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Cabinet sets mergers of state-run banks in motion

CONSOLIDATION Panel to oversee move; proposals to come from bank boards

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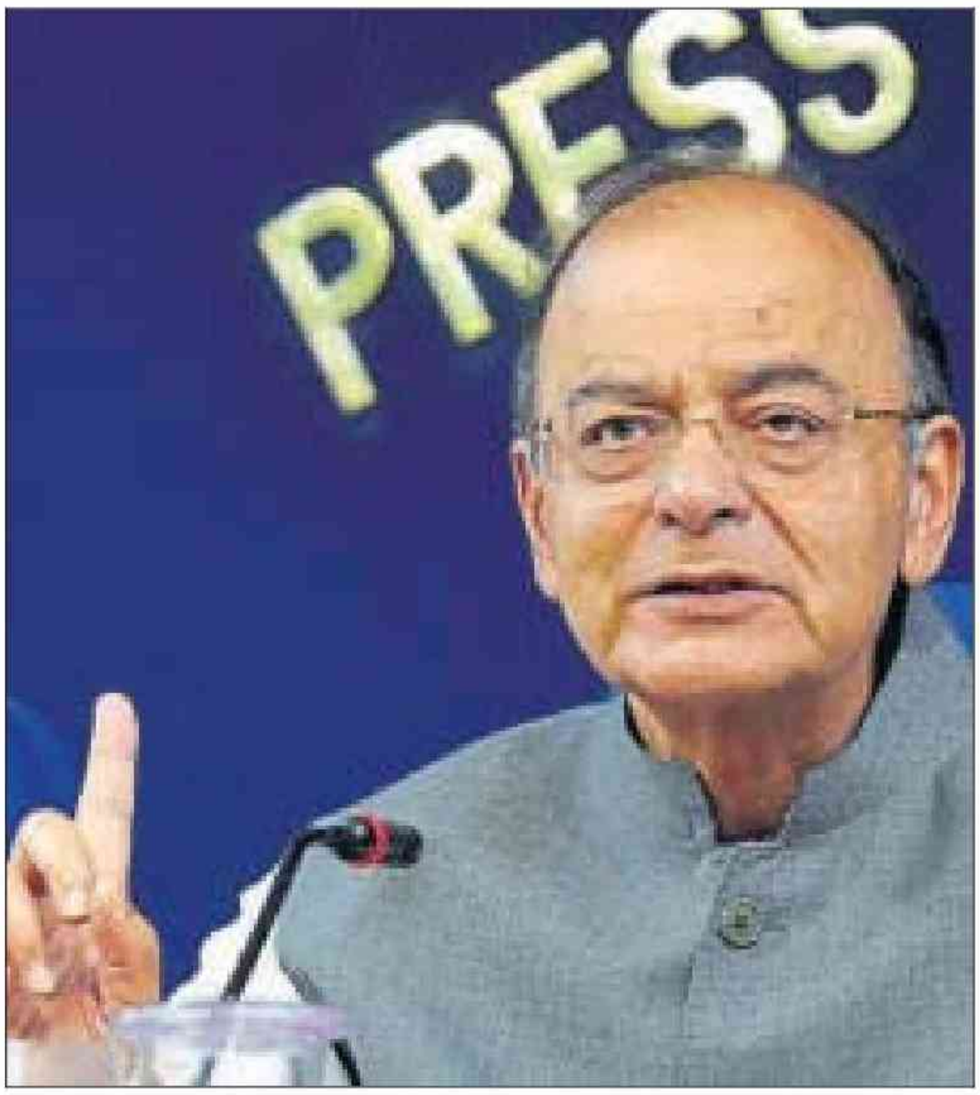
NEW DELHI/MUMBAI: The government on Wednesday decided to take consolidation in the banking sector to the next level by setting up a ministerial panel led by finance minister Arun Jaitley to consider and oversee mergers among the country's 21 state-run banks. The decision, which comes a day after bank employees' unions went on strike and at a time when state-owned banks are reeling under losses and stressed loans, has raised questions about the timing and purpose of such a large-scale consolidation.

Jaitley said that merger proposals have to come from bank boards and that decisions will be taken purely on commercial considerations. Such considerations include the desire of banks to reduce the concentration of their loan portfolio in certain geographies and to acquire a fresh footprint in certain other markets, said a government official on condition of anonymity.

"The objective is to create strong banks and the experience of bank mergers has so far been positive," said Jaitley.

Prime Minister Narendra Modi will decide who will be there in the ministerial panel, referred to as the alternative mechanism, said Jaitley. On Monday, Mint reported that the government will reduce the number of state-owned banks to 10-15, more than what was envisaged earlier, through a series of mergers and acquisitions so that none of the banks become too big to fail, citing Sanjeev Sanyal, principal economic adviser at the finance ministry.

The idea of bank mergers has been around since at least 1991, when former Reserve Bank of India governor M Narasimham recommended the government merge banks into a three-tiered structure with three large banks with an international presence at the top. In 2014, the PJ Nayak panel had suggested that the government either merge or privatize state-owned banks.



Finance minister Arun Jaitley during a press conference after the Cabinet meeting, in New Delhi on Wednesday PTI

The government hopes that state-owned banks will achieve economies of scale and operational efficiency while managing risks in a better way after merging. Consolidation is also likely to help them deal better with their credit portfolio, including stressed assets. Consolidation prevents multiplicity of resources being spent in the same area and strengthens banks to deal with shocks, the minister said.

"If banks operating in the same region are merged the synergies will be higher," said Udit Kariwala, senior analyst, India Ratings and Research. Ratings could also improve for the merged entity as it becomes larger "and will have more support from the government."

However, not all bankers agree that efficiency will be the outcome, at least in the short-term, pointing to State Bank of India's merger with its five associate banks and Bharatiya Mahila Bank in April. After the union, there was a drastic deterioration in SBI's asset quality. At the end of June, almost one out of every ten rupees it has lent has turned bad.

With state-owned banks accounting for a lion's share of the ₹10-lakh crore stressed loans in the system, and at least eight of them reporting losses at the end of June, there is skepticism about the benefits.

"The merger will result in large scale financial repression. Banking system will become more inefficient and too-big-to fail by merging two inefficient banks," said KC Chakrabarty, former deputy governor, RBI, and also a former chairman and managing director of Punjab National Bank.

Besides, bankers also point to integration of human resources and cultural fit as key challenges.

In any case, mergers won't result in the government escaping the burden of infusing additional capital in these banks. According to a Moody's estimate, the 11 big state-owned banks will require additional capital of ₹70,000-₹95,000 crore, higher than the budgeted ₹20,000 crore until March 2019.

"I believe merger of public sectors at this time is ill-advised. The government should instead infuse capital or look at reducing stake in weak banks and bring in an equity partner," said TT Ram Mohan, professor of Finance at the Indian Institute of Management at Ahmedabad.

To be sure, the government is willing to go the extra mile to support banks by infusing capital in excess of the ₹20,000 crore promised earlier, Sanyal told Mint in an interview.

The merger exercise will also not affect the capital infusion plan and merged entities may be better placed to mobilize funds in future, said the government official cited earlier.

Delivering the Nani Palkhivala lecture on Tuesday, SBI chief Arundhati Bhattacharya warned that mergers driven by the "need to meet the capital adequacy ratio of banks are ill advised. A merger should serve three purpose — efficiency, market power and better accounting ratios."

The government official cited earlier said that the merger will not result in any job cuts including in senior positions. While the ministerial panel will facilitate putting merger proposals of different banks together, individual banks have already been consulting each other on possible combinations, said the person.