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Megha Middha, is working as an Assistant Professor of Law in Mody University of Science and Technology, Lakshmangarh, Sikar (Rajasthan). She has an experience in the teaching of almost 3 years. She has completed her graduation in BBA LL.B (H) from Amity University, Rajasthan (Gold Medalist) and did her post-graduation (LL.M in Business Laws) from NLSIU, Bengaluru. Currently, she is enrolled in a Ph.D. course in the Department of Law at Mohanlal Sukhadia University, Udaipur (Rajasthan). She wishes to excel in academics and research and contribute as much as she can to society. Through her interactions with the students, she tries to inculcate a sense of deep thinking power in her students and enlighten and guide them to the fact how they can bring a change to the society

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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC - NET examination and has been awarded ICSSR - Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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MERGERS AND ACQUISITIONS IN FINANCIAL SECTOR: **ANALYSING THE HDFC CASE AND ITS IMPACT ON** **CREDIT AVAILABILITY AND LENDING POWER**

AUTHORED BY: V. V. BADARINATH & P. V. S. S. SRINIVAS

(5TH YEAR STUDENT B.A.LL.B)

ABSTRACT

As a part of Corporate Restructuring many Companies and Corporations resort to Mergers and Acquisitions in order to achieve different objectives. This phenomenon is not just limited to specific sector, in the recent times the financial sector in India has witnessed quite a few Mergers and Acquisitions the most prominent one among all is the merger of HDFC limited and HDFC Bank. While such consolidation builds synergies to operate more efficiently in a complex environment the impact of such mergers on crucial aspects like credit availability and lending power cannot be understated. While the Mergers and Acquisitions are not new in the financial sector the merger of HDFC limited and HDFC Bank holds a special position due to the market position of both the companies individually and collectively. This research paper will examine the above discussed merger through legal framework and undertakes a meticulous examination scrutinising the intricate legal aspects and regulatory implications along with the market impact of this significant corporate consolidation.

Key words: Corporate Restructuring, Companies, Corporations, Mergers and Acquisitions, HDFC limited, HDFC Bank, financial sector, legal framework and market impact.

INTRODUCTION

Restructuring is nothing but to rearrange something to make it work better. Corporate restructuring is a process that involves reorganizing company's operations, finances and management to work in a better way. As the time passes and company expands in many cases the need for corporate restructuring increases. Generally corporate restructuring is needed to expand business of the company, carrying out business more economically, focus on its core strengths, to avail tax benefits and lastly to get competitive edge in the market. Also, the objectives of such

corporate restructuring include improve growth prospects, maximize utilization of available resources, improve their market presence, reviving a sick company and get operational advantage¹.

Merger is one out of many forms of corporate restructuring. Merger is combination of two or more companies into a single company. Merger can take place either by absorption or consolidation. Some types of mergers include²

- Horizontal merger
- Vertical merger
- Conglomerate merger
- Cross-border merger
- Market-Extension merger
- Product-Extension merger
- Reverse merger
- De-merger

In a horizontal merger two or more companies producing same type of goods or services gets merged. In vertical merger two or more companies producing different products or services for one final product gets merged. Conglomerate merger is a merger between unrelated companies while cross-border merger between companies belonging to different nationalities. Meanwhile, market-extension merger is a merger between two or more companies producing same goods and services in different markets gets merged to expand their business and product-extension merger is a merger between two or more companies producing related products in same market. It is also important to know about reverse merger. The reverse merger is a type of merger where the private company gets merged with a public company and becomes a public company and de-merger is a case where one company divides into two or more companies.

LEGAL FRAMEWORK

In the recent times HDFC merger has been in news. Actually there are four entities involved in the process those are HDFC Investments limited (Transferor company – T1), HDFC holdings

¹ Corporate Restructuring course by Ledx

² Corporate Restructuring course by Ledx

limited (Transferor company – T2), HDFC limited (Amalgamating company/Transferee company) and HDFC bank limited (Amalgamated company) and accordingly the sanction for amalgamation was sought under section 230 to section 232 of Companies Act, 2013 by all the companies mentioned above. The proposed scheme of amalgamation provides for amalgamation of T1 and T2 with and into amalgamating company and the consequent dissolution of transferor companies without being wound up. Followed by amalgamation of Transferee company/Amalgamating company with and into the amalgamated company and consequent dissolution of Transferee company/Amalgamating company without being wound up as well as the issuance of new equity shares to equity shareholders of Transferee company/Amalgamating company in accordance with Share Exchange Ratio as provided in the scheme³.

