Mains Practice Questions

Q. Discuss the rationale behind the merger of the state run banks and its impact, along with challenges in its implementation. (250 words)

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Approach

- Give introduction with context and definition of bank merger
- In body, give rationale behind bank merger and its impact on economy
- Conclude by giving steps how to overcome challenges and better alternatives to bank merger.

Introduction

- Recently, Government announced the merger of three banks viz. Bank of Baroda, Vijaya Bank and Dena Bank.
- The step has been envisaged by the government under 'alternative mechanism' set up last year to consider consolidation in the banking sector, to create bigger banks.
- Narasimham committee (1998) recommended merger of banks into three-tier structure.
- In 2014, PJ Nayak Committee had recommended either to merge banks into five or six large banks or privatise them.

Body

Reasons for Merger

- The merger will help in creating bigger bank that will meet the criteria of global banks.
- To resolve NPAs and improve operational efficiency by cutting down costs.
- Comply with Basel-III norms: India has the target to meet the Global Basel III capital norms by March 2020 (this date was extended by RBI recently).

Impact of the merger

Positive Impact:

- **Rationalising scale of economy**: The merger will facilitate in paying closer attention by the government to these bigger banks, protecting the financial system and investors' interest & depositors' money since these banks will be more profitable and better deal with bad loans.
- **Better stronger banks**: Banks will function more efficiently and effectively due to cutting down of operational costs and grow internationally by adopting best practices of each other. It will also increase their lending capacity by pooling of resources.
- **Better service delivery**: They will able to offer wider products and services to customers and will focus on their investors and customers more.

- **Manage NPAs**: NPAs would be better managed due to close monitoring. The practices adopted by stronger banks, like BoB and Vijaya, to manage their NPAs can be replicated.

Negative Impact:

- **Impact of weak banks on stronger banks**: Weak banks like Dena Bank will make unhealthy impact on the strong holdings of Bank of Baroda and its overall functioning. These mergers will ultimately affect the stronger banks as the excess NPAs of other banks are laid off with them.
- **Human Resources**: Branch rationalisation without shedding any staff will prove difficult.
- **Cosmetic measure to manage NPAs**: Without prompting to solve the NPAs, this merger will only assemble them.
- **Interest of minority shareholders**: can be affected if the rate of their holdings comes down following the merger. They may lose their interest too.

Challenges

- Management of HR excess staff would need to be accommodated.
- Process: Management of these banks are also one of key factor to acknowledge, as policies of banks, staff integration, rationalisation of branches, cultural compatibility are affected. The process of merger involves various essential decisions like, transfer of shares, including government and private holdings.
- Technology integration – technological systems and processes could be different and would have to be harmonised.
- Ensuring accountability would prove difficult in absence of clear cut hierarchical order.

Way forward

- The government will have to see that mergers do not end up creating an entity that is weaker than the original pre-merger strong bank.
- It would need to ensure that the impact of the merger is managed prudently; identifying synergies and exploiting scale efficiencies of the entities being merged.
- For long term sustainability of public sector institutions, improved governance, autonomy along with accountability of state owned banks would be needed.