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Merging the three banks was the best option available

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THE IMMEDIATE REASON for the government wanting to amalgamate Dena Bank and Vijaya Bank with Bank of Baroda (BoB) is clearly to use precious resources smartly. One can't blame the government because it has been compelled to capitalise state-owned banks to keep them afloat although it didn't create the non-performing assets (NPAs) problem. Given the combined 16% stressed assets in Q1FY19, the common equity Tier I capital of 9.4% for the new entity would need to be beefed up, but, in the process, some capital will be saved on Dena Bank.

While Dena Bank gets a new life, the larger synergies of this merger can't really be exploited immediately since there is going to be no reduction in what is the biggest cost for state lenders, namely, wages. Ahead of the general elections, it was always clear there would be no lay-offs, and the unions should be grateful for this since the merger turns what was a positive return-on-assets for BoB into a negative one for the merged bank. The government has given employees of Dena a great deal and must stand firm if the unions want a better deal than what they have got.

In terms of a business profile, the merger doesn't look quite so bad since the combined entity will have a well-diversified ₹6.5 lakh crore loan book, a loan-weighted net-interest-margin of 2.7% and not too much of an overlap in the branch network. A private sector management would have leveraged what is going to be the second-largest deposit base in the industry, backed by a healthy 34% CASA, and a common back-end base core banking solution. But, in a PSU world, any meaningful improvements are unlikely before two or three years because merely getting the teams to work together will be a Herculean task.

The good news is that, by 2020, a large chunk of employees—almost all general managers—retires from PSU banks. By then, the government must usher in HR reforms to both infuse fresh blood into PSU banks and introduce performance-driven remuneration. Although these have been discussed, nothing has been done about it. While the government could consider other merger options in the PSU space, the real problem is there is no strong bank—other than State Bank of India—around to be able to absorb a weak one. BoB was the last such candidate, and it would not be wise to hurt SBI's balance sheet at this point.

Unfortunately, even if the hits from loan losses at state-owned banks are expected to be much smaller in the next couple of years, one can't see the emergence of a lender strong enough to take a weak one into its fold without hurting itself. The BoB-Vijaya-Dena amalgamation should be supported and made a success so that more mergers can be initiated, if nothing else, with the aim of bringing down costs. Consolidation in the PSU banking space is inevitable, and the sooner the trade unions recognise that the job losses will be higher if they stall the mergers, the better. There is no way the government is going to be able to revive a dozen PCA banks and it shouldn't attempt to do so. Indeed, if the employee headcount can be brought down, private sector banks may want to buy into some PSUs since they have valuable customer franchises.