

PSB mergers a good idea? The problem gets rolled over for another day unless this big issue is tackled

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The government's decision to merge three public sector banks, Bank of Baroda, Dena Bank and Vijaya Bank, has brought the issue of bank consolidation under the spotlight. This comes close on the heels of the merger of the State Bank of India, on April

1, 2017, with five subsidiary banks. The question is: Is consolidation of banks a good idea when the banking sector is suffering from the overhang of huge stressed assets and fragile balance sheets?

In the present circumstances, it is doubtful whether our relatively large banks can absorb weaker counterparts and make profits. The reason is that it is hard to find a single PSB that is strong enough to absorb a weaker PSB. The large banks are, at present, saddled with high NPAs. For instance, in 2017-18, the gross NPAs of Punjab National Bank stood at 18%, Bank of Baroda at 12.26%, Bank of India at 16.58%, Canara Bank at 11.84 % and Union Bank at 24.10%.

Hence, the endeavour should be to first clean up the balance-sheets of PSBs. Over the next two or three years, managerial energies should focus resolutely on addressing the NPA problem while, at the same time, also concentrate on building and nurturing talent in both old and new areas.

Consolidation can wait till the NPA situation gets better. Otherwise, mergers will only end up diverting the energy of the top management from addressing the crucial NPA issue, and the gains of consolidation would prove elusive. The government may also seriously consider banking reforms, including improving governance standards, strengthening of bank boards as well as top management, providing greater autonomy and strengthening the institutional framework of the Insolvency and Bankruptcy Code (IBC).

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There is also a need to privatising PSBs, a move that will alleviate the pains and ills associated with public ownership of banks. It is also a fact that India needs more banks. RBI should continue to give licences to more small banks as well as universal banks even while carrying out the experiment on consolidation. This would also be in line with the Narasimham committee which was in favour of a large number of regional and local banks at the lowest tier of banking structure.

It is anticipated that PSBs would be merged into 5-7 large or 'global-sized' banks through mergers and acquisitions. But, this would confer the benefits of efficiency and scale-economies only when certain parameters are fulfilled. First, it is important that the initiative comes from the banks themselves. It should be market-driven, based on commercial considerations and result from synergies among the merging entities. The government should not dictate mergers.

The government-induced consolidation effort, not backed by synergies, has not brought desirable results. This is borne out from the experience of the merger of New Bank of India with Punjab National Bank in 1993, and the Global Trust Bank (GTB) with Oriental Bank of Commerce (OBC) in 2004.

In the latter case, the decision was taken by the Reserve Bank of India (RBI) and, post the merger, it resulted in OBC's capital adequacy ratio declining and gross NPA rising as GTB's gross NPA was close to 26%. It took OBC some years after the merger to restore its financial health. Similarly, the SBI merger has contributed to the bad loan portfolio of the combined entities and the net profit of the bank has taken a sharp hit. Second, the likely capital size of the merged entity needs to be considered while evaluating the decision for consolidation. There should be gain, and not an erosion of capital base post the merger process.

Third, it is essential to carefully weigh and assess the likely benefits of the proposed merger through rationalisation of branches, additional business, harmonisation of procedures, productivity gains, common treasury pooling, enhanced scale of operations

and rationalisation of common costs against the likely future costs such as the anticipated increase in non-performing assets, integrating technology and human resources and loss of business with closure of some branches. Fourth, banks from different geographies should be chosen for merger going ahead.

For example, a South-based bank could be merged with a North-based bank as this would enhance business through additional customers. The acquisition by Kotak [Mahindra](#) Bank of ING Vysya Bank in 2014 was primarily driven by geographical synergies. This is also one of the positives of the recent three-bank merger that is expected to increase the footprint of the merged entity in the southern states. Five, the PSBs would have to emerge as strong and valuable after consolidation; otherwise, their capacity to raise resources from the market would be constrained. Size alone does not matter.

The merged bank needs to be strong and profitable. This is one of the lessons to be learnt from the global financial crisis of 2008 wherein it was believed that no big bank could ever fail. Hence, banks would need to cut costs by shutting down unviable branches, reducing staff, avoiding duplication of work and improving on technology to retain a large capital base and stay ahead of the global competition. Six, to ensure that the integration of entities is a smooth process, the most important task would be to embark on a human resource strategy that can help address the core concerns of employees.

Many employees would fear job loss and disparities in the form of regional allegiances, benefits, reduced promotional avenues, new culture, etc. This may lower their morale and create problems which could come in the way of success of the merged entity. Seven, harmonisation and integration of technology is a challenge as various banks are currently operating on different technology platforms. Hence, IT integration strategy should be aligned with the business strategy right from the beginning to ensure a successful merger. Eighth, it is also desirable to guard against the possible monopolistic and anti-competitive tendencies which might accrue from consolidation.

To conclude, it could be said that bank consolidation, if properly leveraged, can confer significant benefits to the economy. But, consolidation should be a well thought out strategy, by looking at synergies and assessing the likely costs and benefits, so that post- merger, there is a distinct improvement in the balance sheet of banks.

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