

Impact of Recent Banking Mergers Systems and Economic Development – A Study

***Dr.M.Krishnappa. Associate Professor of Economics, Govt. First Grade College, Kolar.**

Abstract

As a result, the banking products, operational systems and procedures and norms of business were all common. Third, all ABs were operating under the same information technology platform as SBI. Since the time SBI launched massive computerisation in the mid-1990s to automate all branches, it had included the ABs in the exercise. In 2002, it had engaged Tata Consultancy Services to roll out a core banking solution covering the entire group, and the ABs were beneficiaries of the common code and linkages. Fourth, the treasury operations of the ABs had been integrated with SBI for several years. This has provided valuable expertise to them, and cost advantage in fund mobilisations. Lastly, major loan decisions of ABs used to be vetted first by SBI under centralised control before the proposals received local approval at the concerned AB's board. This oversight had added a valuable layer and helped steer the asset portfolios of ABs on generally prudential lines. While the formal merger of the ABs went through quickly, SBI's task of fully integrating the new arrivals has just begun. While SBI would take considerable time to benefit from scale economies, its biggest challenge meanwhile will be on the human resources front. The Narasimham Committee had envisioned in 1991 that SBI should progressively merge all the seven subsidiaries with itself. Long thereafter, in 2008, State Bank of Saurashtra was the first to merge with SBI, and two years later, State Bank of Indore was integrated.

Key words: RBI, Merger, SBI, PNB, Narasimham Committee

Introduction

The combined headcount of employees at ABs, about 70,000, is a third of SBI's aggregate strength, which is now the fifth largest employer in India. Integrating this huge number and deploying them productively would pose major issues. Besides the bloated employee costs, the pension and retirement benefits would make a large dent on SBI's profitability for several years. SBI is said to be evaluating the issue of rationalising the branch network post-merger. Early estimates might reveal that over 1,000 branches may need to be combined, or operations rationalised/relocated. There are challenges in enhancing skill levels of employees of erstwhile ABs who had so far had a regional focus with limited exposure. While SBI has some bandwidth to face these and other challenges due to its trained executive pool and large capital resources, absorbing more than one bank at the same time would be a nightmare for other PSBs. Merger of PSBs It is well known that the consolidation exercise of PSBs has moved to the front pages of newspapers following their mounting non-performing assets (NPAs) and the pressures

for infusing additional capital faced by the government. In the process, there is a visible sense of urgency to rush through a process that should have been spaced out in an orderly and well-thought-out manner from the time it was mooted more than two decades ago. The excessive bad loans in some PSBs have not been a new phenomenon. The public sector Indian Bank, for example, was once saddled with a record loss of ₹1,336 crore in 1996, a result of faulty credit decisions in the past. There were suggestions to restrict Indian Bank as a “narrow bank.” The bank, however, did a remarkable turnaround in three years and bounced back to sustained profitability.

Objective:

This paper intends to explore impacts of merger / acquisition in banks with government as the biggest shareholder of over 25 banks had to provide capital for them

What is keeping PSBs from stepping up credit to industry, especially project loans? Lack of capital is undoubtedly the biggest factor. The capital adequacy ratio at PSBs is currently 11.82% compared to 15.68% at private banks.

The average for PSBs masks differences among various banks. Some nationalised banks may be operating close to the minimum prescribed level of 9%. For banks to be able to take risks with lending to industry and especially with project finance, they need a cushion of at least 4 to 5 percentage points above the minimum. This means they should be having a capital adequacy of around 13%–14%.

The principal failure today is thus of adequately recapitalising PSBs. Many PSBs are in no position to raise equity capital from the markets. The government, for its part, is unwilling to provide the necessary capital. We keep hearing that the government does not have the fiscal space to provide the necessary capital. This contention needs to be squarely refuted.

First, the government does not have to infuse cash from its budget. It could subscribe to PSBs’ equity and the banks could invest the proceeds in Recapitalisation Bonds offered by the government. In the year in which such an exchange takes place, the government bonds are not treated as part of the fiscal deficit. It is the interest payment in future years that counts towards the fiscal deficit.

Second, the fiscal cost of recapitalisation in India—less than 1% of GDP in over two decades—is probably the lowest in the world, so we can afford to spend more.

