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Why merger of PSBs is not a good idea

Human resource and cultural issues apart, most mergers in the past haven't led to improvement in profits

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Emboldened by the apparently frictionless merger of the associate banks with SBI, the Ministry of Finance has decided to merge two weak banks with one strong bank, namely, Bank of Baroda, Dena Bank and Vijaya Bank, in the PSB (public sector bank) space. That this should happen exactly 10 years after the Great Recession of 2008, which was triggered by big banks, indicates a certain overconfidence about financial stability in India.

Since nationalisation, Indian banking has grown and exhibited much diversity in size, content and structure, represented by PSBs, regional rural banks, new generation private banks, old private banks, foreign banks, co-operative urban banks, cooperative rural banks, small payments banks, small finance banks, and NBFCs.

Business correspondents support the financial inclusion efforts of banks. Such diversity and effective regulatory oversight contained the contagion effect of the decade-old global recession on the Indian economy. The Narasimham Committee (1994), while arguing for six large globally competitive banks, preferred closing the weak banks to merging them with strong ones.

There have been 39 mergers and takeovers during the post-nationalisation period, which includes the SBI merger. It is important to draw lessons from all these mergers.

While all banks reduced their presence in rural and semi-urban, non-profitable centres post-liberalisation, SBI, post-merger, closed 5,000 branches, thus effectively guillotining the plan to reach the unbanked poor.

Regulator-driven financial inclusion efforts of 2005, board-monitored measures, and Jan Dhan have supplemented the financial inclusion agenda. India Post Bank is the new institution aimed at taking banking services to the doorsteps of the least banked.

Against this backdrop, the latest merger is enigmatic.

Former RBI Governors YV Reddy, D Subba Rao and Raghuram Rajan have, on one occasion or the other, cautioned the government against seeing consolidation as a panacea for the ills of the banking system.

Though the RBI's Financial Stability Report has estimated healthy economic growth of over 7.5 per cent for 2018, it has warned against complacency. And, this comes despite legal and regulatory measures to stem the NPA (non-performing asset) rot in banking through 'market-based resolution plan for insolvency' (IBC), putting 11 banks under surveillance via prompt corrective action plan, and continuing efforts to de-stress the sector.

The government, however, has put together another merger, even before the results of the PCA were known.

Of the three banks — Bank of Baroda, Vijaya Bank and Dena Bank — slated for merger, BoB is on the plate for the second time in the merger exercise. As at the end of 2017-18, BoB was the biggest with a total income of ₹50,306 crore, a net loss of ₹2,432 crore and net NPA of 5.5 per cent.

Vijaya Bank comes next, with a total income of ₹14,190 crore, a net profit of ₹727 crore, and net NPA of 4.4 per cent. And, Dena Bank recorded a total income of ₹10,096 crore, a net loss of ₹1,923 crore, and a net NPA of 11.95 per cent.

Profitability ratios

Results of a study by Jagadeeshwaran *et al* on the pre- and post-merger comparisons of profitability — with the year of merger as base year — in the case of SBI, IOB, BoB, PNB, IDBI and OBC reveal that net profit to total income, net profit to interest income, net profit to total assets and net profit to net worth declined for all except PNB and BoB. The exception was partly due to the period of merger, when the capital regulations post-Basel did not hit them. Banking is all about financial intermediation.

People are at the epicentre, both in front and behind the counters. The culture of the institutions is intertwined with the culture of the regions. Human resource and cultural issues have impeded the success of mergers across periods and nations.

It is, therefore, important that the big banks think twice before turning into unwieldy conglomerates. Basic banking and customer services cannot be compromised.

The government would do well to start development banks to fund infrastructure projects and, thereby, relieve PSBs of this task. Experience has demonstrated that PSBs are not right channel for the job as it involves their funding long-term projects with short term resources.

Universal banking did enough damage with banks selling more third-party products, eyeing hefty commissions, instead of focussing on core banking operations. Hopefully, thanks to the latest directive from the Finance Ministry, this damage will be minimal, where banks alone will stand to gain, and not the officials selling such products.

Looking ahead

While past accomplishments are no guarantee to future success, past failures can serve as good foundation for enduring success. To improve its own stock, the government would do well to concentrate on improving governance in PSBs, pledge not to interfere in loan sanctions, and move a resolution in Parliament that no party would indulge in loan write-offs either for the farm or other sectors unless the areas are affected by severe natural calamities.

Further, higher capital allocation with or without Basel-III cannot prevent bank failures triggered by systems, people and processes.

Both demonetisation and GST had hit not just the MSMEs but also resulted in the lengthening of processing time. Even politically speaking, with elections round the corner, toying with the financial sector with mergers looks faulty, unwise and untimely.

The writer is an economist and risk-management specialist.

NOT A HAPPY PICTURE — Profitability ratios (%)

Banks	Net profit to total income		Net profit to total deposits		Net profit to interest income		Net profit to total assets		Net profit to total net worth	
	Pre-merger*	Post-merger (5 years)	Pre-merger	Post-merger (5 years)	Pre-merger	Post-merger (5 years)	Pre-merger	Post-merger (5 years)	Pre-merger	Post-merger (5 years)
SBI	10.88	7.49	25.61	13.99	13.27	8.6	0.94	0.64	17.88	10.2
IOB	6.22	5.37	0.72	0.59	7.26	5.87	0.65	1	20.33	-1.03
BoB	8.15	12.48	0.96	1.16	9.16	14.76	0.77	0.98	13.39	17.35
PNB	7.55	12.6	1.02	1.23	8.52	14.36	0.75	1.04	20.93	19
IDBI	8.82	7.98	26.18	0.91	9.94	8.9	0.96	0.66	7.54	13.02
OBC	9.6	9.12	1.39	0.92	10.8	10.22	0.99	0.81	16.99	14.03

Source: Money Control & Dept of Banking Supervision, compiled by Jagadeeshwaran & Basavaraj, IPE Journal of Governance & Public Policy, vol.8(1), 2018 pp.6

*Around the time of merger