NEED OF CONSOLIDATION IN INDIAN BANKING INDUSTRY

Saurabh Babel
B.com, MLSU, Udaipur
MBA, Pacific Institute Of Management

Although late, both the Indian Government and the Management of Banks have realized the possible results of synergy effects that could be achieved after consolidation in the banking industry. The reasons for this may be many varying from bank to bank but the very basic underlying reason that would benefit Indian Economy is to move from a state of large number of small banks to a state of few number of large banks.

Before moving further into the pros and cons of consolidation,let us first see the stages of developments in Indian Banking system.

1) 1786 – 1969 : Initial phase of banking when many small banks were set up
2) 1969 – 1991 : Nationalization, Regularization and Growth
3) 1991 onwards : The Indian banking industry after reform processes started after 1991 has become quite mature in its supply, product range and its geographical reach. Although not at par with the global standards, slowly but surely it is moving towards having clean, strong and transparent balance sheets.

Moreover there are three type of ownership formats in Indian banking system. The state owned, the privately managed and the old private sector community dominated banks. As of now the health of PSU banks in India is not at all at desired levels. These banks have been losing their market share. NPA's are rising at an alarming level. The share of their deposits fell to 71% in 2016 from 77% in 2012.Capital ratios are not at all appealing. Because of fragmented nature of Indian Banking system, banks are not able to compete globally, they face difficulty in fund mobilization, credit disbursal and investment. As a result the government is also no more willing to inject capital into the black hole. Equity investors in old private sector banks have realized that the age old management on the board is not all apt and professional in understanding the global perspective. At the same time the new age private Banks are more smart and bold and moving ahead at a very good pace.

As India prepares for competitive times, more banks are planning to combine for competitive advantage. The Raghu Ram Rajan Committee has also recommended to encourage consolidation in PSU Banks. The Government has also made its stand clear that the initiative for consolidation has to come from the management of banks and the government will play a supportive role. The benefits that accrue through consolidation are :

- A consolidated banking structure would be a positive development in the long term.
- A large bank enjoy scale benefits leading to better diversification of risks and strong overall profitability.
- A bigger bank would also work well in achieving financial inclusion, a key objective of government.
- Cash rich firms use the acquisition route to buyout an established player in a new market and then build upon the existing platform.
- Many different banks are fighting for the same market space offering same products at almost same margins which encourages mis selling, fake and illegal offers, and creating a mess in the minds of customers. Consolidation will actually reduce competition amongst banks.
- Those banks who have a very limited presence in the rural areas can increase their presence by buying out regional banks.

- Weak banks who have very poor balance sheets can merge with a better and bigger bank rather than going on for liquidation or a state of bankruptcy.
- Organic growth takes years in present day economic dimensions. Dynamic firms prefer acquisition route to grow quickly in size and geographical reach.

Some of the examples of recent consolidation deals that happened recently in India are cited for better understanding.

The biggest merger that happened recently is merger of Associate banks of SBI (SBBJ,SBP,SBM,SBT,SBH and Bhartiya Mahila Bank) into SBI. After this merger SBI now stands amongst the top 50 banks in world. SBI has now 23% market share in the industry. Initially there will be some challenges in the short run and it will shoot up the cost because many employees will be relocated, many ATM,s will be relocated and many branches will be reconsolidated. But the long term benefits will far outweigh the short term challenges.

Another example is the merger of Centurion Bank of Punjab with HDFC Bank in 2008.It also provided massive scale economies and improved distribution network of branches. It made HDFC largest in terms of number of branches in private sector at that time. Kotak Bank’s buyout of ING VYASA Bank, ICICI buyout of Bank of Rajasthan Ltd are few more examples of consolidation that happened recently.

In the coming years while a merger among relatively strong banks is likely, weak banks are expected to shrink in their size. PNB,BOB,BOI,CANARA Bank are being seen as the lead banks to merge other banks with themselves in the coming years. Most of the consolidation deals have been successful and fruitful in achieving the desired objectives yet consolidation in itself does not guarantee success unless it is coupled with good governance and capital reforms in the banking industry.

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