Third, recapitalisation in the past has served to improve the government’s own returns from PSBs, so recapitalisation is not “money down the drain.”

Fourth, the cost of recapitalisation must always be weighed against the loss of economic output on account of inadequate credit.

Management Needs Attention

Turn now to the third issue at PSBs today, the impending wave of exits at the top management level. One post of chief executive officer (CEO)/chairman and managing director (CMD) is lying vacant at the moment. In 2016, eight retirements of CEOs/CMDs are due and another 10 retirements are due in 2016. At the executive director (ED) level, five retirements are due in 2016, seven in 2016, and 10 in 2016. More than 73% of staff in deputy general manager/general manager cadre are over 55 years of age (Mundra 2016). The neglect of succession planning, which has happened over several years, is now showing up.

We do not see the requisite urgency in tackling the issue of managerial manpower. The immediate challenge is to select persons to fill the top management vacancies and give them a clear mandate to plan for vacancies down the line. The Bank Board Bureau (BBB) has been tasked with recommending names for the posts of CEO/CMD and ED with the final decision vesting with the government. The entire process appears to be taking longer than it should, else we would not be seeing a CEO-level vacancy at a PSB.

The BBB is said to be asking for the power to make appointments of CEOs and independent directors to be devolved to itself, as recommended by the P J Nayak Committee in 2014. There is also a clamour for appointments to be devolved further to the boards of PSBs themselves.

These changes are unlikely on past record. If they do happen at all, it will be over a very long period. Until then, the onus is squarely on the government to expedite appointments of top management as well as of independent directors.

It is hard to miss the broad message underlying the state of drift at PSBs. The government appears to have concluded that the best way to deal with the governance challenges posed at PSBs is to reduce the number of PSBs. That would, in principle, leave the government with fewer PSBs, and stronger ones at that. If this means that the market share of PSBs in bank credit and deposits must fall, so be it.

Trading in stock market.

There have been several learned discussions recently, that the high level of NPAs of PSBs is attributable to the general business cycle—the downswing in economic climate following the boom years of 2007–08. PSBs are faulted for their overzealous involvement in lending to the infrastructure sector following the vacuum created by the absence of development banks, without caring to build proper risk assessment and project monitoring capabilities on their own. By March 2015, NPAs in the infrastructure sector of PSBs were 22.8% of their aggregate problem loans. As pointed out by former RBI Governor Raghuram Rajan, a large chunk of NPAs at PSBs relate to projects that are indeed viable. These projects have remained incomplete for several extraneous reasons, such as problems in land acquisition and environmental clearances, which are hopefully being addressed by the concerned ministries. This is bound to improve the risk rating of NPAs in the period ahead. While the bad loans have resulted in negative credit growth in PSBs and a general mood of risk aversion, the banks have, at the

same time, stepped up personal lending activity, specifically housing loans. PSBs' personal loan growth today has approached that of the private sector banks. The exercise of consolidating PSBs should therefore be based on a sound analysis of every PSB, a granular analysis of its assets and liabilities, sector-wise loan exposures, security back-up, common loans among PSBs, etc. A key factor to consider is whether the merger of any two PSBs would result in substantial value addition in the combined entity, or result in value diminution. Just the large size of a combined balance sheet cannot be a conclusive indicator. It is also worth asking as to whether PSB mergers would make better sense once there is progress in resolving the current unconscionable levels of NPAs.

It should therefore be an immediate task to strengthen the talent in "anchor" institutions before initiating mergers. Recruiting the right people from the market, and attracting experienced executives from other banks by offering better pay packages, would deserve consideration among others. A talented leadership should be able to work on integrating the cultures of two merging banks. Culture has remained a dominant barrier to effective integration worldwide. Despite an apparent uniform culture in PSBs, there are wide differences borne out of regional backgrounds and several intangible factors. While private sector banks have attempted to forge a uniform culture by taking some drastic measures, such as forcing employee severances (which was adopted by ICICI Bank towards Bank of Madura's staff in the aftermath of their 2001 merger), this is seldom feasible in PSBs. Integrating human resources in matters such as compensation, deployment and performance appraisal can be daunting in PSBs. While this was disastrous in the merger of PNB with New Bank of India, IDBI Bank in the recent past is known to have faced several issues while attempting to streamline human resource policies of staff of the erstwhile development bank with the commercial banking stream. Another key challenge is on the technology front. Unlike the SBI merger, there is no uniformity in the information technology architecture in PSBs, each bank having engaged multiple vendors for developing its system.

