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A STUDY ON THE CONSOLIDATION AND MERGER OF PUBLIC SECTOR BANKS (PSB) IN INDIA: ISSUES AND CHALLENGES

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ABSTRACT

Indian economy is known for its perseverance, over the years it has faced continuous fluctuation, global economic depressions, and recent reforms of the government with ease. The Banking sector is considered as the lifeline of an economy. The Indian banking sector has its own reputation in the international level for maintaining its stability, even though the global economic environment and the emerging trends in financial sector pose challenges. There are many public sector banks in India; given this, consolidation and merger is a good idea in principle. The merger will help the banks to improve operational efficiency and customer services; this would involve synergies in the branch network, low-cost deposits and subsidiaries. But consolidation and merging of banks is not an easy task, because these are not normal times and with many public sector banks in distress and facing precarious situation. It is a challenging situation for the Government to identify stressed banks and motivate them to merge with a larger entity. In this research paper the author has tried to examine the scope, implications and drawbacks of the merger process, and also to identify the major challenges and consequences in its way.

Keywords: Public Sector Banks, NPAs, Consolidation and Merger

INTRODUCTION

As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalized and well regulated. The Financial and Economic conditions in the country are far superior to any other country in the world. Credit and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. Indian banking industry has recently witnessed the roll out of new banking models. Among them the merger of weak and loss incurring Public sector banks with the large banks is under serious debate. The merger is part of the government's efforts to consolidate the banking industry with an eye on overcoming the bad loan crisis. Merger is an attempt by the government to help stem the rise in bad loans or NPAs at a time when corporate demand is weak. Mergers of banks are one way of managing the problem and therefore cannot be totally discounted. However, the trick lies in ensuring that the merger fallout is managed prudently. The proposal is a part of a broader move to consolidate the banking system and reduce pressure on the national exchequer.

RBI will watch Banks on their performance, especially in terms of NPA (Non-Performing Assets) otherwise loans which are not recovered. If NPA percentage of bank is above prescribed norms, it will be asked to merge with a

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bigger bank to ease the situation as combined capital of Banks will be higher and thereby reducing the NPA percentage.

There are 10 PSU banks under RBI's Prompt Corrective Action (PCA) framework. They are - Dena Bank, Allahabad Bank, United Bank of India, Corporation Bank, IDBI Bank, UCO Bank, Central Bank, Indian Overseas Bank, Oriental Bank of Commerce, Bank of Maharashtra and Bank of India with NPAs ranging from 15% to 31%.

OBJECTIVE

The main objectives of the study are:

- To understand the concept and reasons for consolidation and merger of Indian Banks.
- To identify the banks with high Non Profitable Assets (NPAs).
- To examine the implications and challenges from merger of Indian Banks.
- To suggest measures for achieving the goal of merger.

RESEARCH METHODOLOGY

The research paper on the title "A Study on the consolidation and merger of Public Sector Banks (PSB) in India: Issues and Challenges" is done on the basis of descriptive analysis method, based on secondary sources. For this study, various articles and research papers on the relevant topics are comprehensively studied. Since it is one of the most debated issue in recent times, in the Indian economy, more emphasis is given on articles published in Newspaper, Editorials, online learning sources, debate and discussions conducted in news channels to obtain recent statistical data and to comprehensively cover the issue. The author has tried to produce the research paper in an authentic manner.

