International Journal of Research Publication and Reviews, Vol (6), Issue (5), May (2025), Page – 12548-12551

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

Mergers and Acquisitions in Indian Banking Sector

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ABSTRACT :

In the present scenario, merger and acquisitions have become vital for the expansion and development of the Indian banking sector. The M&A strategies contribute to development mainly by reducing operational costs and boosting revenues. M&As have thus become a practical necessity. Bank mergers, especially, are viewed as a strategic approach to reinforce the Indian economy by strengthening the banking infrastructure. In line with these goals, the Government of India is actively executing the policies focused on the consolidation of public sector banks.

This research paper undertakes a critical examination of the different M&As that have taken place within the Indian banking sector. It provides valuable insights into the legal system governing M&As and attempts to clearly define the concept of mergers and acquisitions, along with outlining the legal requirements for a valid M&A transaction in the Indian banking context. The paper offers an indepth analysis of the key legislations that regulate M&As in the sector, and it explores the procedural steps that banks must adhere to during such transactions. It discusses the relevant provisions under the Companies Act, 1956, as well as the Competition Act, 2002. Additionally, the study investigates the concept of anti-competitive combinations and examines the legal mechanisms in place to address them.

It also tried to discuss latest trends and development, like the consolidation of public sector banks and the emergence of large private sector players. This study also highlights the motivations behind these mergers, like progressing operational efficiency, achieving economies of scale, and expanding market reach. It also highlights the role of judicial oversight in ensuring that M&As comply with the legal system, safeguarding stakeholder interests, and maintaining market stability.

Introduction

Over the past decade, M&As have played the major part in transforming the Indian banking sector. These strategic consolidations aim to boost operational efficiency, strengthen financial constancy, and expand client outreach. By pooling their resources, banking institutions can become more competitive, speed up growth, and provide a broader range of services to a more diverse client base. Mergers have mainly been prominent within the banking sector. A number of reforms and successful mergers and acquisitions in the Indian banking industry have greatly contributed to its growth. M&As have become a popular trend across the country, with numerous public sector banks, private sector banks, and other financial institutions actively participating in these activities. These M&A processes are crucial for the banking industry to achieve substantial financial gains, with the primary goal being to enhance economies of scale.[1]

The four anchor banks had to delay certain implementation steps and processes, such as the proposed loan procedures, because of the nationwide lockdown. Despite these delays, the consolidation of banks is expected to strengthen the merged entities by enhancing their capacity for large-ticket lending and improving their competitiveness through increased financial strength. Dena Bank and Vijaya Bank were merged into Bank of Baroda. Earlier still, the government had consolidated five associate banks of the SBI along with Bharatiya Mahila Bank into the SBI. These associate banks included State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Mysore, State Bank of Travancore, and State Bank of Hyderabad, with the merger becoming effective in April 2017.[2] The recent wave of mergers in the Indian banking sector is intended to reinforce the industry by forming larger, stronger banks and enhancing overall competitiveness. Although these mergers have resulted in a decreased number of PSBs, they also offer potential advantages such as achieving economies of scale and enhancing financial efficiency and performance.

In India, corporate M&As are mainly regulated by the Companies Act, 2013, which establishes the procedure and requirements for carried out these transactions. This Act mandates that mergers, demergers, and other forms of corporate restructuring must be approved by NCLT and should adhere to stringent corporate governance standards. Complementing the Companies Act, other key regulations include the Competition Act, 2002 to prevent anti-competitive practices and ensure fair market competition. The SEBI regulation oversee M&As comprising publicly listed companies, ensuring transparency and compliance with disclosure norms. Additionally, the FEMA governs cross-border M&A, focusing on FDI regulations, while the Income Tax Act, 1961, addresses the tax implications of such transactions. Together, these regulations make an inclusive regulatory system that balances market efficiency with legal oversight. Under Section 45 of the Banking Regulation Act, RBI can request a moratorium from the Central Government on a banking company for certain valid reasons. [3]

[1] Bishnoi, Sofia Devi, Mergers and Acquisitions of Banks in Post-Reform India, EPW, Sept 12, 2015

