MERGER OF GTB WITH OBC

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Abstract

Strengthening the banking system has been one of the central issues facing emerging markets and developing economics. In India, the banking industry is currently in a transition phase. On the one hand, the PSBs, which are the mainstay of the Indian Banking system, are in the process of shedding their flab in terms of excessive manpower, excessive non Performing Assets (NPAs) and excessive governmental equity, while on the other hand the private sector banks are consolidating themselves through mergers and acquisition. However there had been a few hiccups for these new banks with many either being taken over or few other s finding the going tough. This case is aimed at finding out the strategic issues that led to the merger of Global Trust Bank, a private sector commercial bank in OBC. GTB was facing several problems including asset-liability mismanagement, inadequate growth in good assets and income to cover the bad assets, heap of non-performing assets, reckless lending to stockholders treading the risky edge of the capital market, negative capital adequacy ratio and eroded net worth. Taking into account the interests of the millions of depositors of GTB, as well as the bank's strengths and weaknesses. Reserve Bank of India declared the amalgamation of GTB with OBC. This case will analyze the pre and post merger position of OBC with the intention of finding out the effect of merger on OBC. The case will also deal with issues and problems with regard to strategy, operations and HR, as faced by OBC.

Keywords: *Non-performing Assets, Capital Adequacy Ratio, Transparency and Regulatory Authority, Merger, Strategy, Economics of Scale.*

Backdrop

Around 3 p.m. on Monday, 26 July 2004, B.D. Narang, chairman and managing director of Oriental Bank of Commerce (OBC), took time off from chatting with journalists in his office to answer a call from finance minister P. Chidambaram. "You have cooled the market" the FM told him. Narang seemed enthusiastic in answering these calls. Earlier that day, the Reserve Bank of India had announced the merger of Global trust Bank (GTB) with OBC. To every reporter who came to him, Narang commented that the merger would be in favor of OBC's shareholders and they would gain enormously from this OBC's share price was up almost 4 percent by the close of the day.

The shareholders of GTB have been suffering from long as they had lost over 94 percent on their investment since 2001. The announcement of this merger was the final low in a story which began in early 2001, when a proposed merger with UTI Bank fell a part after speculation in the press that GTB's stock price was being ramped up ahead of the merger. GTB's shareholders would have gained enormously, had that merger none through. But now, they were facing the prospect of GTB shares becoming worthless.

In all the previous cases, RBI's intention behind the merger of the sick banks with healthy bank has been to protect depositor's interests. Shareholders, however, have generally been the losers. Narang, in his address, assured GTBs stakeholders' that their interests would be looked after. This move by OBC came in the wake of the RBI composing a moratorium in order to prevent a run on the GTB after the banking regulator found some irregularities in the bank, whose net non-performing assets stood as high as 19 percent of the net advances. The apex bank had finalized that the moratorium would be inclusive of October 23, 2004 or an earlier date, until an alternate arrangement was made. The depositors were permitted to withdraw upto Rs 10,000 from their savings bank or current accounts or any other deposit account through any of the branches of the bank. All ATMs were disabled. The bank was ordered not to issue any new loans without central bank permission. D-mat accounts and Safe Deposit lockers of customers were allowed to be operated as usual. However, the Central Bank assured that any requirement of cash at the branches of the bank for making permitted payments will be met in full by the RBI, since cash balances were maintained with it by the GTB. RBI maintained that this was a standard way of preventing large depositors from withdrawing their funds. If there would have been large withdrawals from GTB, when its value as an acquisition target would have slumped. Also, such moratorium on withdrawal of money was not the first of its kind. Similar moratoriums were imposed by GTB in Nedungadi Bank's merger with Punjab National Bank, Lakshmi Commercial Bank's merger with Canara Bank, to maintain a few.

Countdown to Collapse of Global Trust Bank (GTB)

GTB commenced operations in 1994. Although the banking license was granted to Mayanta Madhab, who was associated with the Asian Development Bank (ADB), to public image of the bank had always been associated with Ramesh Gelli. Gelli was a former executive at Vysya Bank and he played a key role in mobilizing funds when this ecunderabad-based bank started its operations. In media circles Gelli acquired the reputation of being a "Super banker". Not surprisingly, Gelli quickly attracted controversy.

