General Studies-3; Topic: Indian economy – growth; Resource mobilization

Merger of BOB, Dena Bank and Vijaya Bank

1) Introduction

- The government recently announced the merging of Bank of Baroda, Vijaya Bank and Dena Bank.
- Cleaning of the balance sheet and minimising NPAs is the objective of the latest merger announced by the government.
- The strategy which the government has adopted is merging one weak bank with its stronger counterparts.
- In this case, the weaker bank is Mumbai-based Dena Bank.

2) Significance

- For the first time, we are witnessing a merger of three PSBs which can be a precursor to other such moves.
- The three banks involved consist of two strong and one Prompt Corrective Action (PCA) bank (Dena Bank).
- It is seen as an attempt to revive a relatively weaker bank with two healthier ones.
- While two banks criss-cross one another in geographical space, the third becomes strategically significant being based in the south.
- The merger comes at a time when all PSBs are walking the thin edge negative profits.
- The success of this merger, according to analysts, is crucial for future such attempts.

3) Positives

- Capital will be higher when merged together and will give a feeling of a stronger bank.
- Large banks with larger lending capacity.
- It will provide efficiencies of scale and help improve the quality of corporate governance for the banks.
- The merged entity will have a market share of about 6.8 per cent by loans, according to data as of March 2018, making it the third largest bank in the system, Moody's said.
- Improvement in operational efficiency.
- Cost of funds for the merged entity is expected to come down.
- Bigger banks can attract more Current Account, Savings Account (CASA) deposits.
- Banks will have the capacity to raise resources without depending on the State exchequer.
- Improve the capacity of the banking system to absorb shocks that the markets may cause to it.

4) Need for Consolidation

- PSBs are highly fragmented, especially in comparison with other key economies.
- The merger will enable the government to pay closer operational attention to the enlarged institution, as is the case with SBI.
- To protect the financial system and depositors' money.
- To build capacity to meet credit demand and sustain economic growth
- The need to bridge geographical gaps.
- In 1991 Narasimham Committee suggested that India should have fewer but stronger PSBs.

5) Concerns / Challenges

- Integration of technology platforms and cultures of these organisations.

- Aligning the distribution of professionals in the merged bank and handling of human resources.
- As issues on seniority are structured and important in a public sector set-up, ensuring that there is harmony would be a challenge.
- Rationalisation of physical infrastructure.
- Dena Bank came under prompt corrective action of the RBI in May 2017 in view of high Net NPA and negative RoA (return on assets).
- Bank of Baroda is the largest among the three and will take a hit on its asset quality.
- The other challenge is customer retention which we saw in SBI's recent merger with its associate banks.
- For the banking system as a whole, things cannot change as the capital remains unchanged.
- The quantum of Gross NPA (GNPA) cannot change and will still have to be addressed.
- Mergers are not the panacea in the context of PSBs.

6) <u>Way Forward</u>

- Without addressing the governance issues in the banks, merging two or three public sector banks may not change the architecture.
- Unless there is a change in the operating structures, mergers will may not deliver the desired results in the long run.
- Giving the PSBs autonomy along with accountability.
- Merged entity will require capital support from the government, otherwise such a merger would not improve their capitalisation profile.
- The merger will yield the desired results if these banks rationalised their branches, looked to reduce costs and handled people issues well.
- RBI should continue to give banking licences for more small finance banks as well as universal banks along with bank mergers.