Mergers: A Case Study of Forceful Merger of Global Trust Bank with Oriental Bank of Commerce

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Abstract

Mergers and Acquisitions in the Indian Banking Sector are going to be the order of the day. India is slowly but surely moving from a regime of 'large number of small banks' to small number of large banks'. Clearly, therefore from the point of view of financial system, consolidation of banks is imperative. The objective would be strengthening of banks, economies of scale, global competitiveness, cheaper financial services and retaining of employees for merging skill sets. Consolidation will provide banks with new capabilities, technologies and products, help to overcome entry barriers, ensure immediate entry into new markets and lower operating costs through consolidation of resources. In India history of Mergers is as old as formation of Imperial Bank of India y merging Bank of Bengal, Bank of Bombay and Bank of Madras in 1921. Mergers in public sector mainly took place primarily to protect the interest of depositors of weak private banks like, Hindustan commercial Bank faced the moratorium in 1988 and was merger with PNB. Another example of merger is merger of Global Trust Bank with Oriental Bank of Commerce. In this moratorium, government imposes a freeze on the bank's liabilities so that bank is not able to grant any loan or advances, incur any liability, make any investment or disburse any amount.

1. Introduction

Mergers and Acquisitions in the industrial and service sector have brought new life to the style of doing business in today's world. Globalization, technological changes, market deregulation and liberalization have driven the M&A wave across the world. Banking sector is also moving along this wave. As the existence of too many banks result in the paradox of low profitability per customer for the banks and higher pricing for the customers. Clearly, therefore, from the point of view of financial system, consolidation of banks is imperative. The objective would be strengthening of banks, economies of scale, global competitiveness, cheaper financial services and retraining of employees for merging skill sets Consolidation will provide banks with new capabilities, technologies and products, help to overcome entry barriers, ensure immediate entry into new markets and lower operating costs through consolidation of resources. In India history of Mergers is as old as formation

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of Imperial Bank of India y merging Bank of Bengal, Bank of Bombay and Bank of Madras in 1921.

Few mergers have taken there after mainly in the public sector primarily to protect the interest of depositors of weak private banks like early 1990’s Karur Central Bank in Kerala was merged with Bank of India, Hindustan commercial Bank faced the moratorium in 1988 and was merged with PNB, Bank of Tharur in Tamil Nadu in the late 1980s was later merged with Indian Bank, Nedungadi Bank in 2002, which was later merged with Punjab National Bank. However the Times Bank merger with HDFC Bank a few years back and bank of Madura with ICICI Bank portend a new wave of consolidation in the banking industry for mutual benefit. The merger in these cases sought to attain critical size. Another example of merger is merger of Global trust Bank. In a moratorium, government imposes a freeze on the bank’s liabilities so that bank is not able to grant any loan or advances, incur ay liability, make any investment or disburse any amount. The purpose of the paper is to examine the mergers and acquisitions in Indian Banking sector and know the rationale behind mergers. The paper is based on secondary data which is drawn from various journals and magazines, newspaper articles, websites, annual reports of banks and books.

2. Case Study of Forceful Merger of Global Trust Bank with Oriental Bank of Commerce

Global Trust Bank popularly known as GTB is India’s first new generation private sector bank established its business after obtaining RBI license in the year 1990. It was started with stringent capital adequacy standards of atleast [1] 100 crores to begin with and a technology platform that even foreign banks did not have and above all on a clean slate. The most striking feature of GTB is that it is typically a symbolic new generation private bank that came with the financial liberalization of the 1990s. It was offered permission to enter the industry with the intention of increasing competition, improving efficiency of operations with new technology, offering better services to the customers and in the process to be a model against low-profit public sector banks.

Before RBI moratorium it was working with 103 branches and 276 ATMs having more than 8.5 lakh customers. As on 30-06-2004, Indian promoters of GTB held a 19.28% stake while the Indian Public held a massive 51.28% stake in GTB.

It is one of the largest private banks placed under RBI moratorium.