The bank had been hit by periodic bouts of reckless lending. It was in 1997-98 that the initial problems surfaced after revelations regarding the risky advances made to small and medium-sized corporate. The beleaguered bank, instead of adopting a more conservative approach to banking, actively fuelled the Ketan Parekh-led Bull Run in the stock market between December 2000 and March 2001. In September 2001, while investigating the role of the GTB in the stock scam, the Joint Parliamentary Committee (JPC) observed that the bank was guilty of not monitoring the end-use of the funds that it lent. After deposition by GTB's top officials, the chairman, S.P.M. Tripathi, told reporters that the bank should have acted because JPC members felt there was :definite evidence of misappropriation" of funds. Depositions by bank officials before the JPC confirmed SEBI's finding of diversion of funds lent by GTB to several companies, among them Ketan Parekh-linked companies, Zee Telefilms and Himachal Futuristic Communication Ltd (HFCL).

GTB's association with Ketan Parekh had two versions. The more charitable view regarded GTB as a recklessly playing, high-stakes gambler. The less sympathetic view was that GTB acted as the fulcrum for Ketan Parekh's transactions in the market. This version is backed by the claim that Ketan Parekh's corporate associates, their investment companies and his network of numerous investment firms had accounts with GTB. The JPC proceedings also revealed the tremendous velocity with which funds were transferred among these entities, often within a day. Instead of being guided on the basis of business potential in their sectors of operation, GTB's lending to corporate groups was dictated by the logic of the stock market. The shares of companies such as Zee Telefims and HFCL were Ketan Parekh favorites. GTB would lend money to Ketan Parekh and he would drive up share prices for these companies, in turn. The decline in the share prices due to market crash resulted in a gaping hole in the banks' balance sheet. In 2001, when GTB was attempting a merger with UTI Bank (which also attracted controversy), GTB lent more than Rs 800 crores. However much of the lending proved injudicious.

After JPC's revelations regarding the harmony between Gelli and Ketan Parekh, the RBI had asked Gelli to step down as the chairman of the bank. The JPC found that Gelli and other promoters of the bank colluded with Ketan Parekh so as to push up GTB's share price. The promoters would have benefited directly from this merger as the price of the GTB share would have been a key variable in determining the terms of the proposed merger. However, the observations and comments of JPC proceedings were so strong that the deal fell apart. Then reports indicated that Gelli's successor quite after six months because Gelli and his supporters in the bank hampered him. Further, Gelli's son was elected to the bank's board. In fact, Gelli managed to re-enter the board in February 2004 but had to resign again when several complaints were made to the RBI about his induction.

A bank in trouble could have chosen either to implement a course correction or to indulge in window-dressing. From the GTB fiasco, it is evident that the management preferred the latter course. For instance, the RBI, during the course of its inspection of GTB's accounts for 2001-02, found that GTB's net worth had turned negative. This was in sharp contrast to the claim of the bank's management that its net worth was about Rs 400 crores. In view of very large variance in the assessment of GTB's financial position as reported by auditors and by RBI's inspectors, an independent chartered accountant was appointed to reconcile the position. GTB was placed under directions relating to certain types of advances, certain premature withdrawal of deposits, declaration of dividend and its capital market exposure. RBI 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. On March 31, 2003, GTB announced deposits of Rs 6,921 crore and advance (loans) of Rs 3,276 crore. On its balance sheet, it showed gross non-performing assets of Rs 915 crore while total provisions (against bad loans) were Rs 268 crore.

This development made RBI appreciate the decision and move taken by GTB and its board for cleaning up the balance sheet. RBI commented that even though the financial statements showed an overall loss, the bank had made an operating profit for the year 2002-03. RBI's report after further inspection was not as positive as it showed that bank's net worth had further eroded and capital adequacy ratio (CAR) was negative.

In fact, the central bank removed the bank's auditors and made a complaint to the Institute for Chartered Accountants of India about Lovelock and Lewes-

GTB's auditors for 2001-02. GTB's new auditors, PricewaterhouseCoopers, heavily qualified the balance sheet of year 2002-03. PwC has submitted its eligibility for reappointment for 2003-04. It was not reappointed by GTB but neither did the latter complain to the Institute of Chartered accounts of India. ICAI saw it sufficient to act on the basis of complaints as it had now shot off the letters to the firms after RBI pointed out the deficiencies of the banks auditors PwC and Lovelock and Leewes. The new auditor Bhaskar Rao and company took up the audit. There was strategic tie up between PwC and Lovelock and Lewes and they were practically the same.

GTB was advised to take immediate steps to infuse fresh capital to restore its CAR to 9% and indicate a time-bound programmed. Bank was advised to explore options of raising capital through domestic sources or through merger with another bank. Earlier, Centurion Bank was able to get RBI permission for Sabre Capital of Rana Talwar to infuse capital to bail out the bank.

Life Support to GTB

GTB was given time to improve its financial positions and capital adequacy ratio (CAR). In response to that, it submitted a "concrete proposal", through which Newbridge capital would have brought in substantial capital, tuning to Rs 800 crore (approx). An international private equity fund, Newbridge capital has done similar deals in the US and Korea. Domestic institutions would have infused another Rs 700 crore. In return, Newbridge had asked for numerous exemptions from the RBI-on the amount of capital it needed to set aside for each loan made, on priority –sector (agriculture) lending norms, ad on the classification of non-performing assets (NPA). It also wanted to bring in a new management team. The existing one would have no say in GTB under this structure.

Roadblocks in GTB's way

RBI seemed clearly uncomfortable with the conditions that Newbridge put forward for infusing money into the bank. If it gave into Newbridge's demands for waiver of norms on capital adequacy, provisioning, and accounting for bad loans, it would set a precedent. Future bidders for banks might also ask for the same concessions. The other reason was Newbridge itself. Newbridge capital is a company registered in the US, but has its investment arms registered at various tax havens. The Newbridge Company that invests in Asia is registered and run out of the Cayman Islands. It is registered as proprietary firm with limited liability while such firms are usually registered as unlimited liability firms. These are standard practices among private equity firms, and Newbridge already had invested in India, using this structure. RBI was not going to get into unnecessary controversy by allowing a Cayman Islands-registered company to take a large stake in a bank already dogged by controversy and corruption charges. It also had 8.3lakh retail depositors. So the RBI played it safe and chose to follow standard practice and merge GTB with a big public sector bank.

As pointed out in its inspection report, RBI was aware about the serious problems in GTB for the last 2-3 years. After knowing these facts in January 2004, the RBI even went to the extent of appointing nominees on the bank board. The apex bank justified its actions by saying that it wanted the bank to emerge out strongly out of this crisis and so the ailing bank was given some time to recover. However, the real reason lied with the ballot box. It was one of the financial sector's worst-kept secrets that Gelli was thick with to the then Andhra Pradesh chief minister Chandrababu Naidu. Right from the Ketan Parekh days of 2001 and through the JPC inquires into the scam, Naidu had backed him. With such a powerful backer, there was little the RBI could do, even if it had wanted to. Once Naidu went out of power in May, it was clear that the RBI felt far more comfortable in taking Gelli on.

Opportunities for Oriental Bank of Commerce (OBC)

Simultaneous to the Newbridge proposal, RBI was considering other possible alternatives, of which OBC's desire to expand in South was one. Since the GTB was a south-based bank, it would give OBC the much-needed edge in the southern part of the country. GTB had delivery channel network of 104 branches and

275 ATMs in 34 cities across the countries. GTB had a strong presence in South with 51 branches and 174 branches with a very high franchise value. GTB also had strong exposure to developed States of Maharashtra, Andhra Pradesh, Karnatak and Tamil Nadu with more than 70 percent of branches in seven cities and four metros. While OBC had a strong foothold in North, it had been looking forward to expand aggressively in South. The merger would clearly provide OBC with a ready infrastructure to leverage in South.

Moreover since the two banks shared common technology platform, the merger would present a unique coincidence that will effectively make technical collaboration easier. Both GTB and OBC used the same Core Banking Solution (CBS), i.e. Infosys Finacle, and Oracle database. So synergizing operations would not pose any problem. The GTB was having nearly one million IT savvy customers. It takes long time for a bank to build such a large quality customer base, which is well spread across the country. The quality and spread of GTB's retail and corporate customer base was one of the best in the industry. Moreover OBC would directly be able to add~mn GTB customers to its kitty.

Further, since GTB was a private player and OBC a PSU, the difference in terms of IT usage was fairly wide. OBC was still in the process of migrating its legacy, while GTB had been providing technology-enabled services since a long time. GTB was equipped with a trained force of 1,300 plus employees to work in high technology environment.

Computerization and a wide network of automatic teller machines were the areas that OBC was lagging behind in. GTB had a huge server network, consisting of 10 Sun-RISC-based machines, 10 Alpha servers, and around 50 Intel based boxes. The network essentially connected 104 branches and 275 ATMs across the country, providing a wide array of services including Internet and mobile banking. 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. This would be a big value addition to the OBC.

Merger of GTB with OBC

The merger came into force on August 14, 2004. All the branches of GTB started functioning as branches of OBC with effect from this date. As per the draft amalgamation scheme, all GTB depositors would become OBC deposit holders on the prescribed date. According to the scheme, every savings bank account, current account or any other deposit account, including fixed deposit, cash certificates, monthly deposit, deposit payable at call or short notice with GTB, would be transferred to IBC on the prescribed date in the name of the respective account holders. OBC would credit interest to GTB deposit holders according to the rate determined by RBI, for the period from July 24, 2004 to the prescribed date. From the prescribed date, the rate of interest would be similar to that offered to OBC deposit holders. The scheme identified three periods –one up to July 24, 2004, another from July 24, 2004 till the prescribed date (merger date) and the last would be post the prescribed date. For deposits held till July 24, 2004, depositors would earn interest according to the rate determined by GTB, between July 24, 2004 and the prescribed date, interest will be paid as per the RBI determined rate. In the post prescribed date period, the interest rate would be as per the prevailing rate at OBC.

Under the scheme, all GTB employees would continue in service and would be deemed to have been 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. Employees of GTB who didn't wanted to be a part of OBC fraternity, would be entitled to compensation, under the provisions of the Industrial Disputes Act 1947 (14of 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 close of business on July 24, 2004.

After proper valuations, all assets and liabilities of GTB would be transferred to OBC. Investments other than Government securities would be valued at market rates. On the commencement of the scheme for amalgamation, the entire amount of the paid-up capital and reserves of GTB would be treated as provision for bad and doubtful debts and depreciation in other assets of OBC. OBC would have to call upon every person who was, as 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. The bank would take all available steps considering the circumstances of each case to demand and enforce the payment of the amounts due with interest at six per cent per annum for the period of the default. OBC may appropriate the realizations effected by these means in the first instance towards expenses incurred for the recovery of such amount. If any surplus remains after appropriation, the bank shall make payment or provision in respect of nay contingent liability whether contingent or absolute, which was not assessed and had arisen or been discovered after the prescribed date. Also, the acquirer OBC sent a communiqué to the Finance Ministry and BSE that all reliable assets of GTB would be set aside in a separate "Asset Account", which would be used to meet all outstanding liabilities of GTB. If any surplus remains after the appropriation, the bank would make payments, on a pro rata basis, due to the accounts of the former shareholders of GTB, to the specified extent.

The Reserve Bank of India's swift move to announce the merger of GTB with OBC came as a wonder-balm for the worried and agitated depositors of GTB. The assurance of the protection of the interests of the stakeholders in GTB, including depositors, borrowers and employees, by Mr. Narang, further calmed and eased the situation.

Post Merger Challenges for OBC

Since OBC lacked in cutting edge banking technology solutions, there were wide variation in the type of clientele that both banks catered to (With GTB's customers qualifying as the more IT savvy kind)

Another important issue was regarding different working cultures of two banks, OBC and GTB were so different that it would be a challenge to channelise cultural synergies to attain objectives of growth and optimal asset utilization.

Also, RBI had directed that the wage structure for GTB employees would be retained at current levels for the next three years. There were huge discrepancies in the pay structure of the two banks, which definitely would cause heartburn for the existing OBC staff. However, this does not in any ways imply a mismatch and a complete analysis of the nitty-gritty's of both architectures will be essential.

