Merger of PSBs

Why in News?

- Cabinet Committee on Economic Affairs (CCEA) recently approved the merger of state-run Vijaya Bank, Bank of Baroda and Dena Bank.
- The merger is set to make it the **third largest lender** of the country after SBI and ICICI.

Important Points

- Merger was proposed through a ministerial panel called **Alternative Mechanism** headed by **Finance Minister**.
- The idea of bank mergers floated since 1998, when 2^{nd} **M. Narasimham Committee** recommended the government to merge banks into **three-tiered structure** —
    - Three large banks with an international presence at top,
    - eight to ten national banks and
    - a large number of regional and local banks.
- **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.

Recent History of Bank Mergers

- In April 2017, 5 **associate banks were merged with SBI** – State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Travancore, State Bank of Mysore and State Bank of Patiala.
- **Bhartiya Mahila Bank** was also merged along with RBI.
- Government also initiated **amalgamation of Regional Rural Banks** under Phase 3 consolidation, bringing them down from 56 to 38.

Procedure of Bank Merger

- An application for merger is submitted by the concerned banks to the Central Registrar of Cooperative Societies (CRCS).
- A copy of the application is also sent to Reserve Bank of India (RBI) along with valuation report and information relevant for consideration of the scheme of merger.
- The RBI then examines the scheme in respect to the interests of depositors and conveys its decision to the CRCS.

Reasons for Merger

- To protect weak PSBs from loss - thereby securing customers and financial system.

- 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.
- Problem of credit lending, based on the **twin balance sheet crisis,** can be checked by the formation of bigger banks.
- 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.

Twin Balance Sheet Crisis

- Debt accumulation by companies is very high and thus they are unable to pay interest on outstanding loans.
- Failure of companies to pay back principal or interest further restricts banks' ability to lend, halting the entire banking mechanism.

Benefits of Merger

- With number of PSBs coming down after merger – **capital allocation, performance milestones, and monitoring would become easier** for the government.
- Large banks through consolidation of PSBs will have large balance sheets which can meet credit needs of growing Indian economy.
- It will also build capacity in PSBs to raise resources without depending on the state exchequer.
- The banking entities formed after merging PSU banks will be able to absorb financial shocks better.
- **Economies of Scale**
    - Merger of banks will result in better **scale efficiency** due to rise in customer base, increased market reach.
    - Wider bouquet of products services for customers would result in **decreased risk in lending capital**.
- **Increased Operational Efficiency**
    - A synergistic relationship would optimally use one another's network, customer base and access to low cost deposits.
    - Organizational restructuring would lead to better managerial efficiency and also provides scope of learning best practices of each constituent entity.
- **Global Bank**
    - Stronger and globally competitive banks would provide increased choices to the stakeholders.

Challenges

- 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.

Way Forward

- **Dual regulation** by the Ministry of Finance and RBI on PSBs often results **in paralysis in**

decision making – which makes consolidation of banks a redundant measure if they are not given power to act swiftly, as pointed by PJ Nayak.
- **Governance of public banks needs to be improved** before making any significant change in any emerging architecture.
- Bigger banks offer more resilience to the banking sector but overlooking **bigger red flags like strong credit appraisal and risk control system** would do little help in creating robust banks.
- Therefore due focus on ensuring strong foundation of PSBs is important.