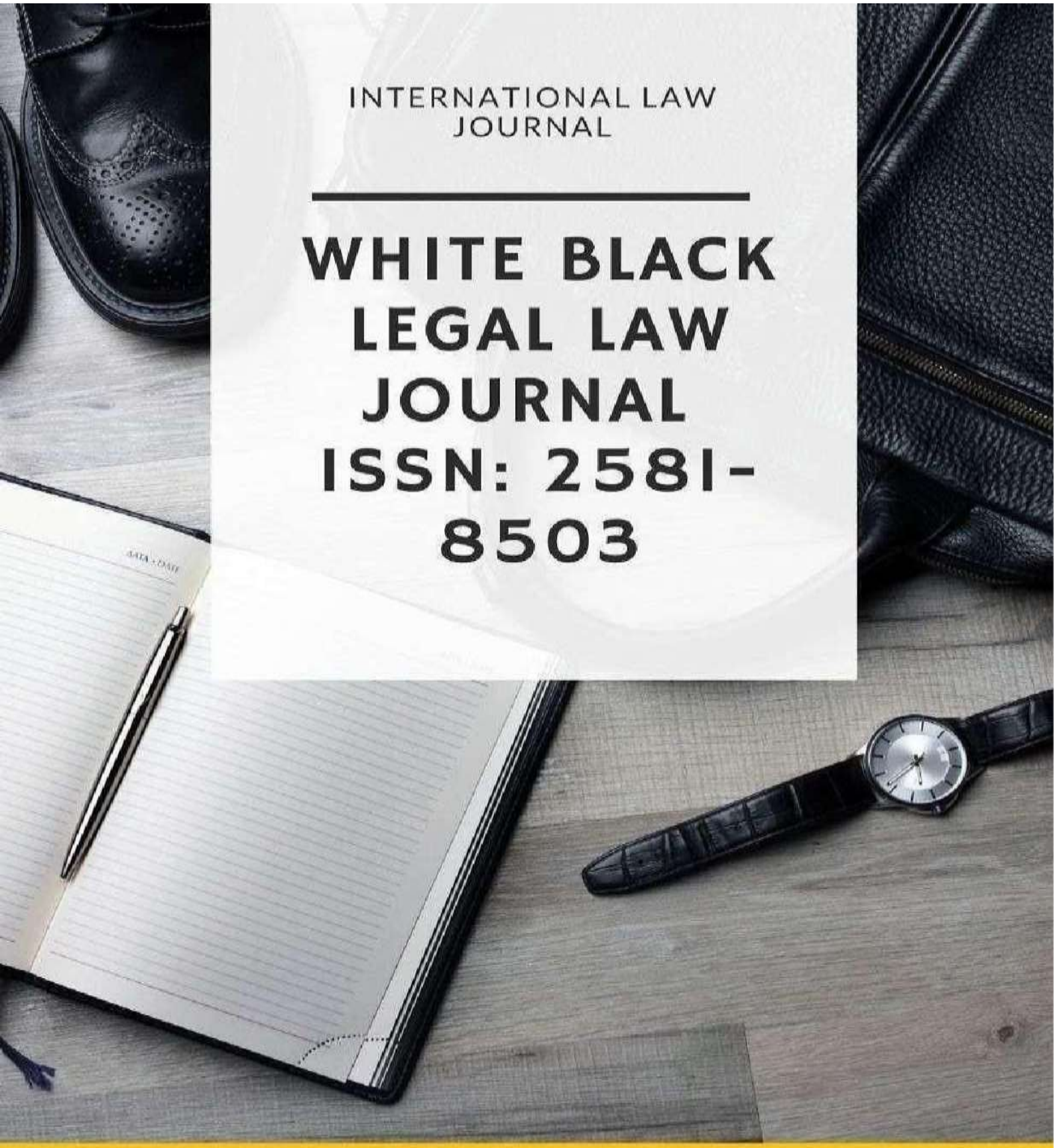

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A LEGAL ANALYSIS OF MISMANAGEMENT IN MERGERS AND ACQUISITION OF BANKING AND NBFCs

AUTHORED BY - G. KALAIVANI
Student of III LLB, School of Law, Vistas.

CO-AUTHOR - DR. A. SUGANTHINI
Assistant Professor And Research Supervisor, School of Law, Vistas.

ABSTRACT:

Mergers and acquisitions (M&A) in the banking and non-banking financial companies (NBFCs) sector in India is a crucial mechanisms for financial consolidation, market expansion[1], and the resolution of distressed entities. While such transactions are often supported by regulatory intervention to ensure systemic stability and protect stakeholders, they also present significant risks of mismanagement due to their inherent complexity and regulatory asymmetries.

