A Thematic Study of Literature on Merger of Indian Banks with Special Reference to Public Sector Banks

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Abstract- This article highlights the development of mergers in Banking industry through the learnings of literature. This article discusses on banking mergers in Indian context and focuses on happenings around the Public Sector Banks in the recent past. The moot purpose of this article is to encapsulate the developments of mergers in Banking sector. This article provides an insight for the researchers to go through the details of the merger in this section

Key words: Merger, Banking Sector, Public sector banks, performance evaluation, Non-Performing Assets.

I. INTRODUCTION

The banking system is the backbone of every economy. It plays an important role in the economic development of a country. Banks are the institutions that provide banking facilities to the people. Its main objective is to mobilize the deposits of the household by collecting their savings and lending it out to the business houses who require fund to run their business, purchase assets and meet the daily expenses. Thus, the banking system leads to an increase in the saving habits of an individual, provides financial assistance for establishment and running of businesses, provides employment opportunities directly and indirectly and helps in infrastructural development and capital formation. Therefore, a sound banking system is a reflection of a financially stable economy.

In recent times, merger is widely used as a strategic tool to fuel growth in the banking sector. In India, the merger of Public Sector Banks is conducted and governed by the central government. On August, 2019, the government announced the merger of ten Public Sector Banks to four Public Sector Banks with an objective to achieve a $5 trillion economy. This marks the biggest merger in the history of Indian banking system. It can thus be understood that a robust banking system has a significant contribution in the economic development of a country.

This paper is an attempt to study various literatures on Indian banking sector, performance of banks, problems faced by banks, mergers in the banking business and effect of merger in the performance of banks so as to gather various findings and views on the merger of banks in India.

II. MERGER OF BANKS: INDIAN SCENARIO

The most important point to discuss about in relation to merger is value creation. It is the nucleus around which the entire concept of merger revolves. Various studies have been carried out globally to find an answer to whether merger leads to the creation of synergy, whether such activities impact a firm's performance and how long does it take to reap the benefits of merger. While there is no right answer to these questions, several researchers have come up with various conclusions based on different researches and have given their insight on this matter.

A study on merger of banks by (Bhasavaraj, 2019) states that merger cannot be the solution to all the problems faced by a banking institution. It must come up with measures to resolve problems of upsurging Non-Performing Assets, frauds and bad loans. Banks have to build strong internal management to deal with these problems and corporate governance norms might help in tackling them efficiently (Singh, 2019). Despite having several merits of merger in banking sector, a great deal of difficulty is faced in the human resource front like integrating employees, restructuring their job profiles and positioning them productively (Ishwarya, 2019), (Aadhana,2020), (Krishnamurthy, 2017). It subjects the new bank to unstable and unforeseeable risk and also leads to the reduction of net profit (Reddy, 2020) especially when mergers have been performed between weak and strong banks with an objective to prevent the weak banks from dissolution (Mubarak, 2021).

Studies suggest that mergeris a technique of reducing risk by diversification (Sinha, 2011). It leads to overall reduction of risk of the firm. However, it takes time to reap the benefits of merger and immediate synergy gains should not be expected (Boateng, 2020). This idea is supported by the researches of (Gandhi, 2020) and (Ishwarya, 2019).

(Boateng,2020) attempted a pre and post merger analysis of the financial performance of IDBI, HDFC and ICICI bank using the DuPont model based on five parameters namely profit margin, asset yield, financial leverage, return on asset and return on equity. In all the three banks, there was no significant improvement in the profit margin and asset yield post merger. Return on asset and return on equity marginally improved in HDFC and ICICI banks but marginally reduced in IDBI bank. Financial leverage considerably and marginally reduced in IDBI and ICICI respectively while it significantly improved in HDFC. A study with similar objective was conducted by (Gandhi,2020) on ICICI bank. CAMEL model has been implemented to inspect the post merger financial performance of the bank. It has been observed that no significant improvement could be seen in the performance parameters. However only three years pre and post period data has been used in the study and by considering the gradual improvement in the performance of ICICI bank over years, it has been concluded that the bank took a longer period to gain synergistic benefits. The same model has been used by (Reddy,2011), (Matkar, n.d), (Gupta, 2008) for comparative analysis of financial performance. (Reddy,2011) compared the performance of two Regional Rural Banks namely Andhra PragathiGrameena Bank (APGB) and SapthagiriGrameena Bank (SGB). APGB outperformed SGB on areas like earnings quality, