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BANKS MERGER AND RECAPITALISATION

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BANKS MERGER

After the wave of economic liberalization, a committee under the chairmanship of **Maidavolu Narasimham** was constituted in 1991 and again in 1998 to recommend reforms required in banking sector.

PJ Nayak Committee in 2014 had also suggested that government either merge or privatize state-owned banks. Public Sector Banks (PSBs) in India are fragmented, with some of them reeling under the mounting pressures of Non Performing Assets (NPAs).

Economic Survey points out that constant failure of banks to provide credit to both emerging and existing industries has resulted in stagnation in the economic growth of the nation.

NARSIMHAN COMMITTEE 1991 RECOMMENDATION:

Structural Reorganizations of the Banking sector :

- Actual numbers of public sector banks need to be reduced
- Recommended mergers to form a three-tier structure
    1. Three to four big banks including SBI should be developed as international banks
    2. Eight to ten banks having nationwide presence should concentrate on the national and universal banking services.
    3. A large number of Regional Banks focusing on agriculture and rural financing.

No further nationalization

Liberal entry norms for private and foreign banks

NARSIMHAN COMMITTEE 1998 RECOMMENDATION:

Strengthening Banks in India:

It recommended the **merger of strong banks** which will have 'multiplier effect' on the industry.

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CASES OF BANK MERGERS IN INDIA

- **Punjab National Bank (PNB) and New Bank of India (NBI) (1993-1994)** – first ever merger between two nationalized banks.
- **Bank of Baroda (BoB) and Benares State Bank Ltd (2002)** - another bailout in the form of a merger
- **Oriental Bank of Commerce (OBC) and Global Trust Bank (2004)** - It was proposed in order to protect the interests of the depositors of GTB. The bank had suffered massive losses and its net worth wiped off.
- **State Bank of India and State Bank of Saurashtra (2008) -** This was the first of the seven mergers between SBI and its associate banks. After the banking sector was opened to foreign banks in 2009, consolidation of SBI with associates was actively considered in order to increase its competency vis-à-vis entry of foreign banks.
- **SBI merger with associate banks and Bharatiya Mahila Bank (2017)** - As the largest lender, State Bank of India was already designated a systemically important institution. It became bigger after merging five associates and the BharatiyaMahila Bank. The merger helped SBI gain a spot among the top 50 banks globally.
- **Private Banks Merger** - Kotak Mahindra Bank picked up ING Vyasa bank recently to increase its footprint in southern region. Similarly, ICICI bank had picked up Bank of Madura to get a rural footprint and increase its banking services.
- **RECENT MERGERS**
  - Bank of Baroda, Vijaya Bank and Dena Bank
  - Punjab National Bank, Oriental Bank of Commerce and United Bank of India will combine to form the nation's second-largest lender.
  - Canara Bank and Syndicate Bank will merge.
  - Union Bank of India will amalgamate with Andhra Bank and Corporation Bank.
  - Indian Bank will merge with Allahabad Bank.

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RATIONALE FOR CONSOLIDATION

- **Lower return on the capital employed by the government**: All the PSBs have a government sharing upward of 53.81%, they are doing same business and compete to serve similar customers. It meant a lower return on the capital employed by the government which has competing demands for funds, and growing competition.
- **Reduced Recapitalisation Burden**- With a larger capital base and higher liquidity, the **burden on the central government to recapitalize the public sector banks** again and again will come down substantially.
- **Cutting Cost and Acquiring Efficiency** - Several banks that are majority-owned by the government, virtually doing the same business, and competing for the same pie of customers wasn't a sensible strategy. Since financial stability is not threatened and depositors are not running the risk of losing money (as long as the banks have government backing), the primary logic for consolidation should be cutting cost and acquiring efficiency.
- **To increase the risk taking ability**-The aim of the government is to increase the risk taking ability of the banks. Banks will not be reluctant to approve big loans to averse the risk.
- **To reduce government holding**-The government owns majority stakes in 21 Public Sector Banks (PSBs) virtually doing the same business and competing for the same pie of customers.
- **Bad loans problem**-Ever-rising NPAs have created the urgency for bank consolidation. Big banks can absorb shocks and have capacity to raise resources without depending unduly on the state exchequer. Bigger banks with **diverse portfolios** have lesser chances of failure since it is unlikely that different sector of an economy will face a crisis at a same time.
- Absence of international level bank - with **only one bank in the list of top 50 largest banks in the world** understates the global clout we share in present scenario.
- Bigger banks would also be able to adhere to **BASEL III** norms.

