Business Standard

Decoding govt's move to amalgamate Bank of Baroda, Dena Bank, Vijaya Bank

The recent announcement by the government to go in for an amalgamation of three public sector banks raises several legal/regulatory issues. Sudipto Dey explains the key implications

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Illustration: Ajay Mohanty

What are the key differences between a merger and an amalgamation?

Often, the terms ‘merger’ and ‘amalgamation’ are used interchangeably.

However, experts point out that a merger refers to a corporate restructuring activity of two or more companies into a single company, whereby the identity of some of the companies gets dissolved. Amalgamation, on the other hand, is a wider concept than ‘merger’, they add.

Under the Companies Act, 2013, there are two kinds of mergers — ‘merger by absorption’ and ‘merger by formation of a new company’, points out company secretary Gaurav Pingle. In the case of ‘merger by absorption', the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company.

In the case of 'merger by formation of a new company', the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company.

Under accounting standards, in amalgamations which are in the nature of 'merger', there is a pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of the companies, points out Pingle.

In amalgamations in the nature of 'purchase', one company acquires another company and, as a consequence, the shareholders of the company that is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued.

What were the reasons for the government going for an amalgamation in this case, and not a merger?

According to Ashvin Parekh, managing partner, Ashvin Parekh Advisory Services, the term amalgamation signifies placing two or more companies of same size or stature together. "Merger in some form would connote an acquirer and one or more entities being acquired. In this case, the term amalgamation has been carefully used to ensure that there isn't feeling of difference when integration is carried out," he says.

Most experts feel that as there is a pooling of assets, liabilities, shareholders' interest and the business of the banks, 'amalgamation' may be preferred over 'merger'.

From the perspective of the banks involved, who stands to gain, who loses?

All of them could stand to lose if the desired synergies are not achieved, say experts. "The answer also lies in the swap ratios. It would be very unfair to the amalgamating banks if the valuations are done without a thorough due diligence," says Parekh.

Announcing an amalgamation is the first step. "The development of a scheme of amalgamation with proper objectives and business plans, of the nature of a red herring statement is essential to evaluate whether the effort rendered the visualised outcome," adds Parekh. More importantly, the stakeholders who are responsible for the outcomes should be adequately incentivised or punished based on the results, say experts.

The government's pitch has been that the combined entity will benefit from the amalgamation. Gross NPAs for the combined entity have started declining and the cost-to-income ratio of the combined entity is better than the PSBs' average. The capital adequacy ratio is significantly above the regulatory norm.

For the combined entity, the larger distribution network will help reduce operating and distribution costs.

Where does it leave the minority shareholder?

Hypothetically, they benefit or lose, based on the swap ratios and thereafter in the performance of the merged entity, says Parekh.

"Minority shareholders of the larger and better performing bank will of course lose while those of the poorer performing bank will gain," says Avimukt Dar, partner, IndusLaw. Dar is of the view that such decisions encourage speculative investment in banks that are not doing well on the basis that there will be a rescue package eventually.