

Is there much to gain from bank mergers?

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2



The post 1991 experience doesn't indicate so. Also, on the metrics of bad debts and profit, most of the mergers weren't required

Every policy has a perspective and purpose. Merger of public sector banks (PSBs) too might have its own reason. Pressures on the banking sector are building up globally, more so in emerging markets.

A recent McKinsey report sees banks in Asia Pacific 'grappling with thinning margins, declining asset quality, and rising capital costs'. Pre-tax profits that grew 12 per cent a year during 2010-14, slipped to 3 per cent in 2014-18, four percentage points lower than the global average. Returns on equity are sliding whereas operational costs are rising. Search for scale once again returned to centre-stage to seize 'benefits in distribution, productivity, and capabilities'.

To that extent the intent to merge is consistent with current concerns and in the context of Indian banking, which is grappling with a huge wave of worries.

The government might have done its own math for the merger, but from the point of a heavily banked intermediated country, with a credit-to-GDP ratio of 75 per cent, that still gives industry a lot of space for growth.

In this context, a few issues arise: the scope for organic growth, as most of the merged banks had performed well in the past and still hold potential to rebound; the procedure of picking targets in accordance with the severity of problems; and the opportunity costs of foreign investments.

If the merger is a market-driven process, some of these factors could have been discounted. But since it is one from a mandate, uncertainties arise about efficacy of this exercise falling short of expectations in the long run.

Conventionally, the motives for bank mergers fall into four major groups: cost benefits (economies of scale, efficiency, cost of funding, risk diversification); revenue benefits (economies and scope for large deals); economic conditions (up and downswings in business cycles); and other motives (valuation, managerial benefits, pre-empting possible takeovers, etc).

Add to these the need to speed up growth, which is the biggest concern now for India. Bank mergers are a common fare. More than 700 banks were merged in Asia, Latin America and Eastern Europe in 1997-99, following the Asian financial crisis, and an equal number after the global financial crisis.

Every merger creates its own noise but it is the substance that counts in the long run. A BIS paper finds “empirical evidence on gains from mergers is often weaker than the claims of the merging institutions and some economies of scale could be exhausted at relatively low levels”. A study covering 20 years of bank consolidation in industrial countries found it “beneficial up to a relatively small size, but there is little evidence that mergers yield economies of scope, or gains in managerial efficiency”

Some of it could be seen from India’s own experience that saw merger of 30 banks since 1991, some induced by mandates and others by markets. Merger of New Bank of India with PNB in 1993 did not have a good effect on the latter.

Merging United Western with IDBI Bank also did not do any good.

The benefit to ICICI acquiring Bank of Madura, Sangli and Bank of Rajasthan is unclear, though HDFC (Times Bank and Centurion) and Kotak (ING Vysya) claim benefits. Irony is that OBC which was asked to take over Global Trust Bank in 2003 itself now has become a target of mandated merger with PNB.

Metrics for mergers

Then there is the issue of the metrics chosen for the merger. If it is about bad debts, then Gross NPAs for the system as a whole fell from an average 43 per cent in 2013 to 24.1 per cent in 2018 with similar decline seen in nationalised banks (42 to 24 per cent) and in private banks (26 to 18 per cent) that reveals the issue is more systemic in nature than ownership specific.

About choice of targets, Andhra and Corporation reduced NPAs by ₹9,972 crore in FY18 on a combined NPA portfolio of ₹34,714 crore, whereas Union Bank with whom these two were merged could reduce ₹3,476 crore on a total bad loan portfolio of ₹33,712 crore.

The merged banks had Basel III capital ratios of 9-11 per cent that does not cause an immediate threat. Vijaya Bank's Basel III CRAR of about 14 per cent is higher than that of many other banks with no record of loss since 2005, yet became a target of merger. Whereas Indian Bank, considered a basket case a decade back, has become suitable enough to absorb another PSB. The metrics for merger should have gone beyond mere size.

Then there is the disconnect in profit criteria. The losses of Dena and Vijaya at ₹3,721 crore during 2016-18 were less than those of Bank of Baroda at ₹7,828 crore; that of OBC and United, at ₹8,701 crore, lesser than the ₹16,256 crore of PNB; and Syndicate's, at ₹4,683 crore, lesser than Canara's ₹7,034 crore.

Andhra and Corporation are an exception with losses of ₹7,971 crore, higher than Union's ₹5,247 cr. But that's not such a big difference. In contrast, UCO with combined losses of ₹9,086 crore, IOB with ₹12,614 crore and Bank of

Maharashtra with ₹2,517 crore during 2016-18 are still awaiting action, raising speculation on their being left out.

About 85 per cent of new recapitalisation is given to four banks that will absorb six banks, leaving questions about its efficacy.

Then there is opportunity cost too. For instance, foreign investment in nationalised banks averages a mere 4.8 per cent, compared with 43 per cent in new private banks and 27 per cent in old private banks. If the idea behind consolidation is to attract foreign investment, that seems misconceived. There will no longer be a number of banks for investors to choose from.

Banks like Vijaya, Syndicate, Corporation and Andhra are located in regions that are witnessing rising income levels and an expanding middle class amidst booming technology and modern manufacturing, which could surely have helped them recover their prowess with a little more focus and thrust.

How many banks does a big and growing economy needs? India thinks 12 PSBs is enough along with 20-odd private banks and 35 foreign banks that have little share in business. China has 136 in the World's Top 1000 and if that is not comparable, then a small economy like the Philippines has 45 big universal banks, 54 mid-sized thrift banks and hundreds of rural banks, with Moody's rating them as stable in the medium term.

The writer runs the consulting firm 'Growth Markets Advisory Services'. The views are personal

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2

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