This study examines the legal and practical dimensions of mismanagement in M&A transactions, focusing on issues such as inadequate due diligence, weak corporate governance, asset misvaluation, and post-merger integration failures. It critically analyzes the existing legal framework, including the Companies Act, 2013, the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, and the Insolvency and Bankruptcy Code, 2016, along with regulatory guidelines issued by the Reserve Bank of India.

KEYWORDS: Mergers and Acquisition, Banking Sector, Non-Banking Financial Companies (NBFCs), Mismanagement, Due Diligence, Corporate Governance, Financial Stability, Fiduciary Duties, Judicial Review, Regulatory Oversight.

[1] Ingo Walter, *Mergers and Acquisitions in Banking and Finance: What Works, What Fails, and Why* (Oxford University Press, 2004).

INTRODUCTION:

The increasing significance of mergers and acquisitions (M&A) in the financial sector reflects a broader shift toward consolidation, competitiveness, and resilience in modern economies. In India, the banking sector and non-banking financial companies (NBFCs) have increasingly relied on M&A as strategic tools for expansion, diversification and restructuring [2]. Despite these objectives, M&A transactions in the banking and NBFC sectors are often fraught with challenges that extend beyond commercial considerations. Issues such as inadequate due diligence, flawed asset valuation, weak corporate governance practices[3], and ineffective post-merger integration have repeatedly undermined the success of such transactions.

The legal and regulatory framework governing M&A in India is comprehensive involving multiple statutes such as the Companies Act, 2013, the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, and the Insolvency and Bankruptcy Code, 2016. In addition, regulatory bodies like the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the Competition Commission of India (CCI) play a crucial role in overseeing and approving such transactions. However, gaps in enforcement, overlaps in jurisdiction, and limitations in post-merger monitoring often hinder the effective prevention of mismanagement. This study seeks to examine the legal dimensions of mismanagement in M&A transactions within the banking and NBFC sectors. It focuses on the accountability of directors and management, the adequacy of regulatory mechanisms, and the protection of minority shareholders. By adopting a doctrinal and case study-based approach, this research aims to identify structural weaknesses in the current framework and propose measures to strengthen regulatory oversight, enhance corporate accountability, and ensure that M&A transactions serve their intended purpose of value creation and financial stability.

CONCEPT OF MERGERS AND ACQUISITION:

A merger involves the combination of two or more companies, usually of similar size, to form a new entity, where both companies cease to exist independently. In contrast, an acquisition occurs when one company purchases another and absorbs it into its operations, with the acquired company losing its separate identity.

[2] Ingo Walter, *supra note 1*.
[3] H. Kaur & R. Kaur, "Impact of Mergers on the Efficiency of Indian Banks," *Journal of Accounting and Finance* (2010).

M&A transactions are undertaken for several strategic reasons, including expansion into new markets, achieving economies of scale, diversification of business risks, access to technology and skilled workforce, and enhancement of shareholder value. In the Indian context, M&A is also influenced by regulatory objectives such as financial stability, especially in the banking and NBFC sectors.

EVOLUTION OF MERGERS AND ACQUISITION IN INDIA:

The evolution of mergers and acquisitions (M&A) in India reflects the country's economic transformation from a controlled economy to a liberalized and globally integrated market. The origins of M&A can be traced to the pre-independence and immediate post-independence period, particularly around 1946, when British managing agencies began divesting their holdings in anticipation of India's independence. This led to large-scale transfer of ownership to Indian business houses and marked the early phase of industrial consolidation, especially in sectors like banking, insurance, and textiles.

During the 1960s and 1970s, M&A activity declined due to strict government regulations aimed at preventing concentration of economic power. The enactment of the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 imposed significant procedural barriers, discouraging mergers, particularly horizontal combinations. However, conglomerate mergers and government-supported restructuring of sick units continued during this period.

The late 1980s marked the re-emergence of M&A activity in India, although at a limited scale. Transactions were mostly friendly and negotiated, with regulatory constraints still playing a dominant role. A major turning point came with the economic liberalization reforms[4] of 1991, which dismantled licensing requirements, encouraged private investment, and opened the Indian economy to global competition.

Post-1991, M&A activity increased significantly across sectors, supported by regulatory frameworks such as the SEBI Takeover Code, 1997. The 2000s witnessed rapid expansion, particularly in the service and financial sectors, driven by globalization, technological advancement, and the need for scale and efficiency.

[4] A. Das & S. Ghosh, "Financial Deregulation and Efficiency of Indian Banks," *Review of Financial Economics* (2006).

