IMPLICATIONS OF CONSOLIDATION OF INDIAN BANKS

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Abstract: Currently the consolidation mantra is the talk of the town. Every second day we - hear one bank or the other talking about its willingness to take over another bank. Every bank also states that it wants to go for a public issue to expand its capital base. The government is in favour of mergers and acquisitions among the banks, provided it is mutually agreed by the banks concerned. The Narsimhan committee which laid down the road map for liberalization and reforms of the Indian banking more than a decade ago, has recommended the existence of a few Indian banks with international presence along with some large national banks and a small number of regional and local banks. The idea behind this recommendation is that in each segment there are not too many players with miniscule operations but a few players operating profitably with large scale and delivering efficient services to the customers.

The governments view on the subject as articulated by the Finance Minister P. Chidambram recently is that "competition, convergence and consolidation" will be the key drivers of the banking industry in the future. Hence, Public Sector Banks ought to consolidate a course of action that will also help to reap other synergies by reducing transaction costs and foray into new areas which is the present Government position.

The public thinking seems to be conditioned by an implicit faith in the "Universal Banking" model. If Public Sector Banks can come together they can offer a variety of services besides commercial banking (or pool together their existing strengths in nice areas). They can truly reach universal banking status with all the attendant advantages in a competitive environment. Union Finance Minister P.Chidambaram has once again advocated that bank consolidation as a means of making Indian banking globally competitive.

Cost efficiency also could increase if more efficient banks acquired less efficient ones. Though studies on efficiency in banking raised doubts about the extent of overcapacity, they did point to considerable potential for improvement in cost efficiency through mergers. Whatever the potential, the research so far on the effects of bank mergers has not found strong evidence that, on balance, merged banks improve cost efficiency relative to other banks. An early view of consolidation in banking was that it makes banking more cost efficient because larger banks can eliminate excess capacity in areas like data processing, marketing, or overlapping branch networks.

For instance, the SBI — SBS merger the new entity will have combined assets exceeding Rs.5,85,365 crore, reserves of over Rs.3 1,500 crore and a combined net worth in excess of Rs.33,422 crore.

Having a nation wide presence acquired through mergers would definitely help in providing the facility of "Any where banking".

Introduction: Every second day we hear one bank or other banks talking about its willingness to take over another bank. Every-bank also states that it want6 to go for a public issue to - expand its capital base. The opinion expressed by the finance minister that the Govt. is in favour of mergers and acquisitions among the banks, provided it is mutually agreed by the banks concerned, has further added impe tpt1ebank management's aggression in this regard. Eminent bankers and policy makers also opinion that the no of nationalized banks should be reduced from the present 19 to around 5 or 6.

Now the question is that what sort of merger is presently needed to consolidate the Indian banking sector? small banks with big banks or weak banks with strong banks? The Narsinthan committee, which laid down the road map for liberalization and reforms f the Indian bnnking more than a decade ago, has recommended the existence of a few Indian banks with international presence along with some large national banks and a small no of regional and local banks. The idea behind this recommendation is that, in each segment there are not too many players with miniscule operations but a few players operating profitably with large scale and delivering efficient services to the customers. By sheer virtue of market forces, needless to mention that weak banks if do not become profitable losses then they will lose their identity over a period of time. Therefore, the merger of a weak ban with a strong bank is a welcome sign, provided the strong bank does become another weak bank in the process. However, the merger of small banks with big banks becomes a difficult, exercise when both of them are making profits and the small banks wants to grow bigger on its own rather than getting merged with a larger banks. Nevertheless, it will ultimately be the survival of the fittest in this game of mergers and acquisitions.