REVIEW OF LITERATURE

a. India-Ratings (2018) revealed that the asset-liability mismatch of the smaller banks such as Vijaya and Dena can be better addressed at the consolidated level. Merger could bring about material operating efficiencies over time reducing combined operating costs, lower funding cost and strengthened risk management practices on a consolidated basis and may act as a roadmap for further consolidations in the public sector banking space.
b. Jyoti H. Lahoti (2016) opined that merger and acquisitions are important corporate strategy actions that aid the firm in external growth and provide it competitive advantage. Mergers and acquisitions (M&A) are being increasingly used in today's globalized economy, for improving competitiveness of companies through gaining greater market share, broadening the portfolio to reduce business risk, entering new markets and geographies, and capitalizing on economies of scale etc.
c. Jayashree R Kotnal (2016) Mergers and Acquisition is a useful tool for the growth and expansion in any Industry and the Indian Banking Sector is no exception. It is helpful for the survival of the weak banks by merging into the larger bank. This study shows the impact of Mergers and Acquisitions in the Indian Banking sector.
d. A.N.Tamragundi, Devarajappa S (2016) examined the impact of mergers on performance of selected commercial banks in India. The impact of mergers on performance of the banks has been evaluated from three prospective. There is a significant improvement in Deposits, Advances, Businesses and Number of Employees of all selected banks. Therefore, this result indicates that Mergers can help commercial banks to achieve physical performance.

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e. Gurbaksh Singh, Sunil Gupta (2015) compared pre -and - post merger performance of the selected banks after the 1990 and collected the data and information. The impact of mergers changes in profitability i.e. return on Capital Employed, Return on Net Worth, Operating Profit Margin and other financial ratio is compare. The financial performance of the banks has increased which margin to the gain of selected public and private sector bank in Indian Banking Sector.

f. Prashanta Athma, A. Bhavani (2012) focused on the pre and post merger performance of SBI and HDFC Banks, during the period between 1991- 2017 in total twenty two mergers have taken place in Indian Banking Sector. During the post merger period, all the key parameters displayed an increasing trend excepting Number of Employees and Profits in case of SBI and Number of Employees in case of HDFC Bank.

g. M Jayadev, Rudra Sensarma (2007) analyzed some critical issues of consolidation in Indian banking with particular emphasis on shareholders and managers. The study revealed that in the case of forced mergers, neither the bidder nor the target banks shareholders have benefited. The study strongly supported that Indian financial system requires very large banks to absorb various risks emanating from operating in domestic and global environments.

BACKGROUND

The first consolidation was recommended in 1991 by the Narsimhan Committee under the chairmanship of M. Narasimham (former Governor, Reserve Bank of India). The Committee recommended that the actual numbers of public sector banks need to be reduced. It recommended a 3-tier banking structure. Again in 1998, the committee reiterated the recommendations for merger of large Indian banks to make them strong enough for supporting international trade. It recommendations are –

- There should be only 3 to 4 large banks which be developed as international banks at the top.
- These large banks will have international presence.
- Then there should be 8 to 10 banks having nationwide presence should concentrate on the national and universal banking services.
- Local banks should concentrate on region-specific banking.

The fiscal year 2016–17, was one of the challenging year for all Public sector banks, with their collective net loss of Rs.11,865 crore. Also, it was the year when the gross and net non-performing loans of banks were at a historical peak. The government is now serious for consideration of reducing the number of Public sector banks from 21 to 12 with a view of creating 3-4 large global sized banks. This move will add to the operational strength of the PSU banks.

The aim of RBI in bank merger is merging weak banks with strong banks to prevent loss to depositors and building strong banking sector. This is done on the basis of evaluation found in the inspection report conducted; sec 35 of the Banking Regulation Act, 1949.The merger of public sector banks is under the policy of central government. According to Financial services secretary Rajiv Kumar, the two guiding principle for merger is –

- To create a healthy bank that was large in size.
- To have an entity that had a strong brand, technology and a good reach.

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Table No. 01: Public Sector Banks; smaller in size but with high NPAs

Sl. No.	Bank Name	Gross NPA (%) 2017	Gross NPA (%) 2018
1	Bank of India	13.05	16.66
2	Bank of Maharashtra	18.59	21.18
3	Central Bank of India	18.23	22.17
4	Dena Bank	17.37	22.69
5	Indian overseas Bank	23.60	25.64
6	Oriental Bank of Commerce	14.83	17.89
7	UCO Bank	19.87	25.71
8	Union Bank of India	12.63	16.00
9	United Bank of India	17.17	22.73

Source: RBI, AceEquity, Government announcements

Important Bank merger Proposals

The Government of India has recently formed a panel to consider and oversee mergers among the country's 21 state-run banks. Finance Minister Arun Jaitley will lead the panel. The other members of the panel are - Railway and Coal Minister Piyush Goyal and Defence Minister Nirmala Sitharaman.

