The Big Picture- Big Bank Reform

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The Finance Ministry recently announced a mega plan to merge **10** public sector banks into **4** large entities. This will bring down the total number of Public Sector Banks in the country to 12 from 27.

The new banks formed after the mega-merger are:

Sr. No.	Amalgamated Banks	Anchor Banks
1.	Punjab National Bank (PNB), Oriental Bank of Commerce (OBC), and United Bank of India	PNB

2.	Canara Bank and Syndicate Bank	Canara Bank
3.	Union Bank of India, Andhra Bank, and Corporation Bank	Union Bank of India
4.	Indian Bank and Allahabad Bank	Indian Bank

- The consolidation will help in **strengthening** the **national presence and global reach** of these banks.
- The merger move was followed by ₹55,000 crore **recapitalization plan** for the merged entities and 6 other banks, enabling them to enhance their lending capacity.

Rationale Behind the Merger Plan

- Mega-merger plan focuses on creating **banks of scale** that would enable India to meet its aspirations of a **$5 trillion** GDP economy.
- To keep pace with the growing economy, there is a need for big banks that can lend to big industries & entrepreneurs that require large amounts of credit.
    - According to banks' **prudential norms,** banks take risks only for those entities that are appropriate as per banks' size. Banks generally avoid investing in a single entity or business.
    - Hence to invest in large projects, banks with huge lending capacity were needed.
- Banks also need **large credit** in order to invest in,
    - Better **customer service & connect,**
    - **Technology** upgradation,
    - Fraud detection, etc.
    - Larger banks can invest in **standardizing these processes** in larger set of customer-facing entities.
    - This will help in bringing good synergy between the banks & the customers.

Merger Parameters

- The **core principles** that were kept in mind during the merger process are:
    - First, there should be **minimal customer disruption** during and immediately after the merger process.
    - Secondly, the **credit activity** of the bank must not get disrupted & disturbed.
- Accordingly, the following parameters were taken into consideration while merging:
    - Similar **Core Banking System**, i.e, the software on which a particular bank works must be common between the merged banks. For e.g,
        - **Canara & Syndicate Bank** worked on similar software named **iFlex.**
        - **Indian Bank & Allahabad Bank** worked upon software named the **BaNCS** software.

- Banks sharing a **glorious tradition & rich history** were looked upon if they could complement each other at the **level of their NPAs,** current capital availability, **distribution of their branches,** etc. Synergies that could have been unlocked between different banks became a crucial parameter while selecting them for the merger.
- The other factors like their **geographical** presence, line of **activity,** the extent of savings account or **CASA (Current & Savings Accounts) deposits** were also taken into consideration.

Note

- **Non-Performing Assets (NPA)** refer to a classification for loans or advances that are in default or are in arrears on scheduled payments of **principal or interest.**
- In most cases, debt is classified as non-performing, when the loan payments have not been made for a minimum period of **90 days.**

Need For Merger

- There was a dire need for **increased competition** between the banks.
  - Indian Public Sector Banks were not taking any concrete steps to distinguish themselves from another bank in terms of- encouraging in the deposits and offering credits & interesting products to the customers.
  - Despite the name they carried, there was no difference in the value they offered. Hence, merging them into one big entity was the desired move.
- Strong banks are beneficial in bringing the **synergy and profits** for both- the banks' employees & the customers.

  For e.g., After the **amalgamation of Bank of Baroda (BoB), Dena Bank and Vijaya Bank,** BOB in the first quarter itself recorded a huge profit after the merger as compared to the huge loss it incurred in the previous year before the merger.

Steps to be Taken for Improvement in Performance Matrix

For a merger to be successful various reforms have to be taken in a continuous manner like,

- There is a need for **additional capital** that can keep the banks sustained for a longer duration.
- **EASE agenda** on the basis of which individual banks are measured and their scorecard is publicly disclosed, can be to be followed.

EASE (Enhanced Access and Service Excellence) Reform Index

- EASE index is prepared by the **Indian Banking Association (IBA)** and the Boston

Consulting Group.
- It is commissioned by the **Ministry of Finance.**
- It is a framework that was adopted to strengthen the public sector banks and rank them on parameters such as responsible banking, financial inclusion, credit offtake and digitization.

  There must be a common **unified messaging & performance review system** to maintain uniformity across banks.

    Processes that are rolled out in one bank from the top must percolate downwards to every employee in that bank for **effective communication.**

Impact of Merger on Indian Economy

- Banks perform an **intermediation role** in the economy. They take the savings of households and make it available for firms as investments.
    - For any economic growth to take place, there is need of
        - **Credit** in terms of debt, &
        - **Capital** in terms of equity.
    - Larger banks have a better ability to raise resources from the market rather than relying only on State exchequer.
- The increased lending capacity of the banks can **bring best in class services** for the industries as well as the retail individuals.

    For e.g, After the SBI merger, it was able to attract its customer by launching the **SBI Yono cards.**

Underlying Challenges

- Despite the **merger of Vijaya Bank, Bank of Baroda and Dena Bank,** their **credit rate** (the rate of interest a bank offers) has not significantly improved.

    Their market capitalization was the underlying reason for the increased profits.
- The merged banks have different levels of profitability, & the ability to handle loans. The associated crucial aspect is the **structure of the management.**
    - Composition of Bank Boards & selection of the CEO on the basis of the seniority level only, will not be very impactful.
    - Their selection must be done on a **merit basis** transparently. Applications can be invited from the market for that purpose.
    - Leadership in the merged entity will be vital to deliver the planned outcome.

Way Forward

- There is a need to **give greater powers** to the banks board in order to drive, review & oversight the decision-making process. And for that, the best talent must be recruited.

Also, there is the requirement of a much stronger risk handling mechanism.

- The need is to now **look at foreign markets,** and set up appropriate **business policies** (in terms of the global location & the product these banks can target) that will help in increasing the efficiency and the competition of these banks with their global counterparts.
- Continuous reforms should be undertaken regarding,
  - Product innovation,
  - Investments in technologies,
  - Better back-end processes,
  - Reduction in turnaround time