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CONSOLIDATION OF PUBLIC SECTOR BANKS-PRESENT SCENARIO IN INDIA

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Abstract: The debate about consolidation in the Indian banking structure is not new. Starting from the age of Presidency Banks, the Indian banking sector has witnessed consolidation to enhance competitiveness. In fact, India's largest bank, the State Bank of India, is a product of mergers of the Presidency Banks. Most bank mergers have been an offshoot of the central bank's efforts to protect the financial system and depositors' money, and very few of them have been driven by the need for consolidation and growth. However, consolidation is required for two reasons. One, Indian banks are not large enough to compete with their global peers. There is therefore a need for increasing the size of operations and reach. Two, public sector banks (PSBs) are too many in number, it can trigger unhealthy competition. A merger will synergise and synchronise the advantages in the consolidated entity. Bigger banks would have wider reach, stronger lending capacity and better products and technology to serve customers of New India.PSBs should useFinancial Technology (FinTech) across all banking functions and employee stock ownership across all levels to make them more efficient. India needs a mix of efficiently run PSBs, small finance banks, Payment Banks and Private banks to achieve growth and development along with social justice.

Key Words: Consolidation of banks, nationalization, mergers and acquisitions, global presence.

INTRODUCTION

Narasimham Committee Report I, 1991, recommended merger of public sector banks to make them stronger. It had envisaged a three-tier banking structure with three large banks with international presence at the top, eight to 10 national banks at tier two, and a large number of regional and local banks at the bottom. Ever since the Narasimham report made this

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recommendation, there have been several rounds of discussions on mergers and consolidation of banks in India at periodic intervals. While the objective has, all along, been building scale and strengthening the risk-taking ability, the trigger for the latest round of discussion is the pile of bad assets under which some of the state-owned banks are likely to get buried.As India prepares for competitive times, more banks are planning to combine for competitive advantage. State-owned banks have been reeling under a bad loan crisis for years now. According to the government, the size of gross non-performing assets of state-owned banks stood at Rs. 7.9 lakh crore, as of March 31, 2019. Although the government has not projected the present merger as a measure to tackle bad loans, bank mergers in the past have been carried out simply to bail out struggling banks.The Raghu Ram Rajan Committee has also recommended toencourage consolidation in PSU Banks. The Government has also made its stand clear that the initiative for consolidation has to come from the management of banks and the government will play a supportive role.

OBJECTIVES OF THE STUDY

- To present the need of bank consolidation
- To study pro and cons of bank mergers
- To present current scenario of bank mergers

NEED OF CONSOLIDATION

Why do we need consolidation? Since financial stability is not threatened and depositors are not running the risk of losing money, the logic for consolidation should be cutting cost and acquiring efficiency. Patel had said in New York that consolidation of banks could entail sale of real estate where branches are redundant, as well as offering voluntary retirement schemes to manage headcount and adding younger, digital-savvy personnel. In one press conference, ArunJaitley had said that weak banks will have to sell assets, reduce overheads and shut loss-making branches, among others. Technology may not be a big hurdle for mergers as most banks are working on a platform managed by the same vendor but the key to success of any merger will be large-scale shutting of branches in urban centres, reduction in staff strength and exploring the right business synergy and work culture. Despite automation, most Indian banks have gone for massive expansion of their branch networks in urban India, many of which will be redundant when some of them merge.

Although late, both the Indian Government and the Management of Banks have realized the possible results of synergy effects that could be achieved after consolidation in the banking industry. The reasons for this

may be many varying from bank to bank but the very basic underlying reason that would benefit IndianEconomy is to move from a state of large number of small banks to a state of a few numberof large banks.Instead of 20-odd small banks, consolidation will pave the way for bigger and larger entities which can compete globally. All public sector banks (PSBs) are government-owned entities. With too many in number, it can trigger unhealthy competition. A merger will synergise and synchronise the advantages in the consolidated entity.

Globalization of Indian banks would further integrate Indian economy with the vicissitudes of global finance, exposing it thereby to higher degrees of contagion and external sources of systemic risk. Globalized Indian banks would be subjected to more stringent regulatory norms under the framework for global systemically important banks (G-SIBs). In addition, consolidation would provide impetus to the merged entities by increasing their ability to support larger ticket-size lending and have competitive operations by virtue of greater financial capacity. Creation of global sized banks through consolidation will facilitate Modi government's resolve to make India a $5 trillion economy by 2024-25.