A merger refer& to the absorption of one firm by another. The acquires firm retains its name and is identity, and it acquires all of thee assets and liabilities of the acquired firm. After a merger, the acquired firm ceases to exist as a separate business entity. A consolidation is the same as a merger except that an entirely created. In a consolidation, both the acquiring firm and the acquired firm terminate their previous legal existence and become part of the new firm. In a consolidation, the distinction between the acquiring and the acquired firm is not important. However, the rules of mergers and consolidations are basically the same. Acquisitions by merger and consolidation result in combinations of the assets and liabilities of acquired and acquiring firms. Consolidation in banking is distinct from convergence. Consolidation refers to mergers and acquisitions of banks by banks. Convergence refers to the mixing of banking and other types of financial services like securities and insurance, through acquisitions or other means.

Objectives of the study

1. To identity the impact of merger on the interest of customer
2. To identify the efficiency and competitiveness in banking in the post-merger period
3. To identify the business risk
4. To achieve diversification

Implications of consolidation of Banks

The implications of consolidation can be seen in different segments like;

1. Cost efficiency, Cost efficiency also- could increase if more efficient banks acquired less efficient ones. Though studies on efficiency in banking raised doubts about the extent of overcapacity, they did point to considerable potential for improvement in cost efficiency through merger ;Whatever the potential, the research so far on the effects of bank mergers has not found strong evidence that, on balance, merged banks improve cost efficiency relative to other banks. This does not mean that many mergers including those of some large banks have failed to lead to significant gains in cost efficiency. It just means that the outcomes for those banks tend to be offset by problems encountered in other mergers and that many banks have improved cost efficiency without merging.
2. In avoiding the business risk: This mega post merger helps in identifying the business risk, which in turn acts as tumbling block in the growth of the Indian banking sector, that one of the hurdle is concerned with Non-performing — Asset (NPA). It is estimated that around Rs.135000 crs is locked up in the form of bad loans for Indian Banks and financial institutions, recovery of such bad loans needs certain harsh steps as well as professional skills in recovery management, which requires a thorough understanding of the basic factors contributing to such bad loans. When banks and financial institutions like standard chatered, Kotak Bank and JP Morgan can buy bad loans of certain Indian Commercial Banks as they are confident of their skills in the recovery of such bad loans, the banking sector as a whole can aim to promote the professional skill in handling the bad loans and recovery of the same.
3. Knowing the effect of merger and acquisitions on the efficiency and profitability of Indian commercial banks: It makes an interesting study, if we see the size of operational and asset base of q few of the top 50 banks in the world and compare the same with the Indian Banks SBI is the only Indian banks to appear in the top 100 banks list of fortune 500 (based on sales, profit assets and market value) and also ranks second in the list of Forbes 2000 among all Indian companies. In terms of the total asset base and net work the Indian banks have a very long road to travel.
4. Diversification: The implications of the mergers for the banking system and the economy are considerable. Banks post merger, may emerge stronger with better earning capacity which would enable them to strengthen their capital base further from retained earnings. The improvement in capital will enable the banks to take up new and diversified activities such as financing equity underwriting, distributing investment and insurance products, issuing asset based securities and providing new delivery channels for their products. Diversification into related activities and other key and potential areas is the need of the hour which will further strengthen the process of consolidation in the Indian Banking by increasing the critical mass and enhancing the asset base and net worth of the banks to higher levels.

Consolidation of Indian Banks: Challenges

It makes an interesting study if we see the size of operations and the asset base of a few of the top 50 banks in the world and compare the same with the Indian banks.

Market Value Ranking

	Ranks	Sales	Profits	Assets	Market Value (in $bn)
Citi group	1	108.28	17.05	1848.10	247.66
U B S	11	62.22	7.10	1115.90	89.16
B N P Paribas	16	55.08	5.80	1128.03	64.39
S B I Group	269	12.09	1.28	127.00	8.62

As the above data clearly indicates that, in terms of the total asset base and net worth the Indian banks have a very long road to travel when compared with the top 10 banks in the world. The asset base and capital of most of the top 10 banks in the world are much more than the asset base and capital of the entire Indian banking sector. In order to enter at least the top 100 segment in the world, the Indian banks need to acquire a lot of mass in their volume of operations. Pure routine banking operations alone cannot take the Indian banks into the list of the top 100 banks in the world. Wide range of financial services in addition to commercial banking functions like mutual funds, merchant banking, factoring, insurance, credit cards, retail loans personal loans, housing finance, auto loans will help enhancing the asset base and also increase the income levels and overall profitability of the banks more importantly spreading the business risk.

