

Banking reforms: Why BOB, Dena Bank and Vijaya Bank merger will have a little effect

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The merger of BOB with Vijaya Bank and Dena Bank is quite singular for different reasons. Firstly, for the first time, we will be witnessing a merger of three PSBs (which is different from the one involving SBI and its associates) which can be a precursor to other such moves. Secondly, the three banks involved consist of two strong (one big and one small) and one PCA bank. Thirdly, the motivation for such a move, though ideological in scope, is an attempt to resuscitate a relatively weaker bank with two healthier ones. Fourthly, while two banks criss-cross one another in geographical space, the third becomes strategically significant being based in the south. Fifthly, the merger comes at a time when all PSBs are walking the thin edge negative profits. Thus, this move hints at a modicum of desperation. And, above all, there is no talk of synergies, which is normally the term used when mergers are spoken of.

Bank of Baroda is the third largest PSB while Vijaya is 17th largest in the hierarchy of 21 banks. Dena Bank is an even lower 20th. In 2017-18, Vijaya Bank was one of the very few banks which posted positive net profit. The merger of these PSBs is an exercise in statistics as it would mean the summation of numerators and denominators. Intuitively, when such additions are made, the stronger entity becomes weaker, while the weaker ones become stronger. By strategically picking up two stronger banks in this merger exercise, this frailty is partially addressed.

When judging the strength and resilience of banks, typically the CAMELS approach is used. This can also be done in this context. Capital cannot really increase as it will be the sum of the individual banks' capital, but this will be higher when merged together and will give a feeling of a stronger bank. Can the combined entity lend more? To the extent that the PCA bank cannot do so now, the combined entity can expand on the loan book. But, for the banking system as a whole, things cannot change as the capital remains unchanged.

Asset quality ratio will become less satisfactory for the banks which have lower ratios in their individual capacity, though the combined number will look better for the weaker bank. However, the quantum of GNPA cannot change and will still have to be addressed. Therefore, again, for the PSBs as a whole, the number will not change. This will not obviate the need to go in for

resolution processes for the weaker bank. Management policy will undergo a change provided the three banks have a variance in terms of governance. But if all banks are run in a similar manner as the ownership is the same, then this may not matter.

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Earnings of the three banks are at different levels and the combined entity will still have the same numbers unless there are drastic steps taken to rationalise costs, which is the only element that can be lowered. Quite clearly, the merger activity will be looking closely at the possibilities here. Liquidity for the merged entity would depend on the existing balance sheets as would the sensitivity (the S part of CAMELS) of market forces. Here, the integration into the model of the best run bank amongst the three would prevail.

The question that can be posed then is that do such mergers only push problems below the carpet, as the fundamental challenges are not being addressed through this statistical combination. Mergers are not the panacea in the context of PSBs where the character does not change. Selection of CMDs is still the government's prerogative, and even today, banks have to take orders from above. A few months back, a government official had warned PSB managers to meet all of the SME lending

targets or else get disqualified for annual increments. It can only be expected that banks will hurry to meet such targets and compromise on quality that can lead to adverse selection. Therefore, if such governance issues are not addressed, merging two or three public sector banks may not change the architecture.

At the operational level, three challenges exist that can either enhance or diminish the possibility of the success of such a merger. The first is the integration of technology platforms and cultures of these organisations. While, often all PSBs are painted with the same brush, this may not be the case, and over the last two decades, the culture has changed in the positive direction for most banks. But there could still be differences which have to be addressed.

Secondly, the way one goes along aligning the distribution of professionals in the merged bank will be interesting. It has been stated upfront that no jobs will be lost. If this is the case, there cannot be any reduction in employee cost, which, for the PSB group, is around 58% of intermediation cost. Further, the multiple posts that exist in the three banks will have to be reconciled as there can be only one head of risk, treasury, credit, HR, etc. As issues on seniority are structured and important in a public sector set-up, ensuring that there is harmony would be a challenge. In case of corporate mergers, normally the acquiring company would continue to hold the important positions, while the merged entity settles for the secondary positions if they are to be retained.

The third challenge relates to the issue concerning rationalisation of physical infrastructure which is also linked with the headcount and existing hierarchy. All bank mergers will lead to multiplicity of branches and ATMs that will have to be reviewed. There would be redundancies of the same in the combined entity. When the policy is to retain the headcount, accommodating them in a smaller set of branches will not be possible. This will probably be the biggest challenge for the merged bank.

There are evidently some positive expectations from mergers of PSBs as it has been on the talking agenda for long. However, one cannot expect alchemy in such a set up when the superstructures do not change. While mergers have been spoken of in the context of having large banks with larger lending capacity, in the present circumstances, it appears to be more of a compromise solution of showing a lesser number of banks with better statistical numbers. The belief here is that, unless there is

a change in the operating structures, mergers will only be symbolic and may not deliver the desired results in the long run. Counter intuitively, if we are willing to change the way in which public sector institutions function by giving them autonomy along with accountability, we may not require such mergers.

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