A large economy needs an efficient banking sector to support its growth. Historically, in the last 50 years, the top-five economies have always been ably supported by their banks. Economic Survey 2019-20 suggests that India should have at least six banks in the top 100. The annual report of the Brand Finance, February 2020 reveals that ICBC (China), China Construction Bank (China), Agricultural Bank of China (China), Bank of China (China), Wells Fargo (USA), Bank of America (USA), CITI (USA), Chase (USA), China Merchant Bank (China), JP Morgan (USA) are amongst the top ten banks. The report used discounted cash flow methodology to arrive at a net present value (NPV) of the trademark and associated intellectual property: the brand value. Only three Indian banks ranked in top 100. Only 20 Indian banks ranked in top 500 bank list. Small Economies like Finland, Denmark, Norway, Austria, Belgium have grouped with India. Sweden and Singapore have thrice the number of global banks as India does.

Ranking of Indian Banks

Name of the Bank	*Global Rank*
State Bank of India	51
HDFC Bank	54
ICICI Bank	91
Axis Bank	121
Kotak Mahindra Bank	124
Indusind Bank	175
Bank of Baroda	200

Source: https://brandirectory.com/rankings/banking/table

Merits of Merger

i) Larger banks may be more efficient and profitable than smaller ones and generate economies of scale and scope.

ii) Consolidation may facilitate geographical diversification and penetration towards new markets.

iii) A bigger bank would also work well in achieving financial inclusion, a key objective of government.

iv) The asset-liability mismatch of the smaller banks can be better addressed at the consolidated level.

v) Big banks are usually expected to create standardized mass-market financial products

vi) Many different banks are fighting for the same market space offering same products at almost same margins which encourages mismarketing, fake and illegal offers, and creatinga mess in the minds of customers.Consolidation will actually reduce competition amongst banks.

vii) Customers will have a wide array of products like mutual funds and insurance to choose from, in additional to the traditional loans and deposits

viii) Large and consolidated banks can mitigate transaction costs and risks associated with financing of small businesses and penetrate through lending into these sectors.

ix) Recapitalization need from the government would be reduce.

x) A consolidated banking structure would be a positive development in the long term.

Demerits of Merger

i) Consolidation may increase the market power of merged institutions and could result in neglect of local needs leading to reduction in credit supply to some category of borrowers, particularly small firms.

ii) Few large inter-linked banks can expose the broader economy to enhanced financial risks

iii) Not all customers are treated in the same way by the big banks. loan approvals for low income applicants may be neglected by large banks.

iv) The consolidated banks are found to shift their portfolios towards higher risk-return investment.

v) It would be tough to manage issues pertaining to human resource.

vi) Bank consolidation could also result in less competition giving fewer choices to the customer and arbitrary pricing of products.

vii) The local identity of small banks won't be that prominent.

viii) Financial consolidationin several other countries led to decline in banking concentration, reflecting increase in competition.

Evolution of State Bank of India

India has a long history of both public sector and private sector banking. Modern banking in India began in the 18th century, with the founding of the English Agency House in Calcutta and Bombay. In the first half of the 19th century, three Presidency banks were founded. The Presidency Banks were the Bank of Bengal, established on 2 June 1806, the Bank of Bombay (incorporated on 15 April 1840), and the Bank of Madras (incorporated on 1 July 1843). The Imperial Bank of India came into existence on 27 January 1921 through the reorganization and amalgamation of the three Presidency Banks of colonial India into a single bank. The Imperial Bank of India performed all the normal functions which a commercial bank was expected to perform. In the absence of central banking institution in India until 1935, the Imperial Bank of India also performed a number of functions which are normally carried out by a central bank.

Later in 1935 when the Reserve Bank of India came into force, the Imperial Bank ceased to have a central banking function. It then became merely a commercial bank and certain business restrictions on it were removed.On July 1, 1955, as per the State Bank of India Act 1955, the State Bank of India (SBI) was constituted and it took over the business and undertaking of the Imperial Bank. Thus the Imperial Bank of India became the State Bank of India.In 1959, the government passed the State Bank of India (Subsidiary Banks) Act. This made eight banks that had belonged to princely states into subsidiaries of SBI. This was at the time of the First Five Year Plan, which prioritized the development of rural India. The eight subsidiaries were State Bank of Bikaner (SBB), State Bank of Jaipur (SBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP), State Bank of Travancore (SBT), State Bank of Saurashtra (SBS) and State Bank of Indore (SBI - Indore).State Bank of Bikaner & Jaipur came into existence on 1963 when two banks, namely, State Bank of Bikaner (established in 1944) and State Bank of Jaipur (established in 1943), were merged.

Nationalisation of Banks, 1969

Many bank failures and crises over two centuries, and the damage they did under 'laissez faire' conditions; the needs of planned growth and equitable distribution of credit, which in privately owned banks was concentrated

mainly on the controlling industrial houses and influential borrowers; the needs of growing small scale industry and farming regarding finance, equipment and inputs; from all these there emerged an inexorable demand for banking legislation, some government control and a central banking authority, adding up, in the final analysis, to social control and nationalization.