Bank of Baroda, Vijaya Bank and Dena Bank

The most recent one is the trio of Bank of Baroda, Vijaya Bank and Dena Bank. The government proposed the merger of these three banks aimed at creating the country's third-biggest lender. Bank of Baroda is the biggest of the three with Rs 10.29 lakh crore of total business, followed by Vijaya Bank and Dena Bank. In this merger, the government found the right fit. "Dena Bank has a strong Current Account and Saving Account (CASA) base with a good retail and MSME presence. Vijaya Bank was sensible in its lending, while Bank of Baroda offers a good international presence, a strong brand and a good tech platform will result in a massive cost rationalization.

Table No. 02: Overall financial standing of the three banks and their combined entity

Sl.No.	Parameters	Bank of Baroda	Vijaya Bank	Dena Bank	Merged Entity
1	Total business (in lakh crs.)	10.29	2.79	1.72	14.82
2	Total Deposits (in lakh crs.)	5.81	1.57	1.03	8.41
3	Gross Advances (in lakh crs.)	4.48	1.22	0.69	6.40
4	Net NPAs	5.4	4.1	11.04	5.71
5	CRAR (%)	12.13	13.91	10.6	12.25
6	Branches	5,502	2,129	1,858	9,490
7	Employees	56,361	15,874	13,440	85,675
8	Net Profits/Loss (in crs.)	528 cr. profit	144 cr. profit	-721 cr. Loss	-

Source: http://www.economictimes.com

The finance ministry stated that the provision coverage ratio (PCR) of the proposed amalgamated entity will be 67.5%, well above the average of public sector banks (PSBs) at 63.7%. The capital adequacy ratio of the combined entity would be at 12.25%, significantly above the regulatory norm of 10.875%. One of the reasons for choosing these 3 banks was that the two stronger ones will absorb the weaker entity.

State Bank of India and its associate Banks

The union cabinet decided to merge the five associate banks of State Bank Group with State Bank of India on April 01, 2017. With this merger, the total customer base of the bank has reached to 37 crores with a branch network of around 24,000 and nearly 60,000 ATMs across the country. This has placed State Bank of India among the top 50 banks in the world.

Table No. The financial status of Associate banks of SBI*

Sl. No.	Name of the banks	Deposits(crs)	Gross Advances	Gross NPAs (%)	Net Profit/Loss
1	State Bank of Bikaner and Jaipur (SBBJ)	1,03,662	68,774	15.5	-1,368
2	State Bank of Hyderabad (SBH)	1,42,955	87,715	20.7	-2,760
3	State Bank of Patiala (SBP)	1,00,507	77,100	23.1	-3,579
4	State Bank of Travancore (SBT)	1,14,323	52,506	16.8	-2,152
5	State Bank of Mysore (SBM)	77,769	38,608	25.1	-2,006
6	Bharatiya Mahila Bank (BMB)				

*As on march 2017

Source: SBI Annual report 2016-17.

State Bank of Indore and State bank of Saurashtra was merged with SBI in 2010 and 2008 respectively.

Other major mergers in recent past.

1. Life Insurance Corportion of India taking over IDBI Bank (2018)
2. ING Vysya Bank merger with Kotak Mahindra Bank In Nov 2014
3. The Bank of Rajasthan merger with ICICI Bank in 2010.
4. Centurion Bank of Punjab merged with HDFC Bank in 2008
5. The Sangli Bank merger with ICICI Bank in 2007.
6. Bharat Overseas Bank merger with Indian Overseas Bank (IOB) in 2007.
7. Global Trust Bank merger with Oriental Bank of Commerce (OBC) in 2004
8. South Gujarat Local Area Bank Ltd merger with Bank of Baroda in 2004.
9. Benares State Bank Ltd merger with Bank of Baroda in 2002.
10. Times Bank Ltd. merged with HDFC Bank in 2000.
11. New Bank of India merger with Punjab National Bank (PNB) in 1993.