Transferor companies are wholly-owned subsidiaries of Transferee company/Amalgamating company and entire paid-up capital of Transferor companies is held by Transferee company/Amalgamating company. It is mentioned that Transferor companies and Transferee company/Amalgamating company are the promoters of Amalgamated company. It is also mentioned that T1 and T2 are systematically important Non-Deposit taking Non-Banking Financial Companies registered with Reserve Bank of India (RBI) and are primarily engaged in the making investments in equity shares, preference shares, venture funds, mutual funds and other securities. Meanwhile the Transferee/Amalgamating Company is engaged in the business of providing finance to individuals, corporates and developers for the purchase, construction, development and repair of houses, apartments and other commercial properties in India supported by robust network of agents for sourcing loans as well as deposits. The Amalgamated Company is a banking company registered with Reserve Bank of India (RBI) under the provisions of Banking Regulation Act of 1949. Accordingly, the requisite permissions for the scheme of amalgamation were taken by the above mentioned companies from Bombay Stock Exchange (BSE) & National Stock Exchange (NSE), Competition Commission of India (CCI), Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) and various other authorities including National Company Law Tribunal (NCLT)⁴.

Just like any other kind of amalgamation this one too has some rationale and benefits behind

³ Company scheme petition no.243 of 2022 connected with company scheme application no.200 of 2022 among HDFC investments, HDFC holdings, HDFC limited and HDFC bank limited, last visited on 09-02-2024

⁴ Company scheme petition no.243 of 2022 connected with company scheme application no.200 of 2022 among HDFC investments, HDFC holdings, HDFC limited and HDFC bank limited, last visited on 09-02-2024

some of those include⁵

- The scheme of amalgamation shall enable amalgamated company to build its housing loan portfolio and enhance its existing customer base.
- It is based on leveraging significant complementarities that exists amongst the parties to the scheme. The scheme would benefit or would be beneficial for various stake holders as the combined business would benefit from the increased scale, comprehensive product offering balance sheet resiliency and ability to drive synergies across the revenue generating opportunities, operating efficiencies and under writing efficiencies amongst others.
- The Amalgamated company is a private sector bank and has a large base of over 68 million customers. The bank platform will provide a well-diversified low cost funding base for growing the long tenor loan book acquired by the Amalgamated company pursuant to amalgamation.
- The combination of Amalgamating company and Amalgamated company is entirely complementary to, and enhances the value proposition of the Amalgamated company.
- The scheme of Amalgamation would allow the Amalgamated company to disburse larger ticket loans and also enable greater credit flow into the Indian economy
- With the Amalgamating company's leadership in the home loan arena that has been developed over 45 years, the Amalgamated company would be able to provide customers with flexible mortgage offers in a cost-effective and effective manner
- Amalgamating company's rural housing network and affordable housing lending is likely to qualify for Amalgamated company as priority sector lending and will also enable a higher flow of credit into priority sector lending, including agriculture
- This scheme will also result in reduction of Amalgamated company's exposure to unsecured loans
- The Amalgamating company has built technological capabilities to evaluate credit worthiness of customers and it has also developed unique skills in financing various customer segments. These capabilities will help Amalgamated company to take advantage of such expertise in underwriting and financing of mortgage.
- Transferor companies being systematically important non-deposit taking Non-Banking Financial Companies (NBFCs) whom are wholly owned subsidiaries of Amalgamating

⁵ Company scheme petition no.243 of 2022 connected with company scheme application no.200 of 2022 among HDFC investments, HDFC holdings, HDFC limited and HDFC bank limited , last visited on 09-02-2024

company this scheme of amalgamation shall result in simplified and better organized corporate structure.

The merger of HDFC limited and HDFC bank came into effect on 1st of July, 2023. This meant that HDFC limited which is India's largest pure play home loan provider now ceases to exist as a company and will be delisted from the stock market. Now, the shareholders of HDFC limited will be allotted with the shares of HDFC bank. This merger will transform HDFC bank into financial services conglomerate that offers a full suite of financial services, from banking to insurance and Mutual Funds through its subsidiaries. Till now HDFC bank acted as a distributor for these products. Post merger the entity i.e. HDFC bank will be a gigantic and will also become 4th largest lender in terms of equity market cap behind J.P Morgan Chase, Industrial and Commercial bank of China and Bank of America. Here in India, the market cap of HDFC bank will be more than the market cap of all other private sector lenders put together and it will be indifferent even when market cap of HDFC bank is compared to public sector lenders combined. When it comes to assets HDFC bank will fall just behind SBI. The larger net worth of HDFC bank will translate into greater credit flow into the Indian economy⁶.

