1. Making the grand Indian PSB mergers Work:

Context:

- Recently, government unveiled a mega plan **to merge 10 public sector banks into four as part of plans to create fewer and stronger global-sized lenders** as it looks to boost economic growth. After the mergers, the country will have 12 public sector banks from earlier 27.

Pros of Bank Merger:

- The move is aimed at creating a robust banking system with global reach.
- The mergers should help create stronger institutions thereby leading to efficiencies of scale and stronger balance sheets.
- It will help rationalize costs across many areas including branches, people, technology etc.
- Customers should be able to get better service and better product suite and the best of all the merged entities.
- The Banking sector as a whole will get strengthened due to obvious efficiencies and will lead to enhanced productivity and better results thereby leading to better lending too.

Lackadaisical approach of Policy Initiative:

- Bank mergers in Public Sector Banks first mooted by **Narasimhan Committee more than a quarter century ago.** While the committee had cautioned against merging weak banks, the government has ended doing precisely that.
- The consolidation should have been a gradual and calibrated exercise resulting in a smaller number of well-capitalized and professionally managed PSBs with a sound governance structure. Instead, what has come is a shotgun 'reform' decision at a time when PSBs are in deep malaise.
- A key concern about merging the ten PSBs into four in one stroke is a lack of clear articulation of the rationale behind bringing disparate and weak banks together, some of whom were still under the Reserve Bank of India's Prompt Corrective Action (PCA).
- Further, such merger announcements generally trigger confusion, anxiety and insecurity in staff, leading to a slowdown in business. Poor communication within PSBs exacerbates the challenges.

Earlier Lesson:

- The smooth manner in which SBI merged five of its associate banks (ABs) in 2017 is not a relevant example in this regard. SBI had managed the ABs over the years with its own

senior team, and all associates had already been functioning on common technology platform. In fact, left to its own, SBI would have preferred a gradual acquisition.

What should be the Objective of the Mergers?

- The efficiency gains from the mergers for large PSBs would be largely illusory in the absence of a sound management with a vision for the future.
- The post-merger scale economies that large international banks seek to achieve with ruthless measures are not feasible in India.
- **Our objective should be to create bigger PSBs that can mirror the efficiency parameters of leading private sector banks here. The chief goal should be to reverse the decline in the PSBs' Return on Equity (RoE) after investing considerable sums in bringing them on a common technology platform, and introducing better risk management measures.**
- The merged entities should become agile and capable of meeting the challenges in retail and mass market segments from private players and open banking sources.

How to smoothen the merger process:

1. Ensured that there is no leadership vacuum in the anchor banks. The technical skills needed for integration planning, transforming business support functions and value build-up have to be cultivated. There is a strong need to revamp Human Resources (HR) practices and culturally integrate the expanded workforce through sustained training initiatives.
2. There is a need to recruit professionals from the market in key areas of technology, HR and risk management, in all of which PSBs are grossly under-equipped.
3. Training of the front-line staff is vital.
4. The government should actively plan steps to offset a possible slow expansion in bank credit in the near term. There is a decelerating trend in loan approvals by PSBs, as brought out in the last RBI report on Trend and Progress of Banking.

- Loan melas and directed lending measures would not be the ideal solution. Instead **Non-Banking Financial Institutions (NBFCs), which have a better understanding of the market needs, need to be tapped to ensure better credit flow.**
- Here, it may be good to consider expanding the scope of the **partial credit guarantee scheme announced in this year's budget to cover all NBFCs treated as Asset**

Finance Companies, instead of restricting it to the top-tier NBFCs, which any way have access to multiple sources.

- The proposed six-month guarantee could also be raised to two years to build a sustained momentum. Further, the Credit Guarantee Fund Trust for Micro and Small Enterprises managed by SIDBI may be revamped to assist more NBFCs.
- Fifth, the government should resolve the tangles in the ownership of the merging PSBs in insurance, asset management and other ventures. The anchor banks should be free to take the best course that would optimise the value of such investments.
- Lastly, the government should consider converting a few 'weak' PSBs outside the merger into regional banks. This was one of the recommendations of the Narasimhan Committee.

Conclusion:

- While consolidation can result in handsome productivity gains, what matters is the quality of execution by a stable and committed leadership, aided by a shrewd and benign ownership.