Table: GTB Merger Equation

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Non Performing Loans	4.9	Branches	88
Net worth	11.0	Total GTB outlets	104
Gross Acquisition Cost	15.9	ATMs	396
Tax Benefit	3.9	Deposits	51,877
Net Cost	12.0	Customer Base	1mn

Reasons for Imposing RBI Moratorium on GTB

- The bank's net worth was wiped out two years ago under the weight of bad debts. These non performing assets were the outcome of large, indiscriminate and dubious loans advanced to companies, which included garment exporters, diamond traders and stock brokers in Mumbai and Hyderabad.
- The bank is said to be saddled with bad loans of anything between ` 1,200 and ` 1,500 crore. Its equity share capital and reserves stood at just ` 300 crore.
- GTB's audited balance sheet for March 31, 2002, showed net worth of ` 400.4 crore & a profit of ` 40 crore. However, RBI inspection revealed that it's networth was negative.
- To overcome the varied conclusions, a independent chartered accountant has been appointed to reconcile and state the actual financial position of GTB. On reconciliation, RBI assessment is proved to be correct. As a step further, RBI positioned GTB with certain directions relating to certain types of advances, certain premature withdrawal of deposits, declaration of dividend and its capital market exposure. It also started monitoring GTB on monthly basis.
- In view of the need to complete the statutory audit and to assess the steps necessary to be taken on the future set up of the bank, RBI permitted GTB, time up to Sept 30, 2003 to publish its annual accounts. Accordingly, GTB announced that as on March 31, 2003 it's deposits were ` 6,921 crores and advances (loans) of ` 3,276 crores. On its balance sheet, it showed gross nonperforming assets of ` 916 crores while total provisions (against bad loans) were ` 268 crores. The capital market exposure is ` 156 crores and its capital adequacy ratio was negative (-0.07%) much below than the required 9%.
- RBI's inspection showed that bank's net worth was further eroded and capital adequacy ratio (CAR) was negative. On November, 2003, GTB was advised to take immediate steps to infuse fresh capital to restore its CAR to 9% and indicate a time bound programme. Bank was also advised to explore options of raising capital through domestic sources or through merger with another bank.

Accordingly in July, 2004 GTB came out with a proposal to raise its capital by infusing fresh equity from Newbridge Capital, a private equity investor, which is prima facie rejected by RBI because the suggestions and bailout package conditions imposed by the private investor proved to b unreasonable or unacceptable as per the RBI guideline. Further, the RBI declared that the guidelines for equity participation by foreign investors were already in existence at the time of submission of application for approval by GTB and that the new set of proposed guidelines had not been invoked. Earlier Centurion Bank was successful in getting RBI permission for Sabre Capital of Rana Talwar to infuse capital to bail out from it's financial crunch but GTB failed in its attempt to get RBI permission for infusion of capital from NewBridge Capital and to get it restructured.

- To protect the interest and safety of funds of depositors of GTB, RBI imposed three months moratorium on it from 24/07/2004 to 23/10/2004. During the period of moratorium the bank is not allowed to carry on any of its operations- taking deposits or rendering loan till a solution to reconstruct the bank is obtained by RBI. This was the move taken in consultation with the Finance Ministry and after the bank failed to come up with a viable proposal for raising additional capital. Infact, the Finance Ministry declared that the RBI's move was only a temporary one aimed mainly to protect the interests of depositors and to utilize the period of moratorium to work out a long-term solution.

Steps taken by RBI during Moratorium on GTB

- Towards moratorium on GTB, the RBI has appointed three directors- Regional Director of RBI, Hyderabad, former General Manager of Bank of Baroda and a Deputy General Manager of RBI- on the GTB board to monitor the activities of the bank.
- RBI provided some relaxation to the depositors by allowing them to withdraw from their deposits an amount up to ` 10,000 only through the bank's branches and not from the bank ATMs. ATMs' remained disabled throughout the moratorium period.
- Within 48 hrs of declaring moratorium on GTB, RBI announced that GTB is to be merged with the financially strong public sector bank- Delhi based Oriental Bank of Commerce with effect from August 14, 2004. OBC was the bank with zero NPA (Non Performing Assets). The record date for GTB-OBC merger has been fixed at August 31, 2004.

Salient Features of Scheme of Merger

- All types of deposit accounts of GTB shall be transferred to OBC.
- GTB depositors shall receive the same rate of interest on their deposits as offered by OBC to its depositors.
- Every saving bank account, current account or anyother deposit account, including fixed deposit, cash certificate, monthly deposit, deposit payable at call or short notice with GTB, shall be transferred to OBC on the prescribed date in the name of the respective account holders, crediting the full amount including interest to the extent payable under the scheme.
- All assets and liabilities of GTB will be transferred to OBC.
- All assets and liabilities of GTB shall be transferred to OBC after proper valuation is done. Investments other than government securities shall be valued at market rates.
- All realizable assets of GTB shall be set aside in a separate Asset Account Escrow Account which would be used to meet all the outstanding liabilities of the troubled bank GTB. In case

any surplus is left over in the Asset Account, the same be distributed on pro-rata basis to the equity shareholders of GTB after 12 years or on an earlier date specified by the govt after consulting the RBI for this purpose.