PSB architecture and nation's interests

The banks are currently at varying stages of rolling out new initiatives with existing or additional vendors. To forge uniformity and implement a common system that would seamlessly cover all aspects of the banking business in the merged entity will be a challenge that can stretch out for a long time. Careful Plans It is, therefore, advisable to pursue the merger option carefully and with caveats. First, it would be wise to start with two anchor PSBs, each of them getting ready to take over one PSB each, preferably small ones. The aim should be to complete the integration within, say, 12 months, and create a template for further mergers. A consideration in previous RBI-inspired mergers was to facilitate the acquiring bank to enlarge its footprint in regions where it did not have adequate presence. Thus, by asking OBC to take over GTB, it was argued that the latter's branch network in the southern region, where OBC lacked presence, could help it to become a bigger national bank. Such considerations are no longer relevant as alternatives to brick and mortar banking emerge. It would make sense to marry banks that have pronounced common identities that could help strengthen the cultural quotient and network streamlining. Thus, combining Punjab and Sind Bank with PNB, or Vijaya Bank with Canara Bank could make

practical sense due to their common cultural identities and overlapping branch networks. There should be a directive that, post-merger, the branches should be rationalised to eliminate overlaps within a clear timeframe. Second, ahead of the merger, non-banking investments of identified PSBs in areas such as insurance, broking and investment banking would need to be critically evaluated, with a view to requiring the banks to either exit from them, or offload the investment within a firm time frame. This may be necessary to focus on banking instead of dissipating scarce talent to pursue unrelated areas. Third, it is relevant to consider whether one or more “weak” PSBs can be restricted to play a regional role, or in a specific segment, instead of continuing their pan-India presence, or as multi-functional entities. The private sector is already sensing good opportunities for small finance banks, or catering to small and medium enterprises (SMEs), trade financing, and agriculture.

There is sound logic for some PSBs to be assigned exclusive roles in such segments. For example, Dena Bank, which was for several years a highly profitable bank focused on trade financing, could be oriented as a bank exclusively for SMEs or traders. Likewise, the “weak” Bank of Maharashtra could become a bank focused on rural Maharashtra, thanks to its intimate knowledge of the region and the brand equity it enjoys among the local population. In such cases, the PSBs should shed branch networks outside the region, and aim to release resources blocked in real estate in dysfunctional corporate and planning offices. On its part, the government should actively seek to dilute its holdings in PSBs to 52% as and when the banks’ fortunes improve. Currently, government holdings range from 100% in IDBI Bank to 61% in Allahabad Bank and Andhra Bank. There is large headroom for divesting and creating new owners to share the burden of capital infusion. This should be an “on tap” exercise so that the government can move quickly when market conditions and sentiments are favourable. Meanwhile, it is important for the government to keep up the commitment to recapitalise and release funds in a timely way to support fresh lending by PSBs. The government should also seek to sustain and enhance value in PSBs by countering the trend of disparaging the PSB architecture that has served the nation’s interests well in the past. India needs to maintain a right balance between private and public sector ownership in banking for quite some time.

Conclusion

As they say, the best mergers get the timing right. Even in the case of the recent SBI mergers, SBI would possibly have preferred doing the merger at a time when the NPAs of the ABs came down to realistic levels, so as to strengthen its market image. PSB mergers might be more effective when the top brass is free from the unrelenting stress of resolving NPAs so that they can focus on reaping the economic benefits opened by the merger. Key Challenges It is useful to remember that in a growing and vibrant economy, there is scope to run an efficient and profitable bank without aiming to be a big-ticket lender or build a large balance sheet to come under global reckoning. An independent assessment of the scope for mergers in PSBs should look into whether there are alternatives to consider for the long-term soundness of “weak” PSBs, which could also lessen the pressure for

additional capital. For a merger or any other restructuring option, PSBs face the foremost challenge of an acute talent deficit and absence of the right people in sufficient numbers.

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