In recent years, M&A in India has been increasingly driven by regulatory objectives, especially in the banking and NBFC sectors, where consolidation has been encouraged to ensure financial stability, resolve stressed assets, and enhance competitiveness. Thus, M&A in India has evolved into both a strategic and regulatory tool for economic growth.

MISMANAGEMENT IN MERGERS AND ACQUISITION:

Mismanagement in mergers and acquisitions (M&A) refers to the improper, negligent, or inefficient handling of the processes involved in combining or acquiring companies. It is one of the major reasons why many M&A transactions fail to achieve their intended objectives. In sectors such as banking and non-banking financial companies (NBFCs), mismanagement can have far-reaching consequences, including systemic financial risks.

One of the primary causes of mismanagement is inadequate due diligence. Failure to thoroughly examine financial records, legal liabilities, and operational risks may result in the acquiring company inheriting hidden obligations. Poor corporate governance is another critical factor, where lack of oversight and accountability leads to decisions that do not align with stakeholder interests. Additionally, overvaluation of target companies often results in excessive acquisition costs, putting financial strain on the acquiring entity.

Post-merger integration is another area where mismanagement frequently occurs. Ineffective integration of systems, processes, and workforce can reduce efficiency and productivity. Cultural differences between merging organizations may further create internal conflicts, leading to employee dissatisfaction and high attrition rates. Moreover, lack of strategic planning and communication can prevent the realization of expected synergies.

The consequences of mismanagement are significant. Companies may face financial losses, regulatory penalties, and legal disputes from shareholders or other stakeholders. Reputational damage and loss of investor confidence can further impact future business opportunities. In extreme cases, mismanagement can lead to the failure or reversal of the transaction. Legally, directors and management may be held accountable under the Companies Act, 2013 if mismanagement involves fraud, breach of fiduciary duties, or gross negligence.

MERGERS AND ACQUISITION IN BANKING AND NBFCs:

In the banking sector, M&A has often been policy-driven. The Government of India and the Reserve Bank of India (RBI) have actively encouraged consolidation [5]to strengthen public sector banks, improve capital adequacy, and enhance operational efficiency. Notable examples include the merger of Dena Bank and Vijaya Bank with Bank of Baroda, and the consolidation of several associate banks with the State Bank of India. These mergers were aimed at creating larger, more resilient banking institutions capable of competing globally and managing financial risks effectively.

In the NBFC sector, M&A has been largely market-driven but also influenced by regulatory measures, especially in response to financial distress. For instance, the acquisition of Dewan Housing Finance Corporation Limited (DHFL) by Piramal Group under the Insolvency and Bankruptcy Code, 2016 reflects the use of M&A as a resolution tool. Similarly, the merger of HDFC Ltd with HDFC Bank represents one of the largest financial consolidations in India, aimed at creating a diversified financial conglomerate.

MISMANAGEMENT IN MERGERS AND ACQUISITION IN BANKING AND NBFCs:

One of the primary causes of mismanagement is inadequate due diligence. In several cases, acquiring institutions fail to fully assess the financial health, asset quality, and hidden liabilities of the target entity. This results in the transfer of non-performing assets (NPAs) and undisclosed risks, weakening the financial position of the merged entity. Poor corporate governance[6] further aggravates the issue, where lack of transparency and ineffective board oversight lead to flawed decision-making. Another critical factor is misvaluation of assets, particularly in distressed mergers where the true value of assets is difficult to determine. Overestimation can burden the acquiring institution with excessive financial obligations. Additionally, ineffective post-merger integration including failure to align operational systems, risk management practices, and organizational structure. Often results in inefficiencies and operational disruptions.

[5] Reserve Bank of India, *Report on Trend and Progress of Banking in India* (latest edition).
[6] R. Bhattacharya & S. Roy, "Labour Law Implications of Indian Banking Mergers," *Indian Journal of Industrial Relations* (2018).

In the banking and NBFC sectors, regulatory asymmetry also contributes to mismanagement. Differences in regulatory frameworks governing banks and NBFCs can create gaps in compliance and supervision, allowing risks to go undetected. Furthermore, cultural differences between merging entities and lack of effective communication can lead to employee dissatisfaction and reduced productivity. The consequences of such mismanagement are severe. They include financial losses, regulatory penalties, reputational damage, and erosion of investor confidence. In extreme cases, failed M&A transactions may threaten financial stability and require regulatory intervention. Legally, management and directors may be held accountable under the Companies Act, 2013 for breach of fiduciary duties or negligence. However, proving mismanagement remains challenging due to judicial deference to business decisions made in good faith.

