Merger of PSBs

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For Prelims: Public Sector Banks, Non-Performing Assets (NPAs), Twin Balance Sheet Crisis

For Mains: Merger of PSBs: History, Procedure, Challenges, Benefits, Steps that can be taken.

Why in News?

- Recently, the government planned to initiate the next round of public sector **bank mergers** after analysing a detailed study that has been commissioned on the outcome of amalgamation in state-run banks.
  - The aim is to have 4-5 large banks as large and strong as the country's biggest lender **State Bank of India (SBI).**
  - At present, **there are seven large** public sector banks **and five smaller ones.**

What is a Bank Merger?

- **About:**
  - A merger is an agreement between entities where they pool in their assets and liabilities and become one entity. The **merger of Public Sector Banks (PSBs)** is where the PSBs are merged with **'anchor' banks.**
- **Historical Background:**
  - The idea of bank mergers has floated since 1998, when 2nd **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.
- **Procedure for Bank Mergers:**
  - An application for merger is submitted by the banks concerned 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.
- **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.
  - The Government also initiated the **amalgamation of** Regional Rural Banks under Phase 3 consolidation, bringing them down from 56 to 38.

- In 2019, the government **announced the merger of 10 nationalised banks into four large lenders,** thereby bringing down the number of PSBs to 12.
    - There were 27 state-run lenders in 2017. The merger had come into effect starting April 2020.

What are the Reasons for A Bank Merger?

- To **protect weak PSBs from loss** - thereby securing customers and financial system.
- The **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 sectors of an economy will face a crisis at the same time.

- Public Sector Banks (PSBs) in India are fragmented, with some of them reeling under the mounting pressures of **Non-Performing Assets (NPAs).**

- **The** Economic Survey 2019-20 points out that the constant failure of banks to provide credit to both emerging and existing industries has resulted in stagnation in the economic growth of the nation.

What is the Twin Balance Sheet Crisis?

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

What are the Benefits of a Merger?

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

What are the Challenges regarding the 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 instance, a weak Dena Bank (under **Prompt Corrective Action**) **may impact stronger banks** like Bank of Baroda & Vijaya Bank.
- There would be a 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 **a 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.
- The amalgamation of the balance sheet of PSBs **will only impact NPA cosmetically, without actually working on NPA recovery.** This will further divert the process of NPA resolution.

What can be the 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 Committee.
- **The 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 a strong foundation of PSBs is important.

UPSC Civil Services Examination, Previous Year's Question (PYQs)

Prelims

Q. With reference to the governance of public sector banking in India, consider the following statements: (2018)

1. Capital infusion into public sector banks by the Government of India has steadily increased in the last decade.
2. To put the public sector banks in order, the merger of associate banks with the parent State Bank of India has been affected.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (b)