Benefits of Bank Merger

"*This is a progressive move and signifies the government's determination to strengthen the banking sector in the country for a better performance and service delivery,"*

– Rashesh Shah, former President of FICCI

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a. *Reduce the cost of banking operation:* Merging with larger bank will help to increase banks margins by lowering deposit rates. A larger entity can manage its short and long term liquidity better. There will be less need for overnight borrowings in call money market and from RBI under Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF).

b. *Broadening the geographical reach:* The geographical reach of banking services can be achieved better with the merger of large public sector banks. Leveraging on their expertise the merger will help the geographically concentrated regionally present banks to expand their coverage.

c. *Better Risk management and fall in NPAs:* With larger capital base and higher liquidity, the burden on the central government to recapitalize the public sector banks will come down substantially. Large banks would have a wider capital base enabling them to offer big ticket loans on their own without being part of consortium.

"The Indian banking system could be better off if some public sector banks are consolidated to have fewer but healthier entities, as it would help in dealing with the problem of stressed assets".

– Urjit Patel, Former RBI Governor

d. *Access to large customer base:* A bank merger helps a bank to scale up quickly and gain a large number of new customers instantly. Customer will now have more number of branches and ATMs to access their accounts. Another advantage for the customers is the charges on cross bank ATM usage would reduce considerably.

e. *Fill up technology gaps:* Bank mergers and acquisitions will help the banks to fill product or technology gaps. From technology angle, acquisition of a small bank by a larger bank might allow the smaller bank to upgrade its technology platform significantly.

f. *Better control of RBI:* better control on the system and implementation of policies will be seen from RBI. Since, it is convenient for RBI to regulate few banks from regulatory perspective; monitoring and control of less number of banks will be easier.

g. *Reduce scale of inefficiency:* With the large scale expertise available in every sphere of banking operation, the scale of inefficiency which is more in case of small banks, will be minimized. The system could be better off if the banks are consolidated into fewer but healthier banks.

h. *Integrated growth of the Banking sector:* Larger size of the Bank will help the merged banks to offer more products and services. Smaller banks have repeatedly failed to maintain their asset quality. If the small banks merge into larger ones which have the capability to do appraisal of projects and large businesses they can grow with less risk.

i. *Better management of human resources:* The human capital in the banks will be better managed, better integration of the workforce, centralized transfer system, uniformity in pay-scales, and uniformity in terms of employment policy etc. Consolidation will also increase capital efficiency, apart from improving the ability of banks to recover bad loans which are rising.

j. *Greater recognition of Indian Banking:* In the global market, the Indian banks will gain greater recognition and higher rating. The consolidation will help create a strong global competitive bank with economies of scale and enable realization of wide ranging synergies.

k. *Consolidation of infrastructure:* With a centralized system, unproductive competition is wiped out, a centralized management system will solve the time wasted in transaction, paper work and delegation is reduced. This has a snowballing effect whereby the system is now able to function as a well oiled system, with minimal hindrances in day to day functioning.

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l. *Improving the professional standards:* There is an improvement in professional standards amongst the merging entity and new entity and the best of service conditions continue to apply to all of them. So, employees of relatively smaller banks will get an opportunity to improve their working through knowledge and technology transfer.
m. *Financial savings:* Multiple posts of CMD, CEOs, GM and Zonal Managers will be reduced, resulting in substantial financial savings. Bank staff will be under single umbrella in regard to their service conditions and wages instead of facing disparities.

