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Public sector bank consolidation may be necessary, but the belief that size solves everything needs a rethink

The idea that an economy of India's size cannot aspire for higher growth without global-scale financial institutions to bankroll it, has led Indian governments to toy with the idea of bank consolidation every now and then. But this has translated into little action. This is why it is good to see the State Bank of India moot the proposal to consolidate five of its subsidiaries (the State Banks of Bikaner and Jaipur, Hyderabad, Mysore, Patiala and Travancore) as well as the Bharatiya Mahila Bank into itself. *Prima facie*, there appears to be a sound business case for the merger. Apart from a balance sheet size of Rs. 37 lakh crore that will catapult the SBI into the league of top 50 global banks, synergies in business and treasury operations, branch rationalisation and the ability to access cheaper funds are expected to reduce the merged entity's costs by a good 100 basis points. But the success of the merger will depend on the SBI's ability to win over protesting unions and negotiate tricky integration issues.

While the SBI merger is desirable, the Centre should be wary of applying this as a cookie-cutter solution to all future consolidation moves involving public sector banks (PSBs). While proponents of the big bank theory argue that banks with larger balance sheets are more efficient users of capital, are better at recoveries and resilient to business cycles, the ongoing crisis in PSBs suggests that a more nuanced approach to bank mergers is necessary. Latest March quarter numbers reiterate that PSB giants such as the Punjab National Bank or Union Bank of India (gross NPAs of 12.9 and 8.7 per cent respectively) have proved no better managers of asset quality than the much smaller Dena Bank or Vijaya Bank (9.9 and 6.6 per cent). As poor lending decisions and concentrated exposure to large corporates are at the root of the bad loan mess, the strength of a bank's credit appraisal and risk control systems contribute far more to capital efficiency and resilience than mere balance-sheet size. While the forced takeover of a troubled bank by a stronger peer has been the quick-fix solution to stave off bank failures in the past, it may not work in a scenario where almost all PSBs are weighed down by asset quality issues. Forcing big banks that have made substantial progress in their clean-up (SBI and Bank of Baroda for instance) to take-over distressed rivals would be retrograde. The universal banking model is also under fire from digital disruption and the advent of small finance banks, payment banks and NBFCs with niche models.

These factors suggest that for public confidence in PSBs to be shored up, an overhaul of their risk control and governance structures should precede consolidation efforts. Consolidation, when taken up, should take individual bank boards into confidence and need to make strategic sense. Mergers that focus on similar lending segments to create larger banks focussed on, say, SMEs, retail loans or project finance could well be the way forward.

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