Merger and amalgamation is a complex procedure involving many regulators and governmental bodies like National Company Law tribunal (NCLT), Securities and Exchange Board of India (SEBI), Competition Commission of India (CCI), Reserve Bank of India (RBI), Bombay Stock Exchange (BSE) & National Stock Exchange (NSE), Registrar of Companies (ROC) among others. Section 230 to 240 of the Companies Act, 2013 contains provisions regarding compromise, arrangements, mergers and amalgamations etc. Most importantly Section 230, 231 and 232 play a major role in such compromise or arrangement.

Section 230⁷ in general talks about power to compromise or make arrangements with creditors and members. Section 230(1)⁸ speaks about power to compromise or make arrangements with creditors and members. Section 230(2)⁹ speaks about application for such arrangement or

⁶ Gyanendra Keshri, DH Deciphers | How will HDFC twins merger impact customers, shareholders and employees, <https://www.deccanherald.com/business/dh-deciphers-how-will-hdfc-twins-merger-impact-customers-shareholders-and-employees-1233364.html><https://www.deccanherald.com/business/dh-deciphers-how-will-hdfc-twins-merger-impact-customers-shareholders-and-employees-1233364.html>, last visited on 10-02-2024

⁷ Section 230 of Companies Act, 2013

⁸ Section 230(1) of Companies Act, 2013

⁹ Section 230(2) of Companies Act, 2013

compromise to be accompanied with the affidavit and section 230(3)¹⁰ says that notice relating to such arrangement or compromise must be placed in the website of the company while section 230(4)¹¹ speaks about right to object such arrangement or compromise by a person holding more than 10% of shares or 5% of debt. Another important provision is section 230(5)¹² which says that notice of such arrangement or compromise has to be sent to Government of India, Income tax department, Reserve Bank of India (RBI), respective stock exchanges along with Competition Commission of India (CCI).

Creditors, shareholders, members of company, liquidators and any other relevant person can apply for amalgamation in National Company Law Tribunal (NCLT) with relevant facts. If no one objects NCLT will pass the order with ancillary order after which Registrar of Company (RoC) has to register within 30 days.

The tribunal also has special powers under Section 231¹³ of Companies Act, 2013. The tribunal has the power to supervise or review terms and conditions of Compromise/Arrangement. The tribunal may also give directions or make any modifications in such compromise or arrangement as it may deem fit for proper implementation of such arrangement or compromise. If the arrangement or compromise is not implemented to the satisfaction of National Company Law Tribunal (NCLT), it has power to order winding up of company.

If a compromise or arrangement leads to merger and amalgamation then section 232¹⁴ comes into picture. It says that if a compromise or arrangement leads to merger or amalgamation then along with the application one has to attach the scheme of merger and amalgamation, effect of such merger and amalgamation on share holders, valuation report and other disclosures as prescribed. Competition Commission of India (CCI) also needs to grant approval for mergers and amalgamations and it plays an important in mergers, amalgamations and acquisitions. Section 5 and 6 of the Competition Act, 2002 speaks about combinations and regulation of combinations. In simple language, Section 5¹⁵ deals with mergers and acquisitions in India and aims to prevent anti-competitive practices in the same. It applies to acquisition or control over companies or

¹⁰ Section 230(3) of Companies Act, 2013

¹¹ Section 230(4) of Companies Act, 2013

¹²Section 230(5) of Companies Act, 2013

¹³Section 231 of Companies Act, 2013

¹⁴ Section 232 of Companies Act, 2013

¹⁵ Section 5 of Competition Act, 2002

enterprises along with mergers and amalgamations of companies or enterprises. It is to be noted that the rules of competition law only applies when the combined entity exceeds certain assets or turnover in the present case of HDFC merger it crosses that threshold by a huge extent and hence the regulations of competition law kicks in. The Competition Act prescribes in such cases that a notification is to be sent to Competition Commission of India (CCI) for review after thoroughly reviewing the same the Competition Commission of India (CCI) may grant the nod with or without modifications to the scheme of mergers and acquisition taking into account competition in the market or totally block such mergers and acquisitions if it adversely effects the combination.