The government through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969 nationalized 14 major Indian Scheduled Commercial Banks with demand and time deposit liabilities of over Rs. 50 crores to serve better the needs of development of the economy in conformity with national policy objectives on 19 July 1969. Soon, the parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received presidential approval on 9 August 1969. These lenders held over 80 per cent bank deposits in the country.These 14 banks Nationalized in 1969 are as follows:

Central Bank of India
Bank of Maharashtra
Dena Bank
Punjab National Bank
Syndicate Bank
Canara Bank
Indian Bank
Indian Overseas Bank
Bank of Baroda
Union Bank
Allahabad Bank
United Bank of India
UCO Bank
Bank of India

Nationalisation of Banks, 1980

Between 1969 and 1980, the number of private branches grew more quickly than public banks, and on April 1, 1980, they accounted for approximately 17.5 percent of bank branches in India. In April of 1980, the government undertook a second round of nationalization, placing under government control the six private banks whose demand and time deposit liabilities were above Rs. 200 crores, in order to further control the heights of the

economy, to meet progressively, and serve better, the needs of the development of the economy and to promote the welfare of the people in conformity with the policy of the State.These 6 banks were:

Punjab and Sind Bank

Vijaya Bank

Oriental Bank of India

Corporate Bank

Andhra Bank

New Bank of India

This entire process resulted in 20 initialized banks in India by 1980. Out of the above six, New Bank of India was later merged into Punjab National Bank in 1993. The RBI had forced this merger under Section 45 of the Banking (Regulation) Act, 1949 as New Bank of India reached a precarious state of liquidity. This left 19 nationalized banks in India at that time.

SBI Merger

Once known as the "seven sisters," the Associate Banks of SBIhad been established by princely states before the country's independence to serve local populations. These came under the fold of SBI as Associate banks after the government passed the State Bank of India (Subsidiary Banks) Act in 1959. In 2008, the State Bank of Saurashtra was the first to merge with the SBI.Thereby consolidated its position in position in the market as a leading player, having been under some threat from the second-largest lender ICICI Bank. SBS is the smallest of the associate banks, operating mainly in regions where SBI does not have a large presence. After the banking sector was opened to foreign banks in 2009, consolidation of SBI with associates was actively considered in order to increase its competency vis-à-vis entry of foreign banks.The State Bank of Indore officially merged into State Bank of India in August 2010. It was the second merger of an associate bank with SBI after a similar exercise with State Bank of Saurashtra. SBI was ranked 52 in the world in terms of assets in 2015. In 2017 Parliament has passed State Banks (Repeal and Amendment) Bill, 2017 to merge six subsidiary banks with State Bank of India.The purposes of merger were rationalization of public bank resources, reduction of costs, better profitability, lower cost of funds leading to better rate of interest for public at large and improve productivity and customer service of the public service banks. The bank became even bigger since April 2017 after its merger with five associate banks and the BharatiyaMahila Bank. The merger had made SBI one of 50 biggest banks of world in terms of assets.

Three Way Merger

The BOB-Vijaya-Dena merger is the first three-way merger in India's history. Even as experts have been divided on the decision as a way to mitigate high NPAs and poor management, some banking veterans have called it a bold move.This is the second big merger of public sector banks after the merger of five associated banks of SBI in April 2017.All three banks were using Infosys' Finacle IT platform which was an important reason for the government's decision to merge them. The then Finance Minister Arun Jaitley had said that banks were chosen keeping in mind that the merger of two strong banks with one weak bank will lead to a strong entity. Bank of Baroda became India's second largest public sector bank behind State Bank of India (SBI) following a three-way merger with Dena Bank and Vijaya Bank. Punjab National Bank was so far the second largest government-owned bank. The combined bank have a geographical reach of more than 9,500 branches, more than 13,400 ATMs with 85,000 employees serving 12 crore customers.

Mega Bank Consolidation

In exercise of the powers conferred by section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), and section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), the Central Government after consultation with the Reserve Bank of India has amalgamated 10 public sector banks into 4 large banks. It is the biggest-ever consolidation exercise involving public sector banks to make them globally competitive, especially at a time when the sector has shown significant weakness. Not only the number of public sector banks reduced due to the merger, but it also added strength to the four freshly merged banks. Six banks, which ceased to exist, merged with four anchor banks. Now there are seven large public sector banks (PSBs), and five smaller ones. There were as many as 27 PSBs in 2017. The total number of public sector banks in the country are come down to 12.