LEGISLATIONS RELATED TO MERGERS AND ACQUISITION IN INDIA:

The legislative framework governing mergers and acquisitions (M&A) in the banking and non-banking financial companies (NBFCs) sector in India is comprehensive and designed to prevent mismanagement, ensure transparency, and protect stakeholders. Key statutes include the Companies Act, 2013, the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, and the Insolvency and Bankruptcy Code, 2016, along with regulatory guidelines issued by the Reserve Bank of India (RBI).

The Companies Act, 2013[7] provides the primary legal mechanism for corporate restructuring through Sections 230 to 232, which govern schemes of compromise, arrangement, and amalgamation. These provisions require approval from the National Company Law Tribunal (NCLT), ensuring that mergers are fair, transparent, and not prejudicial to the interests of shareholders or creditors. The Act also addresses mismanagement under Sections 241 and 242, allowing minority shareholders to seek remedies in cases where company affairs are conducted in a manner oppressive or prejudicial.

The Banking Regulation Act, 1949[8] specifically governs mergers involving banking companies. Section 44A mandates RBI approval for voluntary amalgamations, while the RBI

[7] Companies Act, 2013, §§ 230–232, 241–242.
[8] Banking Regulation Act, 1949, § 44A.

has powers to enforce compulsory mergers in the interest of financial stability. This ensures that mismanagement in banking M&A does not jeopardize depositors or the financial system. For NBFCs, the RBI Act, 1934 and related directions provide regulatory oversight. NBFC mergers require prior approval from the RBI, particularly when they affect public interest or involve systemically important entities.

The Insolvency and Bankruptcy Code, 2016[9] plays a crucial role in resolving distressed financial institutions. It facilitates acquisition of insolvent NBFCs and financial service providers, as seen in cases like DHFL, thereby addressing mismanagement through structured resolution mechanisms.

Additionally, regulatory bodies such as SEBI and the Competition Commission of India (CCI) ensure compliance with takeover norms and prevent anti-competitive practices.

Despite this robust framework, challenges in enforcement and regulatory coordination can still allow mismanagement, highlighting the need for stronger oversight and harmonization.

REGULATING BODIES GOVERNING MERGERS AND ACQUISITION IN INDIA:

Mergers and acquisitions (M&A) in India, particularly in the banking and non-banking financial companies (NBFCs) sector, are governed by a multi-layered regulatory framework involving several authorities. These regulatory bodies ensure that M&A transactions are conducted in a transparent, fair, and legally compliant manner, while also preventing mismanagement and protecting stakeholder interests.

The Reserve Bank of India (RBI) is the primary regulator for banks and NBFCs. It plays a crucial role in approving and supervising M&A transactions in the financial sector. Under the Banking Regulation Act, 1949, the RBI has the authority to approve voluntary mergers and enforce compulsory amalgamations to safeguard financial stability and protect depositors. In the case of NBFCs, prior RBI approval is required for mergers that may affect public interest or involve systemically important institutions.

[9] Insolvency and Bankruptcy Code, 2016.

The Securities and Exchange Board of India (SEBI) regulates M&A involving listed companies through the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. SEBI ensures transparency by mandating disclosures, protects minority shareholders, and regulates takeover processes to prevent unfair practices.

The Competition Commission of India (CCI)[10] oversees combinations under the Competition Act, 2002. Its role is to ensure that mergers and acquisitions do not lead to anti-competitive practices or abuse of dominant market position, thereby maintaining healthy competition in the market.

The National Company Law Tribunal (NCLT) acts as the adjudicating authority under the Companies Act, 2013. It approves schemes of merger and amalgamation under Sections 230 to 232, ensuring that such transactions are fair, reasonable, and not prejudicial to stakeholders.

Additionally, the Ministry of Corporate Affairs (MCA) administers corporate laws and ensures compliance with statutory requirements in M&A transactions.

Together, these regulatory bodies create a robust framework that governs M&A in India, particularly in the banking and NBFC sectors, ensuring accountability, transparency, and financial stability.

REMEDIES AVAILABLE FOR MISMANAGEMENT IN MERGERS AND ACQUISITION:

Mismanagement in mergers and acquisitions (M&A) in the banking and non-banking financial companies (NBFCs) sector can lead to serious financial and legal consequences. The Indian legal framework provides several remedies to address such mismanagement and protect stakeholders, including shareholders, creditors, and depositors.