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BENEFITS OF BANK MERGER

For Banks:

1. Small banks can gear up to international standards with innovative products and services with the accepted level of efficiency.
2. PSBs, which are geographically concentrated, can expand their coverage beyond their outreach.
3. A better and optimum size of the organization would help PSBs offer more and more products and services and help in integrated growth of the sector.
4. Consolidation also helps in improving the professional standards.
5. This will also end the unhealthy and intense competition going on even among public sector banks as of now.
6. In the global market, the Indian banks will gain greater recognition and higher rating.
7. The volume of inter-bank transactions will come down, resulting in saving of considerable time in clearing and reconciliation of accounts.
8. This will also reduce unnecessary interference by board members in day to day affairs of the banks.
9. After mergers, bargaining strength of bank staff will become more and visible.
10. Bank staff may look forward to better wages and service conditions in future.
11. The wide disparities between the staff of various banks in their service conditions and monetary benefits will narrow down.

For economy:

1. Reduction in the cost of doing business.
2. Technical inefficiency reduces.

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3. The size of each business entity after merger is expected to add strength to the Indian Banking System in general and Public Sector Banks in particular.
4. After merger, Indian Banks can manage their liquidity – short term as well as long term – position comfortably.
5. Synergy of operations and scale of economy in the new entity will result in savings and higher profits.
6. A great number of posts of CMD, ED, GM and Zonal Managers will be abolished, resulting in savings of crores of Rupee.
7. Customers will have access to fewer banks offering them wider range of products at a lower cost.
8. Mergers can diversify risk management.

For government:

1. The burden on the central government to recapitalize the public sector banks again and again will come down substantially.
2. This will also help in meeting more stringent norms under BASEL III, especially capital adequacy ratio.
3. From regulatory perspective, monitoring and control of less number of banks will be easier after mergers.

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DISADVANTAGES OF MERGER

- A complex merger with a weaker and under-capitalized PSB would stall the bank's recovery efforts as **the weaknesses of one bank may get transferred** and the merged entity may become weak. For instances, a weak Dena Bank (under Prompt Corrective Action) may impact stronger banks like Bank of Baroda & Vijaya Bank.
- There would be number of **human resources issues** such as difficulty in adapting to new emerging culture, discontent due to far-flung transfers etc.
- **Customer retention would become problematic** as there might be lack of comfort in banking with larger parent bank.
- Bigger banks may follow **monopolistic behavior with increased market power** – resulting in neglect of local needs.
- Amalgamation of balance sheet of PSBs will **only impact NPA cosmetically**, without actually working on NPA recovery. This will further divert the process of NPA resolution.
- The move towards consolidation is **contrary to the initial focus on regional banking** requirements.

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WAY FORWARD

Merger is a good idea. However, this should be carried out with right banks for the right reasons. Merger is also tricky given the huge challenges banks face, including the bad loan problem that has plunged many public sector banks in an unprecedented crisis.

1. **Consultation with stakeholders**- Vinod Rai, former chairman of Bank Board Bureau (BBB) had underlined the need that various stakeholders need to be engaged before bank consolidation is effected, to ensure the entire process is least disruptive. For example: in the recent merger, heads of the banks are not consulted before making the decision to merge these entities.
2. **Divesting the shares**- There is large headroom for divesting and creating new owners to share the burden of capital infusion. For example- currently, government holdings in PSBs range from 100% in IDBI bank to 61% in Allahabad and Andhra bank.
3. **Clean the bank before consolidation**- The need is to first clean the banks then consolidate the weak bank with the strong bank.
4. **Strengthening regulation**- The need is to strengthen the Banking Regulation Act, 1949 to give the regulator enough teeth to regulate state-run banks.