- The entire amount of the paid up capital and reserves of GTB shall be treated as provision for bad and doubtful debts and depreciation in other assets of OBC.
- OBC shall call upon every person who was, an on the prescribed date, registered as the holder of an ordinary share of the bank or would have been entitled to be so registered, to pay within three months from such date or dates as may be specified, the uncalled amount remaining unpaid by him in respect of such share or shares and the calls in arrears, if any.
- OBC shall take all available steps considering the circumstances of each case of equity holders to demand and enforce the payment of the amounts due with interest at six per cent per annum for the period of the default.
- GTB's books shall be closed and balanced and the balance sheet prepared in the first instance as at the close of business on July 24, 2004 and thereafter at the close of business on the date immediately preceding the prescribed date. The balance sheet shall then be audited and certified by a chartered accountant or a firm of chartered accountants, approved or nominated by the RBI for the purpose.
- GTB Advances will be scrutinized by OBC and the securities held a s cover examined and verified. Thereafter the advances, including portions thereof, will be classified into two categories – 'advances considered good and readily realizable' and 'advances considered not readily realizable and/or bad or doubtful of recovery'.
- With respect to 'advances considered not readily realizable and/or bad or doubtful of recovery' or 'which are or may be realizable wholly or partly' after the prescribed date, OBC shall take all steps to demand and enforce payment, and may enter into a compromise or arrangement with the debtor or any other person, or write-off any such debt or asset, or sell or otherwise dispose off any securities transferred to it or any other asset taken over by it.
- OBC can take all steps to demand and enforce the payment of amounts, if any, awarded as damages by the high court against any promoter , director, manager or any other officer of GTB under relevant sections of Banking regulation Act and the Companies Act.

Employees of GTB

- All GTB employees shall continue in service with OBC.
- GTB employees (1300) old employees shall be deemed to be appointed in OBC at the same remuneration and on the same terms and conditions of service applicable immediately before

the close of business on July 24, 2004.

- GTB employees salaries shall be protected even after it being amalgamated into OBC for a maximum period of three years.
- Before the stipulated period, salary levels be aligned at both the banks depending upon qualification and experience of the employee.
- GTB employees who have their intention not to continue to be the employees of OBC shall at any time by notice in writing before the expiry of one month following the prescribed date, shall be entitled to compensation under the provisions of the Industrial Disputes Act, 1947 and pension, gratuity, provident fund and other retirement benefits as may be ordinarily admissible under the rules or authorizations of the bank as in force immediately before the case of business on July 24, 2004.

Shareholders of GTB – The Ultimate Losers in GTB-OBC Merger

OBC has ruled out any share-swap on GTB- OBC merger. The merger of GTB and OBC without a swap ratio for shares implies that current GTB shareholders will be left with zero value for their investments. The GTB equity shareholders shall not get any value for their holding now but they can expect some relief only after 12 years that too if the troubled bank is left with any surplus value.

Benefits to OBC

Financial Year 2004	OBC	GTB	Total
Branches	1013	104	1117
ATMs	72	275	347
Employees	13602	1300	14902

- GTB's latest computer systems and wide coverage of ATMs would help OBC jumpstart its own efforts to introduce cutting edge banking technology and solutions.
- The total balance sheet size of OBC surged by about 20% to ` 65000 crore after the merger of GTB. It also gains approximately ` 300 crore worth of fixed assets of GTB. On the flip side, GTB's non-performing assets of ` 9,000 crore would be adjusted against OBC's assets.
- Besides the fiscal issues, the bigger challenge would be human resource management and operation integration. OBC will retrain the staff of GTB to enable them to carry out lending activities at branch level and attain three times more business from the acquired unit.

Conclusion

The forced merger of Global Trust Bank, a pioneer private bank of new generation with Oriental Bank of Commerce revives the debate for a transparent and uniform policy towards ailing sick banks in private sector including cooperative sector. It is true that Deposit Insurance and Credit Guarantee Corporation with its fragile capacity would not be able to meet the depositors interests on even a portion of insured deposits. GTB episode has once again exposed the vulnerability of banking companies who would conveniently divert the depositor's money to seek their own ends. Reserve Bank's delayed surveillance over the weaker banks and deficiencies in audit and inspection of affairs of banks as in GTB episode pose serious concerns on the safety and soundness of banking system.

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