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Banking is necessary; banks are not – The Case of SBI AND ASSOCIATE Banks Merger

Abstract

"Banking is necessary, but banks are not" – Bill Gates said in 1994 referring to the technology revolution sweeping the banking industry. Though in those times, this seemed to be a provocative statement, in today's times this is seeming to be true. The Indian history witnessed industrialization, rise of the banking sector to support the industrial growth and in turn rise of credit extended to the people to finance their ever increasing and unlimited needs. But not all good times last always, the country also saw slowdown in the industrial activity leading to non-repayment of the loans that were extended to various classes of society. The rise of NPA's lead to a phase of consolidation wherein banks could add their assets and benefit from the joint management and knowhow to finance further projects. An attempt in this case is made to narrate and analyze the case of SBI and Associate Banks Merger that shook the banking sector and the country in March 2017. The underlying reasons, the challenges and the probable benefits are listed to have a bird's eye view of the entire event. Since not even six months have passed, the success or failure of the merger on the basis of profitability cannot be focused upon.

Keywords: *Bank Consolidation, Merger, NPAs, Public Sector Banks*

1. Introduction

1.1 History of Indian Banking

Banking in India is as old as 1770 when Bank of Hindustan was set up which was later liquidated. The State Bank of India originated as the Bank of Calcutta in June 1806.

Nationalization of banks

After independence it was felt necessary that some of the critical and core services and businesses should be brought under the control of the Government. Banking was one of those sectors and India nationalized the banks in 1969p. As the financial services were very important for the development of India, slowly the number of the banks and their branches continuously kept expanding with rising demands. Equity and Justice was the focal point than profitability.

Privatization of banks

Government felt the need for a more competent and aggressive banking structure and in the new Economic policy took the decision to allow private banking. New private banks got licenses and started operations with more focus on profits, costs, customers and better services. The complacent Public Sector Banks began feeling the heat and competition from the private banking sector. The consolidation of banking is not new in India. In the LPG policy of 1991, there were recommendations by the Narsimham Committee to have a three layered structure for the Indian Banking Sector. Table 1 lists the mergers and amalgamations that took place in the Indian Banking Sector from the year 2000 till date. Most of the mergers took place between private players but some also took place between a Public Sector Bank and a Private Sector Bank. The intentions though were not benefitting from consolidation and expansion but mostly saving the weaker banks facing issues with capital adequacy.

Table 1: Major Mergers/Amalgamations in the Indian Banking Sector from FY 2000-2017

Sr.No.	Nam of the Transferee bank	Name of the Transferor Bank	Date of Merger / Amalgamation
1.	ICICI Bank Ltd.	Bank of Madura Ltd.	March 10, 2001
2.	ICICI Bank Ltd.	ICICI Ltd.	May 3, 2002
3.	Bank of Baroda	Benares State Bank Ltd.	June 20, 2002
4.	Punjab National Bank	Nedungadi Bank Ltd.	Feb 1, 2003
5.	Bank of Baroda	South Gujarat Local Area Bank Ltd.	June 25, 2004
6.	Oriental Bank of Commerce	Global Trust Bank Ltd	August 14, 2004
7.	IDBI Ltd.	IDBI Bank Ltd.	April 2, 2005
8.	Centurion Bank Ltd.	Bank of Punjab Ltd.	October 1, 2005
9.	Federal Bank Ltd.	Ganesh Bank of Kurundwad Ltd.	September 2, 2006
10.	IDBI Ltd.	United Western Bank Ltd.	October 3, 2006
11.	Indian Overseas Bank	Bharat overseas bank Ltd.	March31, 2007
12.	ICICI Bank Ltd.	Sangli Bank Ltd.	April 19, 2007
13.	Centurion Bank of Punjab Ltd.	Lord Krishna Bank Ltd.	August 29, 2007
14.	HDFC Bank Ltd.	Centurion Bank of Punjab Ltd.	May 29, 2008
15.	State Bank of India	State Bank of Saurashtra	August 25, 2007
16.	ICICI Bank Ltd.	The Bank of Rajasthan Ltd.	August 13, 2010
17.	State Bank of India	State Bank of Indore	August 26, 2010
18.	Kotak Mahindra Bank	ING Vysya Bank	April 1, 2015
19.	State Bank of India	5 ABs and Bhartiya Mahila Bank	March 31, 2017

Source: Compiled by the author

1.2 The present scenario in Indian Banking

We have a mixed banking structure with 21 Nationalized Banks and several aggressive Private Sector Banks to achieve the twin objectives of Growth and Development along with Social Justice. However the rising bad loans have raised questions on the performance of Public Sector Banks leading the Government to think that consolidation of these banks will help resolve this issue.

We are in the era of Financial Inclusion and banking needs to expand. In the times of digitalization, less people frequent banks for their transactions and more people use the digital platform to transact. Physical presence of the branch is lesser required in times of e wallets, m wallets, e commerce, internet banking and digital applications. There is also emergence of Payment Banks and Small Finance banks since 2015.

2. The state bank of india and its associates

The seven associate banks (ABs) were established in various princely states in the pre independence era to serve local populations there. In 1959, the Government brought them under the fold of SBI after passing the State Bank of India (Subsidiary Banks) Act. In 2007, the State Bank of Saurashtra was the first to merge with SBI followed by State Bank of Indore in 2010. The remaining five ABs were merged in March 2017.

Table 2: Associate Banks, Year of incorporation and present State of existence

Associate Banks	Year of incorporation	Present State of existence
State Bank of Saurashtra	1902	Gujarat
State Bank of Mysore	1913	Hyderabad

State Bank of Patiala	1917	Punjab
State Bank of Indore	1920	Madhya Pradesh
State Bank of Hyderabad	1941	Hyderabad
State Bank of Travancore	1945	Kerala
State Bank of Bikaner and Jaipur	1963	Rajasthan

Source: Compiled by the author

3. The merger and its impact

The merger of five associate banks was a path breaking decision taken by the government of India. Three of these banks had dominant SBI equity holdings and were stock listed entities while two were wholly owned by it.