Major Challenges

a. V.A. Joseph, the Managing Director, Federal Bank opined that "most acquisitions in India were borne out of compulsions and over 90 per cent of past acquisitions had failed to achieve the objectives".
b. Many banks focus on regional banking requirements. With the merger the very purpose of establishing the bank to cater the regional needs is lost. The Large global banks had collapsed during the global financial crisis such as Deutsche Bank, while smaller ones had survived the crisis due to their strengths and focus on micros aspects.
c. The weaknesses of the small banks are transferred to the bigger bank in the current merger. It will be difficult for the entire banking system to sustain. The State Bank of India, which merged five of its associates and Bharatiya Mahila Bank (BMB), with itself, last year, has been struggling with losses for the last three successive quarters (Q1FY19 loss was Rs 4,875 crore).
d. Forced mergers make little business sense for the stronger banks as they are unlikely to solve the bad loan crisis that has gripped the banking system as a whole. It is important to ensure that such mergers do not end up creating an entity that is weaker than the original pre-merger strong bank.
e. Technology integration in theory is easy to achieve but in practice it will require a lot of hard work like just getting a new account code for all customers and communicating that will not be a simple thing. Replacement of cheque books, RTGS, NEFT details and net banking interface will create confusion among customers.
f. Another major concern was the possible reduction in the employment, which has erupted opposition from the employees/Unions about the possible fall out of such merger and the impact of these on their job security, service conditions and career progressions in their respective banks.

Consequences

a. The government considers that there will not be a reduction in workforce; however, there are possibilities that future recruitment will be having lesser vacancies since the bigger organization is already having sufficient work force. On account of merger employment situation may deteriorate.
b. Employees of smaller banks lose identity of their organizations and they will have to increase their efficiency to match with the counterparts in parent units. Thus, Integration of people will be a major challenge in merger.
c. Customers who are allotted new account numbers or IFSC codes will have to update these details with various third-party entities: Income tax department for tax refunds, insurers to get maturity proceeds, mutual funds to get the redemption amounts and the National Pension System (NPS).
d. Customers will have to deal with the branch rationalization exercise. The new IFSC and MICR code applicable to the branch and account will be changed, funds transfer and other financial transactions will also slowdown.

e. The number of public sector banks will come down, perhaps to 6 or 7, after the proposed consolidation of banks. This will end the unhealthy and intense competition going on even among public sector banks as of now. Also, consumers will have less choice of banking.
f. Financial inclusion plans may be affected and the deadline for their implementation may be delayed. 'Direct Benefit Transfer' (DBT) of government aid, subsidies and grants also will be affected.
g. Leads to closure of bank branches in various parts. Chaos and confusion among the customers is common. The customer can feel a sense of loss of their bank and its friendly employees. Further, Customers will have less choice of selecting a bank.

Suggestions

- The central government shall not rush towards the process of banks merger. Because, it requires a careful study of financial status of banks in depth and sufficient time to implement the scheme of mergers.
- The decision with regard to selection of distress banks for merger with larger and stronger banks is to be taken carefully and grouping of various banks for this purpose is the key issue.
- The acquiring bank shall not attempt to dominate or subsume the acquired bank. Good aspects of both the banks before merger shall be combined, in order to build confidence in all stakeholders and to produce better results.
- Employees will have to undergo intermittent training programs to get acquainted with the philosophies, processes and technology in the new environment.
- The management must be ready with a good roadmap for this and allot considerable budgetary resources for this purpose.
- There shall be conscious and organized efforts to synthesize the differing organizational cultures, for the mergers to yield the desired results.

CONCLUSION

Merging two financial institutions is cumbersome and not an easy task in terms of consolidating the accounts, infrastructure, management and marketing policies etc. of merging banks. It will take lot of perseverance to complete the merging process. Considering the above facts though this is good idea for better governance, but the consolidation of banks cannot be successful until and unless issues of corporate governance, structural issues related to them are resolved. The latest merger of Dena Bank and Vijaya Bank with the Bank of Baroda is seen as a rescue mission for Dena Bank. The consequences have to be seen in near future. The last merger of SBI with its associate banks had to contend with depressed performance. But the move of consolidation and merger of banks is motivated by the words "there may be short-term pain but the long-term gains will not take far long to manifest themselves".

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