One of the primary remedies is available under the Companies Act, 2013, particularly Sections 241 and 242[11], which deal with oppression and mismanagement. Minority shareholders can approach the National Company Law Tribunal (NCLT) if the affairs of the company are

[10] Competition Act, 2002; SEBI (SAST) Regulations, 2011.
[11] Companies Act, 2013, §§ 241–242.

conducted in a manner prejudicial to their interests. The Tribunal has wide powers to grant relief, including regulating the conduct of company affairs, removing directors, or even modifying or setting aside the merger scheme.

Under Sections 230–232 of the Companies Act, the NCLT also plays a preventive role by scrutinizing and approving merger schemes. If the scheme is found to be unfair, lacking transparency, or detrimental to stakeholders, the Tribunal may reject or impose conditions before approval.

In the banking sector, the Reserve Bank of India (RBI) has significant powers under the Banking Regulation Act, 1949 to supervise and intervene in M&A transactions. It can approve, modify, or even enforce compulsory mergers to safeguard financial stability and protect depositors. Similarly, for NBFCs, RBI approval is mandatory, and the regulator can take corrective action in cases of mismanagement.

The Insolvency and Bankruptcy Code, 2016 (IBC) provides a structured mechanism for resolving distressed financial institutions. It enables acquisition of failing NBFCs through a transparent resolution process, thereby addressing mismanagement indirectly.

Additionally, shareholders and stakeholders may seek judicial remedies through writ petitions or civil actions in cases of fraud, breach of fiduciary duty, or regulatory violations.

Despite these remedies, practical challenges remain in proving mismanagement. Therefore, effective enforcement and regulatory coordination are essential to ensure timely and adequate redressal.

JUDICIARY IN MERGERS AND ACQUISITION:

The judiciary plays a vital role in addressing mismanagement in mergers and acquisitions (M&A) within the banking and financial sector by ensuring legality, fairness, and protection of stakeholder interests. Although M&A transactions are primarily commercial decisions, judicial bodies act as important safeguards against misuse of power, fraud, and procedural irregularities.

Under the Companies Act, 2013, the National Company Law Tribunal (NCLT) is the primary adjudicating authority[12] for approving mergers and amalgamations under Sections 230–232. The Tribunal examines whether the scheme is fair, reasonable, and not prejudicial to the interests of shareholders, creditors, or the public. In cases of mismanagement—such as inadequate disclosure, unfair valuation, or lack of transparency—the NCLT has the power to reject or modify the scheme. The judiciary also provides remedies in cases of oppression and mismanagement under Sections 241 and 242 of the Companies Act, 2013. Minority shareholders can approach the Tribunal if the affairs of the company are conducted in a manner prejudicial to their interests. The Tribunal may order corrective measures, including regulation of company affairs or removal of directors.

In the banking and NBFC sectors, courts generally exercise restraint and respect the decisions of regulatory authorities such as the Reserve Bank of India (RBI), especially in matters concerning financial stability and restructuring of distressed entities. However, judicial review is available to ensure that such decisions are not arbitrary, illegal, or violative of principles of natural justice. Furthermore, High Courts and the Supreme Court can intervene under constitutional provisions to review regulatory actions and protect fundamental rights.

Despite these powers, the judiciary follows the business judgment rule and does not interfere in decisions made in good faith. Thus, its role is primarily supervisory, ensuring accountability while balancing commercial freedom in M&A transactions.

CONCLUSION:

Mergers and acquisitions (M&A) in the banking and NBFC sector have become vital tools for financial consolidation, growth, and resolution of distressed entities in India. While the regulatory framework—comprising the Companies Act, 2013, the Banking Regulation Act, 1949, and RBI guidelines—provides a structured mechanism, instances of mismanagement continue to persist. Factors such as inadequate due diligence, weak corporate governance, misvaluation of assets, and ineffective post-merger integration significantly undermine the success of M&A transactions. Additionally, regulatory asymmetry between banks and NBFCs and limited judicial intervention in commercial decisions further complicate accountability. Consequently, mismanagement not only affects individual entities but also poses risks to

[12] Companies Act, 2013, §§ 230–232.

financial stability and investor confidence.

To address these challenges, regulatory authorities must strengthen supervision and ensure better coordination, particularly between RBI, SEBI, and CCI. Mandatory and more rigorous due diligence standards should be enforced before approval of M&A transactions. Greater accountability of directors and management must be ensured through stricter enforcement of fiduciary duties. Post-merger integration should be closely monitored with defined performance benchmarks. Additionally, enhancing protection for minority shareholders and improving transparency in valuation processes can reduce disputes. Harmonizing regulatory frameworks between banks and NBFCs will further minimize systemic risks and promote efficient and well-managed M&A transactions.

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