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BANKING ON MERGERS

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

Asking healthy banks to take over weak banks appears to be the strategy to handle the bad loans crisis. On Monday the Union government proposed the merger of three public sector banks — Bank of Baroda, Dena Bank and Vijaya Bank — to create an amalgamated entity that will become the country's third largest lender. The merger is part of the government's efforts to consolidate the banking industry with an eye on overcoming the bad loan crisis. After the announcement of the merger, shares of Bank of Baroda and Vijaya Bank shed a significant part of their value, while Dena Bank gained sharply to hit upper circuit on Tuesday. This is not surprising at all. Dena Bank is the bank in the worst financial situation among the three entities and is currently under the Reserve Bank of India's prompt corrective action framework. Unlike the other two banks, its shareholders are set to gain from being part of a new bank with greater financial strength. The current merger, it is worth noting, comes after the government let State Bank of India's associate banks merge with their parent last year and the Life Insurance Corporation of India take over the troubled IDBI Bank this year.

'Banking system facing temporary challenges'

Forced mergers such as the current one make little business sense for the stronger banks as the weaker banks tend to be a drag on their operations. They are also unlikely to solve the bad loan crisis that has gripped the banking system as a whole. It is important to ensure that such mergers do not end up creating an entity that is weaker than the original pre-merger strong bank. That said, the fact is that mergers are one way of managing the problem and therefore cannot be discounted totally. However, the trick lies in ensuring that the merger fallout is managed prudently; identifying synergies and exploiting scale efficiencies will be crucial here. There is no denying the fact that there are too many public sector banks in India; given this, consolidation is a good idea in principle. But ideally, mergers ought to be between strong banks. Then again, these are not normal times and with many banks in a precarious situation, the immediate compulsions for merging the weak Dena Bank with the stronger Bank of Baroda and Vijaya Bank are clear. From a corporate governance perspective, however, the merger sends out rather poor signals. Here is a dominant shareholder in the form of the government that is dictating critical moves that impact the minority shareholders, who are left with no say in the matter. A merger as significant as this one ought to have been first discussed and approved in the board rooms of the banks concerned. If the shareholders of Bank of Baroda, whose share fell by 16% on Tuesday, feel unhappy, that is perfectly understandable.

As a regional party, the TRS sees the benefit in uncoupling Assembly and Lok Sabha elections

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