Section 6¹⁶ of the Competition Act, 2002 regulates mergers and acquisitions in order to prevent harm to the competition in the market. It prohibits such mergers and acquisitions which create adverse effects on the competition. The most important aspect is when mergers and acquisitions exceed certain threshold the companies involved must notify Competition Commission of India (CCI) before moving forward with the process. It is to be noted companies involved in such mergers and acquisitions may proceed forward after 150 days of notifying Competition Commission of India (CCI) or after receiving nod from Competition Commission of India (CCI) whichever is earlier. It is also worth noting that certain types of mergers and acquisitions like that of public financial institutions, foreign portfolio investors, banks and specific investments funds are exempted from certain conditions.

Another important approval in respect of mergers and amalgamations is to be granted by Reserve Bank of India (RBI) especially in banking sector. Mergers and amalgamations in banking sector are mainly governed by Banking Regulation Act of 1949. The Banking Regulation Act, 1949 provides for procedure where in it says that individual approvals of both amalgamating and amalgamated companies are required. Also Section 44A¹⁷ of Banking Regulation Act, 1949 states that the shareholders must be notified as to the merger meeting and requires approval by a majority (in number) representing two-thirds (in value) of the shareholders present at meetings called for this purpose. Shareholders who disapprove can claim fair compensation for their shares, determined by the Reserve Bank of India (RBI). After the approval of shareholders the merger scheme needs to be submitted to Reserve Bank of India (RBI) which will approve or reject

¹⁶ Section 6 of Competition Act, 2002

¹⁷ Section 44A of Banking Regulation Act, 1949

the scheme based on many factors like financial stability and competition. Upon RBI approval, the merged entity inherits all assets and liabilities of the individual banks. The dissolving bank ceases to exist, and its name is struck off the registration records.

Overall, approval from board of directors, creditors, members, shareholders, Securities and Exchange Board of India (SEBI) & Stock Exchanges (Listed companies), National Company Law Tribunal (NCLT), Reserve Bank of India (RBI) and Competition Commission of India (CCI) are required here in the above amalgamation of HDFC limited and HDFC bank limited.

IMPACT ON CREDIT AVAILABILITY AND LENDING POWER

After the merger the market capitalization HDFC bank will exceed 14 lakh crore rupees. The merger of HDFC limited and HDFC bank limited will benefit the customers of HDFC limited and HDFC bank limited alike. Due to this merger HDFC bank will have an improved product portfolio and will be able to offer new range of services like retail banking, digital banking, digital loan processing, working capital, project financing on a large scale, multimedia-management, supply chain financing, deposits on a wholesale basis on a large scale, correspondent banking, construction finance, foreign asset liability finance among others. This merger greatly resulted in the boost-up of the technological infrastructure, achieve economies of scale and improve operational efficiency of HDFC bank which majorly helped the bank in saving the costs¹⁸.

Merger of HDFC limited with HDFC bank has pushed credit off-take by astounding 500 points to 19.7% on year to reach 148 lakh crore rupees for the fortnight to July 28 excluding which the system wide lending growth was only at 14.7% on-year. Here, credit off-take means total amount of loans and advances disbursed by banks to various sectors during a specific period. This was primarily driven by impact of HDFC limited and HDFC bank merger as well as growth in personal loans along with loans to NBFCs. It represents and acts like a key indicator of economic activity. Generally, increased credit off-take refers to economic expansion while decreased credit off-take indicates economic slowdown leading to less demand for credit. Deposits also witnessed a healthy growth of 12.9% without considering merger it stood at 12.3%. Going forward the

¹⁸ HDFC Ltd's Merger into HDFC Bank: What does it mean for you?, Paytm money, <https://www.paytmoney.com/blog/hdfc-ltds-merger-into-hdfc-bank-what-does-it-mean-for-you/>, last visited on 12-02-2024

deposits are only expected raise as banks looks to shore up their liability franchise and ensure that deposits does not constrain credit off-take. Another important point to be noted is that credit to deposit ratio which has been hovering above 75% since, December of 2022 declined by 40 basis points and stood at 77.2% in the reporting fortnight but annualized growth was around 440 basis points due to the impact of merger. Thus credit availability increased in the market due to merger and the outlook in this regard looks positive. Also, increasing deposits in the bank will give scope for the bank to lend more money and thereby increase its lending power in the market¹⁹.