Following this merger, PNB will become second largest after the State Bank of India (SBI), Canara Bank fourth, Union Bank of India fifth and Indian Bank seventh biggest public sector lender. The merger resulted in the creation of seven large PSBs with scale and national reach, with each amalgamated entity having business of over Rs. 8 lakh crore. It would help create banks with scale comparable to global banks and capable of competing effectively in India and globally.

Anchor Bank	*Amalgamated Bank*	*Core Banking System (CBS)*
Punjab National Bank	Oriental Bank of Commerce United bank of India	Finacle
Canara Bank	Syndicate Bank	iFlex
Union Bank of India	Andhra Bank Corporation Bank	Finacle
Indian Bank	Allahabad Bank	BaNCS

1. *Consolidation of Punjab National Bank, Oriental Bank of Commerce and United Bank*

The merged entity isthe second largest PSB with Rs. 18 lakh crore business and second largest network with 11, 437 branches across India.The merger led to a high Current and Savings Account (CASA) ratio and a high lending capacity. Same Core Banking System (CBS), Finacleis used in all three banks will enable quick resolution of gains.

2. *Consolidation of Canara Bank and Syndicate Bank*

The merged entity is the fourth largest PSB with Rs. 15.2 lakh crorebusiness and third largest network with 10,342 branches. Same CBS platform (iflex) in both banks will enable quick realization of gains. Similar culture will enable smooth consolidation of banks.

3. *Consolidation of Union, Andhra & Corporation Banks*

The merged entity became the fifth largest PSB with Rs 14.6 lakh crorebusiness and fourth largest network with 9,609 branches in India. Large scale benefits all the three with business becoming 2 to 4.5 times that of individual bank. Same CBS platform (Finacle) in all three banks enables quick realization of gains.

4. *Consolidation of Indian Bank & Allahabad Bank*

The merged entity is the seventh largest PSB with Rs. 8.08 lakh crore business and network with 6,104 branches. Strong scale benefits both with business doubling. Consolidation brings high CASA ratio and lending capacity.Same CBS platform (BaNCS) in both banks enables quick realization of gains.

Six Banks Untouched

The mega merger has left untouched six other banks out of which two are national banks and the four have regional focus. The untouched banks are Bank of India, Central Bank of India, Indian Overseas Bank, UCO Bank, Bank of Maharashtra and Punjab & Sind Bank which will continue as separate entities as before.

Three Tier Structure of PSBs.

Tiers	*Bank*	*Business Size* in ₹lakh cr.*
Tier-I Consolidated PSBs for strong national presence and global reach	State Bank of India	52.05
	Punjab National Bank	17.94
	Bank of Baroda	16.13
	Canara Bank	15.20
	Union Bank of India	14.59
	Indian Bank	8.08
Tier-II To strengthen national presence	Bank of India	9.03
	Central Bank of India	4.68
Tier-III To strengthen regional focus	Indian Overseas Bank	3.75
	UCO Bank	3.17
	Bank of Maharashtra	2.34
	Punjab and Sind Bank	1.71

(*March 2019 Financials)

CONCLUSION

Consolidation of Public Sector Banks (PSBs) are expected to be advantageous for reasons like improved profitability, rationalization of operational costs, improved ability to deal with external shocks, reduced geographical concentration risk, greater capacity to invest in technology and to raise capital from the market.But there could be challenges of resistance from trade unions, integration of human resources, technological systems, accounting practices etc. India needs a mix of efficiently run PSBs, small finance banks, Payment Banks and Private banks to achieve growth and development along with social justice. With regard to globalization, there is an opposing view that instead of looking outwards, Indian banks should look inwards by scaling financial deepening. It needs to be noted that looking outwards for global presence and looking inwards for deeper financial penetration both are essential. Therefore, it will be opportune for larger Indian banks to be looking out for opportunities for both organic and inorganic growth.

Indeed, bank consolidation is the flavor of the season, but one should not lose sight of the fact that India needs more banks. RBI should continue to give licences to more small banks as well as universal banks along with the experiment on consolidation. The Narasimham committee had spoken about a large number of regional and local banks at the lowest tier of banking structure.Merging state-owned banks is more challenging given the integration-related issues, especially regarding human resources and operations. It may be inferred based on the above mentioned facts that

Indian banks even with consolidation would not be able to make to the top league of global banks. Besides the issue of size, there are other aspects involved for being in the top league- sophistication in risk management, dealing in a vast range of financial products and in several economies, modern technology and skill, etc. Nevertheless, a measured approach is to be taken both on consolidation and global presence even if attaining global size is not imminent.Financial Technology (FinTech) across all banking functions and employee stock ownership across all levels will make PSBs more efficient.

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