Though OBC had one of the strongest balance sheets among public sector banks with capital adequacy of 16 per cent and zero net non-performing assets (NPAs), whether the merger would enhance OBC's value or not would depend upon the tax breaks that OBC receives on the account of this merger and also on the recoveries of GTB's sticky assets and bad loans portfolio. It would also depend upon the quantum of GTBs NPAs. OBC also had the option of freezing GTB's sticky assets under a separate head for the next two years to retain its zero NPAs image. OBC would get Income Tax exemptions in transferring the assets of GTB in its book during the merger process, while all the bad debts of the merged entity would be adjusted against the cash balances and reserves of GTB. Narang held the view that the merger would bring in positive results to OBC and it would be possible to turn around GTB within a short span of a year. GTB suited OBC because of synergies. While the weakness of GTB had been bad assets, strength of OBC was recovery.

OBC's Strategies to Face the Challenges

After the merger, the first challenges was to satisfy the various stake holders of GTB, which included depositors, employees and creditors. Second important aspect was to cope-up with NPA of GTB as it was a zero NPA bank and also to set-off heavy accumulated losses of GTB. For this, OBC planned to initiate talks and discussions with the defaulting borrowers. Any reluctance on the part of defaulters would lead to the imposition of the provisions as under the Securitization Act.

No existing employee was retrenched and their salaries were protected. However they were told clearly that in order to rationalize salary structure, there will not be any increase in their salaries for the next 3 years as they were already getting more than the OBC employees. GTB employees were intimated that if they wanted to leave or quit, then settlement would be done as per the Industrial Dispute Act 1947. There was no supervisor/Senior executive of OBC over GTBs employees to make them more comfortable in working and work place. Only few Sr. Executives were deputed with some GTBs Sr. officers at regional and head office level, not to supervise and guide but to facilitate, assist and coordinate.

All customers of GTB were getting same facilities and benefits as earlier. Even OBC tried that these customers were dealing with the same employees. Moratorium was lifted and they could withdraw their deposits.

OBC decided that all assets including NPAs recovery were to be set aside in separate account and after meeting with all liabilities from the proceeds of assets, if there would be any surplus, share holders would be paid on pro-rata basis in 12 years time span. Share-swap to GTB share holders was ruled out by OBC. So GTB shareholders did not get OBC's shares against their equity investment in GTB.

OBC decided to set-off all accumulated losses of GTB in next five years starting from 2004-05 to 2008-09. Each year OBC is setting off these losses. (Rs 246 Cr. each year).

This has resulted in reduction of profits and real growth has been hampered due to this. Referring to the trend of share prices from 20-July-2003 to 20-Aug-2007 of OBC as mentioned in the following graph, it's evident that even after the merger and expected growth in share price is around 202-206. However sensex has gained tremendously during this period and surpassed 15K mark. Probably this contrast is due to burden of accumulated losses of GTB on OBC's earning. After 2008-09, when GTB's losses would be fully charged, we may expect increase in the prices of OBC.

Questions for Discussion

1. Point out the reasons responsible for GTB's failure. To what extent do you agree that GTB's top management was responsible for this fiasco?
2. Do you agree with RBI's decision to call OBC top brass and offer acquisitions of GTB to him?
3. Critically evaluate the decision of OBC to go for GTB's merger into it.
4. Analyze the effect of this merger on the various stakeholders of GTB.
5. Evaluate the impact of GTB's merger on all stakeholders of OBC in post merger scenario.