The immediate impact of the merger is also significant. This merger has made space for the bank into the list of top 100 lenders in the world in terms of assets. It has a balance sheet of 32 lakh crore rupees next only to State Bank of India's (SBI) 55 lakh crore rupees as of 31st March, 2023 while ICICI stands at 3rd position with 16 lakh crore rupees. When it comes to balance sheet, the share of unsecured loans has reduced from 30% to 22% due to addition of low-yield mortgages. This gives the bank more room to advance unsecure loans and credit cards. There is also a change from short term loans to retail loans in the bank's book. Before merger the bank's portfolio consisted of auto loans with the highest tenure of four years followed by personal loans with two years, two-wheeler loans with one year and credit cards with the shortest tenure of one month. Due to merger the bank has gained access to parent company's (HDFC limited) forty five plus years in mortgage origination and loan servicing processes which provides golden opportunity to the bank because earlier only one-third of bank's branches offered home loans. Now the network is all set to expand leaps and bounds thereby, increasing overall credit availability in the market and lending power of the bank but an important thing to be noted in this regard is that the bank has to comply with regulatory requirements in regard to Cash Reserve ratio (CRR) and Statutory Liquidity Ratio (SLR). HDFC limited being a mortgage lender does not have to comply with the above said regulations which provided HDFC limited with extra cash that it can use to lend in the market but as a bank irrespective of merger HDFC bank is obliged to comply with those regulations²⁰.

¹⁹ HDFC merger helps boost credit off-take to 19.7 per cent in fortnight ended Jul 28: Report, The economic times, https://economictimes.indiatimes.com/industry/banking/finance/banking/hdfc-merger-helps-boost-credit-offtake-to-19-7-per-cent-in-fortnight-ended-jul-28-report/articleshow/102731352.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst last visited on 12-02-2024

²⁰ HDFC Ltd-HDFC Bank merger: Behind Sashi Jagdishan's big plans for HDFC Bank, business today, <https://www.businesstoday.in/magazine/the-buzz/story/hdfc-ltd-hdfc-bank-merger-behind-sashi-jagdishans-big-plans-for-hdfc-bank-390643-2023-07-20> last visited on 12-02-2024

IMPACT ON COMPETITION

The merger will bring about significant changes into credit landscape of banking sector. While home loans constitute one-fifth of the total credit disbursed by the bank the merger will result in expanding its housing loan portfolio. It becomes even more important as the housing market is poised for substantial growth. HDFC bank's huge balance sheet will enable to underwrite large ticket loans in housing loans segments. Despite being a banking giant HDFC bank holds a meager two percent market share this merger will give it a unique advantage by leveraging extensive network of branches in rural and semi-urban areas. By tapping into a market with huge potential HDFC bank through merger may wield its dominance to penetrate into housing loan market adversely affecting the competitors. Expansion of HDFC bank's customer base through cross-selling will only add to the concerns. Hence Competition Commission of India (CCI) has to be vigilant to prevent potential market disruptions²¹.

CONCLUSION

The merger of HDFC limited and HDFC bank is a unique event in the industry. It is going to have significant impact on all the stakeholders involved and the economy at large. It is evident that the credit off-take has surged which indicates easier access to credit. Also the larger balance sheet inherently allows HDFC bank to lend more money in the diverse segments. When it comes to lending power, this merger enabled HDFC bank to enter into top 100 in terms of assets strengthening its financial position also gaining access to HDFC limited expertise in mortgage origination and servicing will further strengthen its lending power. However, one has to take into account Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) regulations into picture as these regulations have the ability to limit lending power. On a whole one can say that the merger has positively impacted credit availability and lending power but the in the long term access to improved credit availability depends on how the merged entity i.e. HDFC bank will navigate the challenges like regulatory compliance, integration complexities and competition (considering HDFC bank being in a dominant position with significant market tapping abilities it may indulge in anti-competitive practices) in the market.

²¹ Ambuj Gupta, Examining the Competition Law Implications of HDFC Bank & HDFC Ltd Merger, <https://taxguru.in/company-law/examining-competition-law-implications-hdfc-bank-hdfc-merger.html> last visited on 12-02-2024