2000. The stronger employment protection laws and traditions in the countries of both France and Germany have helped to restrain job losses in both the countries. It is not out of place to mention the merger between BNP and Paribas, in connection with the fact that the combined bank would abolish 5,7000 posts, including some 3,600 in France .

In German, the unsuccessful merger between Duetsche and Dresdner banks would have caused 6,000 eliminations. In the Scandinavian countries the decline in bank personnel and branch between 1995 and 1999 averaged 30 percent, with a 50 percent fall for Finland. As against that, only 1,285 employees in Switzerland actually lost their jobs."

In Spain, the product of the merging of the country's first and third-ranked banks, BSCH "planned on eliminating about 4,500 jobs between 1999 and 2002", with the first stage of downsizing involving 2,400 voluntary redundancies negotiated with trade unions before the merger. In the Czech Republic, staff numbers in banks have fallen by 42 percent since 1995. A large bank merger in Australia led to a workforce reduction of 28 percent. Merger of two Thailand banks resulted in the 2/3rd lay off of the combined bank's workforce. Brazil has lost 79,000 jobs in banking and financial services during the last decade, while 22,000 jobs disappeared from the Argentine financial services between 1994 and 1999.The Japanese mergers are also expected to result in widespread redundancies, although the companies involved have pledge that cuts would be through attrition rather than lay-offs .

In India, during 2000-01, a large number of employees opted for VRS announced by the public sector banks. Ascertaining the precise number of job losses worldwide is complicated by the fact that official statistics on banking and financial service include an ever-increasing number of workers in a typical employment. Job losses are usually exacerbated by increased use of information and communications technology and outsourcing of functions previously performed by employees.

Human factor and its effective motivation in the framework of implementing mergers & acquisitions are crucial to the success or failure of every relevant undertaking. Hence human resources management is of the paramount need and personnel management with personal touch alone can pave the way. In view of the saturation on the domestic front, banks have to advance globally and capture the market share worldwide, which can be made through strategic alliances and joint ventures, "Sometimes the best strategy can be ruined by poor implementation." Thus, to prevent the impact of poor implementation, the merger strategy should be implemented in true spirit and letter.

Before Merging, Banks would do well to keep the following Checklist:

- Leadership evaluation of both organizations.
- Compare company cultures.
- Identify strengths of the employees.
- Examine benefits and compensation programs and retirement and welfare benefit plan
- Check the human capital infrastructure.
- Look into people and culture issues.
- Take care of leadership and culture integration.
- Emphasize organization structure and design.
- Finally, human capital and deployment integration.

4 Cultural Shift: Every bank has its own culture and some traditional activities. Some banks concentrate on regional-rural development, offering their lending products which will be different from those being offered by other banks concentrating on housing and personal loans. During the process of consolidation, one set of product or business activity of either of the merging banks will be carried out and the products of the other bank will be ignored and neglected. This leads to industrial unrest, deprivation, de-motivation and frustration among the employees. Such de-motivated human capital can never churn out good results. Consolidation needs not necessarily lead to instant favourable and positive results. It is an established fact that there is an incubation period before the occurrence of eventual targets. Mergers also will bring about a change in the quality and mindset and attitude to work of the employees. The voluntary retirement or compulsory retirement in the process of mergers have in particular affected traditional branches and back office jobs. This type of work is mostly carried out by aged employees and women with traditional banking skills. This sensitive issue should be handled carefully and the policy makers have to take care of the turmoil in the process of consolidation and ensure that a strong banking system emerges eventually, characterized by a contented human force. More than any other root cause, cultural differences are blamed for consuming anticipated efficiencies, undermining prospect for value creation. At the same time, these cultural differences are systematically under-valued in pre-deal analysis.

Before a merger is carried out, cultural issues should be looked into. A bank based primarily out of North India might want to acquire a bank based primarily out of South India to increase its geographical presence, but their cultures might be very different. So, the integration process might become difficult. Even if there are synergies in technology, geographical presence and profile of assets, the birth of mega banks through mergers may not be of great use unless the mindset of public sector banks changes. A number of studies have measured the success of banking merger in terms of three important parameters.

- Profitability
- Cost Efficiency
- Market Power

The success of a merger hinges on how well the post-merged entity positions itself to achieve cost and profit efficiencies. It is difficult to rely on measures of economies and diseconomies of scale in banking, whereas cost and profit efficiencies are far more reliable and measurable indicators and create value. Mergers elsewhere in the world have helped reduce operating expenses by 0.5 percent (percent to total assets). That would translate into a few thousand crores of rupees for Indian PSU banks. One other way of measuring the success of the merger can be seen from analyzing the post merger performance to the stated goals before the merger. This way, one can see whether the banks were able to attain their stated objectives, which are important to realize the full synergies of the merger.

According to study conducted by Accenture (Figure 2) some of the factors critical for success of M&A are addressing cultural integration issues, establishing clear organizational structure and accountabilities, having commitment and leadership from top management, having a good communication strategy, developing a comprehensive integration master plan and having a clear strategic rationale for making the deal.

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