Though public sector banks have a large no of branch network in rural areas, the lowest strata of the society (both in rural and urban places) is still outside the purview of banking services. The traditional cash and carry system that is still prevalent as a common practice in most of the cases, is also an important factor in keeping the people away from banks. In order to increase the critical mass in banking operations attempts have to be made to bring the above segments into the banking fold.

To claim the character of a true international or multinational bank, the larger Indian banks have to think of inorganic growth at global level. SBI has already taken the steps in the right direction by initiating moves to acquire a couple of overseas banks. To acquire such size and large business volumes banks need huge capital base, therefore, the banks have to go in for public issues to expand their capital base. In the case of public sector banks as the government stake cannot go down below 51%, these banks can only resort to restricted disinvestments and expansion of capital base. Private banks have a better coverage in this regard as they are not hampered by this sort of restriction. However, barring two or three leading private banks, rest of the private banks do not have large scale operations to reckon with while talking in the international control. Therefore one can expect mergers between a number of private banks in the next couple of years so that, instead of numerous banks with miniscule operations there will be few banks with reasonably large scale operations.

Another major challenge (issue) acts as a tumbling block in the growth of the Indian banking sector is Non-performing assets (NPA). It is estimated that around Rs.135000crs is locked up in the form of bad loans for Indian banks and financial institutions.

Government's Stand: For public sector Banks the main argument in favour of growing in size through the merger and acquisitions is to take on competition globally. The governments view on the subject as articulated by the Finance Minister P. Chidambram recently is that "competition, convergence and consolidation" will be the key drivers of the banking industry in the future. Hence, Public Sector Banks ought to consolidate a course of action that will also help to reap other synergies by reducing transaction costs and foray into new areas which is the present Government position. Unfortunately this position, while theoretically sound, cannot be supported on practical grounds.

The Government's thinking seems to be conditioned by an implicit faith in the "Universal Banking" model. If Public Sector Banks can come together they can offer a variety of services besides commercial banking (or pool together their existing strengths in nice areas). They can truly reach universal banking status with all the attendant advantages in a competitive environment. Union Finance Minister P.Chidambaram has once again advocated that bank consolidation as a means of making Indian banking globally competitive, he identified seven public sector Banks i.e. State Banks of India, Punjab National Bank, Bank of India, Bank of Baroda, Union Banks of India, Central Bank of India and Canara Bank which "Would take the lead in the consolidation process in the Indian banking industry"

Each of these banks has assets exceeding"s.5O,OOOcrs. The Government's expectation seems to be that these banks can by reasons of their balance sheet size take over another bank, either government owned or private, there by spearheading the consolidation phase in Indian banking. He also said a country with a population of 102cr could not be content with one large bank. The reference is clearly to the state Bank of India. The Finance Minister expects four or five other public sector banks to grow in size and reach the level of SBI to become globally competitive.

The rationale behind such thinking is based on the belief that only large well capitalized banks will in a position to face competition from abroad as India opens up.

Outcome of the Study: Improving the quality of management is yet another challenge for banks, modern banking competition is, by and large a test of management's abilities and competence. Banks need to enhance management effectiveness. One way to achieve this is to reduce the cost and monitor cost — income ratio. Banks now face tougher competition from international banks and vulnerable to economic shocks and political instability. At such juncture, when the urgency of strengthening the capital base can hardly be over emphasized, the mergers can certainly be expected to give the banks a better competitive and marketing edge.

Conclusion: The impact of consolidation on bank structure has been obvious, while its impact on bank performance has been harder to discern. The connection to cost efficiency, in particular, remains tenuous. However, recent stud accounting for the combined effects of adjustments affecting costs and revenues suggest that mergers have had positive effect on bank performance.

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