[2] Banking Mergers in India https://groww.in/p/savings-schemes/banking-mergers-in-india

[3] Aparna Menon "A Legal Perspective on Mergers & Acquisitions for Indian BPO Industry", *PSA Legal Counsellors,* 2016

Bank mergers have a substantial influence on the Indian economy. Their success depends on effective execution and robust regulatory oversight, which help ensure stability in the financial sector, improve the efficiency of banking operations, enhance credit accessibility, and promote financial inclusion. Striking the right balance among consolidation and preserving healthy competition is essential to realizing the benefits of mergers without hindering innovation or creating monopolistic tendencies.[4] When managed well, bank mergers can contribute positively to the Indian economy by enabling inclusive development and driving sustainable growth through the combined strengths of the merged entities while addressing potential challenges.

Statement of Problem

Because of the varied nature of banks and their respective governing regulations, there is a lack of uniformity in the laws and procedures surrounding M&A in the banking industry. For example, the 2018 merger of IDFC Bank and Capital First faced substantial delays in obtaining regulatory approval because of a lack of uniformity in the regulations governing the transaction. The process involved multiple regulatory bodies, including the RBI, SEBI, and the National NCLT, each with distinct requirements and timelines. This lack of coordination and clarity among the regulators led to prolonged approval processes, complicating the merger and creating uncertainty for stakeholders involved in the transaction. Additionally, the existing legislation governing bank mergers in India is primarily used to rescue struggling banks. Establishing uniformity in the regulations for bank mergers would promote M&A activity in the sector, ensuring financial stability and protecting the interests of depositors. Furthermore, the Banking Regulation Act, 1949 does not have a specific provision for the amalgamation of banking companies with NBFCs. As a result, the authority to approve the amalgamation scheme lies with the court. However, if the transferee is a bank, the RBI should be the authority to sanction such M&As.

Objectives of the Study

- To analyze the legal system related to M&As in banking sector in India
- To analyze the motivation behind the mergers of Indian banking sector
- To explore the issues and synergies arising from recent M&As among Indian banks
- To analyze the effectiveness of the existing legal system in facilitating smooth and transparent mergers in the Indian banking industry.

Scope

In the corporate sector, the study explores how M&As serve as a tool for achieving growth, market expansion, cost efficiency, and diversification. The research will examine the primary motivations for M&As, such as increasing market share, accessing new technologies, and improving competitive positioning. By evaluating the financial performance before and after the merger, the study aims to identify key indicators of success, such as profitability, return on equity, and revenue generation. In the banking sector, the study delves into the specific role that M&As play in strengthening the financial stability and competitive position of banks. The research will assess how M&As in the banking industry help banks achieve economies of scale, expand their customer base, improve capital adequacy, and meet regulatory requirements. This study examines the regulatory environment that governs M&As in both sectors, including the role of authorities like the RBI SEBI for corporate M&As.

Motives behind Mergers and Acquisitions in India

Economies of Scale: This concept refers to the ability of a merged company to reduce fixed costs by eliminating duplicate departments or operations. As a result, the company's overall costs decrease while maintaining the same revenue stream, leading to higher profit margins.

Strengthening Financial Position: One of the key drivers behind bank mergers in India is the pursuit of enhanced financial stability. By uniting banks that possess complementary strengths, the resulting entity can benefit from a stronger capital base and improved resilience to financial shocks. This consolidated structure contributes to building a more robust institution that is better equipped to comply with regulatory norms, support greater credit disbursement, and navigate economic fluctuations with greater ease.

Increased Revenue or Market Share: Market share is the proportion of a market (measured by units or revenue) that a company holds. The idea here is that by acquiring a competitor, the buyer can increase its market power and expand its market share, thereby gaining the ability to set prices more effectively.[5]

Positive Synergies: The primary objective of a merger among two organizations is to generate a combined outcome that surpasses what they could achieve individually. This synergy typically includes two key aspects: cost synergy and revenue synergy. Following a merger, weaker-performing banks have often managed to sustain themselves and broaden their branch presence across different regions.