EXHIBITS

Exhibit 1: FY 2003-04

Particulars	GTB	OBC
Business per Employee (Rs Lakh)	624.95	416
Capital Risk-weighted Assets Ratio (%)	0	14.47
Net NPA as % to net Advances	27.99	0
Profit per Employee (Rs Lakh)	-66.7	5.1
Return on Assets (%)	0.9	1.21

Source: RBI

Exhibit 2: Oriental Bank of Commerce (After Merger)

Particulars	2004-05	2005-06
Business per Employee (Rs Lakh)	515	570.26
Capital Risk-weighted Assets Ratio (%)	9.21	12.46
Net NPA as % to net Advances	1.29	0.49
Profit per Employee (Rs Lakh)	5.2	5.37
Return on Assets (%)	1.4	1.39

Source: RBI

Exhibit 3: Oriental Bank of Commerce

(Rs million)

	March 2002	March 2003	March 2004
Liabilities			
Capital	1925.4	1925.4	1925.0
Reserves and surplus	14271.9	19168.0	24842.6
Deposits	284883.9	298091.0	356735.0
Demand deposits	23067.4	27444.3	31134.20
Saving deposits	48481.4	57624.6	70735.50
Term deposits	213335.1	213022.1	254865.30
Borrowings	8173.7	11660.2	11005.0
Deferred tax liabilities	0	0	310.0
Other liabilities and provisions	13374.2	9144.2	15247.60
Total liabilities	322629.1	339988.8	410065.60
Assets			
Cash and bank balance	33317.0	25242.2	36003.60
Investments	137243.5	147805.4	167941.20
Advance and loans	141578.7	156772.4	196807.60
Bills receivables	6913.7	9053.4	8687.10
Short term	7545.5	77394.6	81345.10
Term advances	59207.5	70324.4	106775.40
Deferred tax assets	0	50	-
Other assets	8573.2	8338.8	7531.90
Gross fixed assets	3576.6	3994.6	4637.70
Net fixed assets	1426	1452.9	1617.80
Intangible	490.7	327.1	163.50
Total assets	322629.1	339399.8	410065.60

Source: Prowess

Exhibit 4: Combined Balance Sheet

(Rs crore)

Liabilities	
Capital	192
Reserves and surplus	2480
Deposits	42590
Borrowing	1400
Other liabilities and provisions	1700
Total	48362
Assets	
Cash and balance with RBI	4400
Investments	19300
Advances	22957
Receivables	1220
Fixed assets	445
VRS expenses not written off	16
Deferred tax asset (net)	24
Total	48362

Note: *Based on OBC's 2003-04 balance sheet and GTB's 2002-03 balance sheet. Before any write off in GTB's books for 2003-04, GTB's net worth has been taken as nil.*

Exhibit 5: Oriental Bank of Commerce's Gross NPAs

(%)

Year	Gross NPA (%)
2001-02	6.57
2002-03	6.94
2003-04	5.87
2004-05	9.06
2005-06	6.00

Source: RBI

Exhibit 6: Oriental Bank of Commerce's Net NPAs

(%)

Year	Net NPA (%)
2001-02	3.21
2002-03	1.44
2003-04	-
2004-05	1.29
2005-06	0.49

Source: RBI

Exhibit 7: Cost of Acquiring GTB to OBC (Expected figures before merger)

(Rs Crore)

Possible write offs* (Net NPAs recoverable)	632(approx)
(-) tax benefit on write off	226
Cost after write off	406
(-) tax benefit on write off accumulated losses	95
Net cost	311
OBC's tax provisions for 2003-04	459
Possible tax benefit as above	321
Gross NPA (GTB)	1500(approx)
Net NPA	1232(647^+(1500-915^)
(-) recoverable (the write offs may be spread over a few years)	40% (of gross NPA)

** *Accumulated losses of 265 crore to be written off for tax purpose but will not hit the books. As per the draft scheme of amalgamation the capital and reserve of GTB will be treated as provision and this amount nearly equals the accumulated losses.*

^ *Net NPA: 647 crore, gross NPA: 915 crore (as per 2002-03 balance sheet)*

Exhibit 8: Comparative Rate of Interest on Deposits

(%)

Period	GTB	OBC
6 months and above but less than 12 months	5.50	4.75
12 months and above but less than 18 months	6.00	5.00
18 months and above but less than 24 months	6.00	5.00
24 months and above but less than 36 months	6.00	5.25
36 months and above but up to 120 months	6.25	5.50

Source: Respective bank websites

Exhibit 9: Number of Branches

Region	OBC	GTB	Combined
North	691	9	700
South	52	50	102
East	74	5	79
West	172	39	211
Total	989	103	1092

Source: RBI