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BIG BANK THEORY: ON PUBLIC SECTOR BANK MERGERS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

For its sheer magnitude, the scale and the ability to disrupt the status quo, the **mega bank mergers** announced by Finance Minister Nirmala Sitharaman on Friday must go down as the most significant the banking industry has seen in the five decades since nationalisation. The bottomline is clear: to create banks of global level that can leverage economies of scale and balance sheet size to serve the needs of a $5-trillion economy by 2025. The jury is, of course, out on whether this strategy will succeed. Mergers are driven by synergies — in products, costs, business, geographies or technology and the most important, cost synergies. While there may be some geographical synergies between the banks being merged, unless they realise cost synergies through branch and staff rationalisation, the mergers may not mean much to them or to the economy. This is where the government's strategy will be tested. It is no secret that public sector banks are overstaffed. There is also bound to be overlap in branch networks such as in the Canara-Syndicate Bank merger, especially in Karnataka and a couple of other southern States. Ditto with Punjab National Bank and Oriental Bank of Commerce, both of which have strong networks in the north and the west. The success of these mergers, therefore, will hinge on how well these banks handle the sensitive issue of staff rationalisation. The All India Bank Employees Association has already raised the red flag.

It was the Narasimham Committee in the late 1990s that recommended consolidation through a process of merging strong banks. The issue has been the proverbial bee in the bonnet of successive governments since then. What the committee also recommended was shutting down the weaker banks and not merging them with the strong ones as is being done now. But this is obviously not an option politically even for a government with a brute majority in Parliament. The biggest plus of the mergers is that they will create banks of scale — there are too many banks in India with sizes that are minuscule by global standards with their growth constricted by their inability to expand. Yet, this advantage of scale cannot be leveraged without adequate reforms in governance and management of these banks. To be sure, Ms. Sitharaman did announce a few measures to make managements better accountable to the board. But the key reforms to be made are at the board level, including in appointments, especially of government nominees. These are often political appointees, with little exposure to banking. Surely, such practices need to be curbed as the definition of global banks is not just about size but also professionalism in governance. The government will also have to manage the fallout of unleashing four mergers simultaneously which is bound to cause upheaval in the industry. Would it have been better if these mergers had been done one by one? The future will colour the past.

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