Raghuram Rajan, has, in his note to the Estimates Committee of parliament spelt it out clearly: "improve governance of public sector banks and distance them from the government" and "delegate appointments entirely to an entity like the Banks Board Bureau."

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BANKS RECAPITALISATION

The Indian Banking System has been under severe stress due to NPAs and has faced a capital crunch forcing it to curtail lending. Due to this, the **Government of India has announced a 2.11 trillion bank recapitalisation plan for state-owned lenders** weighed down by bad loans, seeking to stimulate the flow of credit to boost private investment. The plan has the following components - 1.35 trillion from the sale of **recapitalisation bonds** and the remaining 76,000 crore through **budgetary allocation** and **fundraising from the markets**.

What measures has the government taken to recapitalise banks?

1. Indradhanush Scheme - the Government had announced to infuse Rs70,000 crore in state-run banks over four years while they will have to raise a further Rs1.1 trillion from the markets to meet their capital requirement in line with global risk norms, known as Basel-III. In line with the plan, public sector banks were given Rs25,000 crore in 2015-16, and similar amount has been earmarked for the current fiscal. Besides, Rs10,000 crore each would be infused in 2017-18 and 2018-19.

2. Recapitalization with Rs.2.11 trillion using recapitalisation bonds, budgetary allocation and funds raised from the market. This decision was taken after the Asset Quality Review conducted by the Reserve Bank.

3. Using funds from the National Investment Fund. This fund is constituted from the sale of the stake in public sector enterprises I.e. disinvestment.

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BENEFITS OF RECAPITALISATION

- The recapitalisation package will create an incremental **lending capacity** with the banks.
- This is expected to catalyze the **revival of the capital investment cycle** in the economy.
- Banks will now be sufficiently capitalised to maintain **regulatory capital requirements** and also to lead growth.
- Banks would have to subject themselves to **reform**, become more professional, and do prudent and clean lending.
- Even, the government can sell its share in the market once the banks are revived out of the NPA crisis, and earn huge profits.

DISADVANTAGES OF RECAPITALISATION

1. The increased budgetary allocation will cause the government to **breach its fiscal deficit targets**. Such a move will hurt economic growth and investor confidence in the Indian economy.
2. There is a concern that **recapitalisation only addresses the symptom and not the root of the problem of NPAs**. Thus, without complementary measures (as suggested under Indradhanush scheme) it becomes a political tool like the farm loan waivers.
3. The **ethical concern that poor decisions of the public sector banks will be backed by the money of hardworking taxpayers** is a cause of worry for the general public.
4. There can be an **increase in NPAs** as companies will be more tempted to default due to writing off of loans by banks.
5. Recapitalisation does not directly address the quality of lending and the **cycle of bad lending could go on** without other adequate measures such as reforms in the management of banks.
6. The practice is a moral hazard, as it involves **use of taxpayer's money for unproductive purpose**, to finance the frauds by a few.

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CONCLUSION AND WAY FORWARD

The decision of the Government to recapitalise banks is welcome as it will not only help in cleaning up of balance sheets but also help boost private investment in the economy. However, it also raises the issue of breaching the fiscal deficit target where the government may itself turn into the largest borrower and crowd out private borrowing as well as the bond market. Also, without other measures mentioned under the Indradhanush scheme, the recapitalisation of banks may turn out to be a temporary relief rather than a solution. Thus, it is required that all resolution measures be taken together promptly for an improvement in the Indian banking system.

Some suggested measures are:

- The capital offered should be able to meet the government's **service priorities**.
- This, in particular, applies to smoother **credit flows to small businesses**.

The constitution of the **Banks Board Bureau** was a welcome move in the governance of PSBs. But impact thus far has been very minimal. PJ Nayak committee's recommendations including giving more **autonomy** to Bank Boards need to be implemented in true spirit. Thus, a sustained solution lies in taking forward the **structural reforms**. This is even more crucial for the current recapitalisation exercise to pay favourable results.

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