Expanded Customer Base: Mergers lead to a larger market share and improved outreach, especially in rural areas. In order to remain competitive in the global banking landscape, banks need to enhance their infrastructure, minimize internal competition, ease overcrowding in the sector, and make better use of previously underutilized resources.

Taxation: A profitable company may acquire a loss-making company to take advantage of the target's losses by reducing its own tax liabilities. However, in the United States and many other countries, regulations are in place to prevent profitable companies from specifically seeking out loss-making companies for this purpose, thereby limiting the tax benefits for the acquiring company. In light of the Supreme Court's decision in Mc Dowell

[4] Aditya Kumar (2023). Impact of Merger on Efficiency, Stability, and Competitiveness of Public Sector Banks, *JCLP* (2023)

[5] Jay Bhavesh, Understanding Legalities - Mergers, Acquisitions and Combinations, ICSI, 2023

and Co. Ltd. v. Commercial Tax Officer[6], such a provision is required if it is proven, the amalgamating company that benefited from the merger must be fined an amount equal to or greater than the amount of tax avoided as a result of the merger and the court in this case also slammed tax evasion with colourable tax planning devices in his decision.

Enhanced Risk Management Capabilities: Merging banks can lead to significantly improved risk management through the pooling of expertise, systems, and resources. The integration of risk assessment and mitigation systems allows for more comprehensive oversight of various risk categories, including credit, market, and operational risks. By leveraging the most effective practices from each merging entity, the new institution can establish a more streamlined and efficient risk governance structure.

Law dealing with M&As in banking sector in India

Mergers And Banking And Regulation Act, 1949

The Banking Regulation Act of 1949 was enacted to provide a dedicated legal system specifically for the regulation of banks. Prior to its introduction, banks operated under the Indian Companies Act of 1913. This comprehensive legislation introduced minimum capital requirements to prevent bank failures and curbed excessive competition by regulating the establishment and location of bank branches. As a result, the B.R. Act has played a crucial role in ensuring the balanced growth and proper functioning of financial institutions, while also safeguarding the interests of customers.[7] The key provisions of the Banking Regulation act are:

Section 6 of the Banking Regulation Act outlines the types of business activities that banks are legally permitted to engage in, including lending and borrowing of funds, issuing bonds, and conducting various forms of guarantee and indemnity-related transactions. However, Section 8 of the Act strictly prohibits banks from directly or indirectly participating in any agreements involving the buying, selling, or trading of goods.

According to Section 9, banks are not allowed to hold immovable property for more than seven years if it has been acquired for the purpose of recovering debts or obligations. The RBI holds the authority to extend this time limit if necessary.

Sections 17 and 18 mandate that banks allocate a portion of their post-tax and post-interest earnings to a reserve fund. Specifically, a minimum of 20% of such net profits must be transferred to reserves, and banks are also required to maintain at least 3% of their total demand and time liabilities as cash reserves. These reserves must either be held in cash or maintained in current accounts with the RBI. [8]

The Banking Regulation (Amendment) Ordinance, 2020 was announced on June 26, 2020. This Ordinance aims to amend the Banking Regulation Act, 1949, which governs the functioning of banking institutions. It addresses various aspects such as licensing, management, and operational procedures of banking companies. .

Companies Act, 2013

The Companies Act, 2013 provides a comprehensive legal system for mergers and acquisitions (M&As) in India, incorporating modern principles of corporate governance and procedural requirements. Sections 230 to 240 of the Act outline the process for M&As, including schemes of arrangement and compromise among companies and their creditors or shareholders. Under Section 230, companies are empowered to propose such schemes, which must be approved by NCLT. This process requires thorough approvals from shareholders, creditors, and the NCLT to ensure transparency and fairness.