3.1 Finance

- The combined Assets of ABs are a fourth of SBI's while the combined Net Loss of the five ABs was Rs. 11,865 crores more than the Net Profit of the SBI.
- The NPA's of ABs are much higher and could offset the controlled bad loan percentage (3.7%) of SBI. (refer Table 3)

Table 3: The position of banks as on 31st March 2017 (Rs. Crore)

Name of Bank	Deposits	Advances	Net Profit	Gross NPA (%)	Net NPA (%)
State Bank of India	20,44,751	15,71,078	10,484	6.9	3.7
State Bank of Bikaner and Jaipur	1,03,662	68,774	-1,368	15.5	10.5
State Bank of Hyderabad	1,42,955	87,715	-2,760	20.7	12.8
State Bank of Travancore	1,14,323	52,506	-2,152	16.8	10.2
State Bank of Patiala	1,00,507	77,100	-3,579	23.1	15.5
State Bank of Mysore	77,769	38,608	-2.006	25.7	16.9

NPA-non-performing assets
Source: SBI Annual Report 2016-17

- HDFC Bank, the second largest private bank with one-fourth the assets of SBI, has a market capitalization of Rs. 3.26 lakh crore, far ahead of SBI's Rs. 1.98 lakh crore.
- The public sector banks need over 1 lakh crore of capital over next two years to meet capital adequacy norms, however government has agreed to give them 20,000 crore by March 2019 as per the Indradhanush plan which involves banks submitting detailed growth plan and indicating how they are going to deploy the funds to get additional money.
- As per the Finance Ministry's data, 1,762 wilful defaulters owed Rs. 25,104 crore to State Bank of India as on Marh 31, 2017, putting a pressure on its balance sheet.
- By March 2015, NPAs in the infrastructure sector of PSBs were 22.8% of their aggregate problem loans. It clearly highlights the lack of risk assessment and project monitoring capabilities.
- The former RBI Governor Raghuram Rajan also highlighted that some of the projects that are viable are not performing due to other bottlenecks like problems in land acquisition and environmental clearances.

3.2 Marketing

- There will be a problem of plenty in some regions post the merger of ABs with SBI. Though the ABs had an advantage of having the same Logo as SBI still there was lot of localization in the ABs. The Ernakulam District in the state of Kerala will now have close to 200 branches of SBI after the State Bank of Travancore merged with SBI.

- Nearly 30 per cent of the 8,616 staff to be redeployed due to branch rationalization will be posted in sales functions. This means the entity will go aggressive in terms of new business sourcing.
- Same products and services offered across the country will be positioned at the national level. There will be uniformity in Brand and Product Positioning.
- The service delivery standards will also be uniform and thereby improving the customer satisfaction levels in smaller regional branches.

3.3 Human Resources

- SBI had to rationalize 716 offices (594 branches and 122 administrative offices) and several thousands of employees had to be transferred beginning this fiscal after the merger.
- Around 70,000 employees (40,000 class III and IV and 30,000 officers), which are around 34 per cent of the parent workforce, were added to SBI's rolls following the merger of SBBJ, SBM, SBT, SBP, SBH and Bhartiya Mahila bank. However the size of these AB's was 25 per cent of SBI. With no issues coming to the fore on the transfers, it seems that the movement of people has been smooth.
- Around 3569 employees have opted for Voluntary Retirement Scheme. After absorbing smaller associated lenders, SBI now has 280,000 employees – 70,000 more than before the merger. According to the chairman, 13,000 people are retiring per year, which could neutralize the excess manpower.

3.4 Operations

- The merged identity now has around 24,000 plus branches and 58,000 ATMs. ICICI, the largest private sector bank on the other hand has around 4,450 branches and 14,305 ATMs. In terms of geographical reach, the merged entity has a wider reach.
- Each AB had a separate Treasury. So there was lot of duplication. Now a single Treasury will save costs.
- There is a possibility of overlapping in terms of branches in specific regions which have to be rationalized.
- Uniformity in Technology architecture across the merged entity has to be ensured and if done successfully will strongly be a driving force for SBI's success as against the private banks which are technologically already advanced.
- The bank is also thinking of releasing resources blocked in real estate in dysfunctional corporate and planning offices as not a central planning office, central treasury etc. could be built.

4. Is customer the king?

Benefits to Customers

- Wider infrastructure of ATMs and branches
- The charges on cross bank ATMs would reduce as now there are more ATMs available of the same bank.
- Financial products such as Mutual Funds, Insurance will be available to customers of small banks.
- Banks will have a wider capital base enabling them to offer big ticket loans to customers.
- More customers will have access to lending by the banks

Disadvantages to Customers

- Regional banks will lose their local flavor since all the regional ABs have come under one umbrella at the national level.
- There is a possibility of a **Systemic Risk** as one large merged entity if collapses, the entire Indian Financial system would be affected.
- The employee growth or uninvited transfers would lead to discomfort to some people reducing their morale and motivation and in turn their behavior and customer service.

5. The way forward

Government is also proposing the same misery for Bank of Baroda, Punjab National Bank and Canara Bank as future scapegoats for bank consolidation. The present count of Public Sector Banks is 21 and government is contemplating of bringing this number down to 6 by merger weak banks with the stronger ones. Though the first quarter ending results of SBI post the merger have not been promising, some more time has to be given to them to be able to adapt to this change. Other public sector banks can learn from the case of SBI how they have managed a smooth transition. India needs both Public Sector banks and Private Sector banks to serve development and social justice.

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