Merger of Public Sector Banks

Banking sector in India is witnessing a slowdown in its credit and deposit growth. Returns on equity are sliding whereas operational costs are rising. This is largely due to Non-performing Assets (NPAs) which have caused liquidity crisis in banking and NBFC sector. To counter this and seize benefits in distribution, productivity and capabilities, the government has come out with merger plan for 10 Public sector banks (PSBs). As per the plan, Oriental Bank of Commerce and United Bank of India will merge with Punjab National Bank, Syndicate Bank will merge with Canara Bank, Andhra Bank and Corporation Bank will merge with Union Bank of India, and Indian Bank and Allahabad Bank will be merged. Earlier, the Government of India approved the amalgamation scheme for Bank of Baroda, Vijaya Bank and Dena Bank, the commencement of which started from April 01, 2019.

Merger of PSBs is a welcome move by the government. It is supposed to be in the right direction as one of the causes for the slowdown in economy is reduction in lending growth following the IL&FS crisis. In 1991, Narasimham committee suggested that India should have fewer but stronger PSBs. Some of them should focus on international as well as domestic banking while others should focus only on domestic banking. However, it was only in May 2016 that effective action to consolidate PSBs began on a large scale by announcing amalgamation of 6 banks into State Bank of India (SBI).

It is important to note that the banking scenario has changed since 1970-80 when banks were nationalized. Now, with an increased banking presence from private sector banks, non-banking finance companies (NBFCs), RRBs, payment banks and SFBs, different kinds of banking facilities are available in almost every corner of the country. With such industry structure and intense competition, consolidation in PSBs makes economic and business sense for the government.

The merger initiative by the government would help banks improve their capital adequacy. Banks with small balance sheet size faces liquidity trouble periodically and the government needs to bailout them frequently. Additionally, the regulatory oversight on large number of banks has become a huge task.

Undoubtedly, consolidation at least a decade ago would have been much more fruitful than now. Banks after consolidation would not have faced a liquidity crunch which they have been facing now and therefore, the economy would not have turned towards slower path. In the face of such situation, the first step which should be taken is to rationalize the large exposures. Every bank has been dealing with large exposures due to which their lending ability has reduced drastically. Rationalizing such large exposures between merged banks would be beneficial and help in improving capital adequacy.

During the time of crisis and economic slowdown, the emphasis by banks should be more on credit growth. Consolidation activity at this time would divert management's efforts towards merger and integration processes rather than business expansion strategies. Also, management would turn conscious while lending to new or existing borrowers due to NPA mess which is going on and which in turn affect lending growth badly. Consolidation program may affect even their day to day business. Although, the government has clarified that there would not be any job loss due to consolidation, employees at every level would be worried about their future rather than focusing on tasks in hand. This might have consequences on performance of banks in initial few quarters. Evidently, recent experience of SBI and Bank of Baroda validates that focus on integration impact near-term growth.

However, due to inadequate capital and huge NPAs, the government needs to take concrete steps. Infusion of liquidity in PSBs is being done periodically but it is not yielding any results. In backdrop of this, the government announced consolidation.

The consolidation will help create strong and globally competitive banks to meet the credit needs of a growing economy, absorb shocks and enable realization of wide-ranging synergies. The banks would have wider reach, the capacity to raise resources without depending unduly on the state exchequer, stronger lending capacity, enhanced risk appetite and better products and technology to serve customers.

Furthermore, large banks will entail cost advantages by way of economies of scale such as centralized back office processing, elimination of branch overlap, eliminating redundancies in administrative infrastructure, better manpower planning, optimum funds management, and savings in IT and other fixed costs. Large banks will also be able to finance large projects on their own even while staying within the prudential lending norms imposed by the regulator. The banks may be able to avert a loss of market share to private banks and NBFCs to some extent.

The important part once the merger is complete on paper would be to effectively manage post-merger implementation to see that all the synergies identified, in terms of technology, products and services, branches, culture, etc. are realized.

One of the most significant elements which was also considered while deciding merger between banks was their Core banking solution (CBS) platform. The banks which are merging together have same CBS platform and hence could enable faster integration. However, even if the banks have same CBS platform, versions of CBS platform need to be examined. Generally, CBS platforms have different kinds of versions with some difference in their user interface, features, etc. Therefore, employees will have to get familiar quickly with the version which is going to be utilized post-merger.

To make consolidation's outcome positive in the long-term for the industry, it must be accompanied by adequate capitalization and governance improvements. If state run banks are going to have similar kind of governance issues which have led them to mounting NPAs, even intense exercise of consolidation would not yield good results. Stronger governance would translate into long-term benefits on multiple fronts including asset quality, better risk management and cost efficiency.

The government has revealed various steps to make governance stronger for PSBs. The government has decided to make a board committee in charge of appraising the performance of officers of the rank of general managers and above, including the managing director. The banks have also been allowed to recruit chief risk officers from the market, at market-linked compensation to attract the best available talent.

Allowing bank boards to reduce or rationalize the number of committees and increasing the effectiveness of the directors on the Management Committees of Boards by increasing the length of their terms were some of other reform measures which were announced to strengthen governance in PSBs.

Finally, implementation of all these measures remains the key and there needs to be some measures to judge success of the program. Whether consolidation in public sector banking has met its objectives will need to be determined. Shareholders and management should decide such success measures and examine if outcome has been in keeping with the objectives.

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