Moreover, the Act includes provisions to protect the rights of minority shareholders and monitor the financial aspects of M&A transactions. For instance, Section 236 deals with the acquisition of minority shares by majority stakeholders, while Section 234 permits cross-border mergers, signaling India's openness to global business integration. The Act also mandates the appointment of independent professionals to conduct objective valuations and provide fairness opinions, thereby reinforcing the legal and ethical system governing M&A activities.[9]

Merger And Competition Act, 2002

The Competition Act, 2002 plays a vital role in regulating India's evolving business landscape, with Section 5 being particularly significant in overseeing mergers and acquisitions (M&As). This section defines the term "combination" and sets financial thresholds that trigger mandatory notifications for mergers, acquisitions, or amalgamations. A combination may involve the acquisition of one or more enterprises or the merger of entities that exceed the prescribed financial limits. The primary objective of Section 5 is to prevent anti-competitive outcomes by empowering the CCI to scrutinize such transactions and ensure they do not cause an appreciable AAEC in the relevant market.

Judicial Approach

In the case of Davis Kuriape v. Union of India[10], the Court examined the extent to which judicial review is permissible under Section 45 of the Banking Regulation Act, particularly in relation to amalgamation schemes. The Court clarified that the scope for judicial interference is extremely limited. Specifically, when RBI exercises its authority under the second proviso to Section 45(5)(i) to resolve issues concerning the equivalence of experience among employees of the merging banks, the High Court, while exercising its writ jurisdiction, cannot function as an appellate authority over such

[6] McDowell & Co Ltd vs Commercial Tax Officer 1986 AIR 649, 1985 SCR (3) 791

[7] Geethanjali Nataraj, "Banking Sector Regulation in India: Overview, Challenges and Way Forward", *IJPA* (2018)

[8] Debabrata Dash, A Report On Legal System Governing Banking Sector, IJLLR (2022)

[9] Jay Bhavesh, Understanding Legalities - Mergers, Acquisitions and Combinations, ICSI, 2023

[10] ILR 2002(1) Kerala 311

decisions. The Court emphasized that determining the comparability of experience in different banking institutions involves complex technical judgments. Since the Reserve Bank possesses specialized expertise in banking matters, it is best suited to assess such issues. The High Court, lacking the necessary technical competence and domain-specific knowledge, is not in a position to second-guess the decisions of the Reserve Bank on such nuanced and specialized matters.

In Religare Finvest Ltd v. State of NCT of Delhi[11] The Court considered whether the transferee bank in a merger could be held criminally liable for offenses committed by the officials of the transferor bank before the merger took place. Based on the particular facts and context of the case, the Court ultimately held that such liability could not be imposed on the transferee bank. According to Section 242(3)(c)[12], NCLT has the authority to decide whether ongoing legal proceedings involving the transferor company can continue against the transferee company following the merger. In contrast, Section 45(5)(e) gives the RBI the power to outline in the amalgamation scheme the procedure and extent to which legal proceedings may continue against the transferee bank.

Conclusion

Fundamentally, M&As including two or more companies have the potential to result in successful business consolidations. In India, the processes of M&As are legally addressed and administered by the Companies Act, 2013. For any company seeking to merge with or acquire another, it is obligatory to remain to the specific procedures outlined in this legislation. The success or failure of an M&A deal largely hinges on the strategic planning and execution by the companies involved, which determines whether the outcome will be profitable or lead to losses.

India has witnessed different judicial precedents that demonstrate its active engagement and progress in the field of M&As, comparable to international practices. However, despite the opportunities M&A presents, it remains a complex and potentially risky undertaking. Problems may arise in areas like organizational management, operational integration, and cultural alignment. Nevertheless, mergers and acquisitions continue to play an important part in driving economic expansion, particularly within the banking sector, both domestically and at the international level.

To conclude, navigating the legal landscape of M&A transactions in India requires careful consideration of various legal and regulatory aspects to ensure compliance, mitigate risks, and facilitate successful transactions. Seeking advice from legal experts and conducting thorough due diligence are essential steps in the M&A process to achieve the desired outcomes and create value for all stakeholders involved.

It is obvious that dealing risks and doing enough due diligence is a severe business that must begin with an appropriate policy and plans. Due diligence work as risk assessment and it weigh the benefits and drawbacks related to the purchase apparent to the buyer. Organizations and their advisors require to cautiously examine all aspects of the due diligence processes because well managed due diligence is a vital part of successful merger transactions. A well managed and capable team must be formed to identify that the risks related to the transactions.

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[11] 2023 INSC 819

[12] Section 242(3)(c) of the Companies Act 2013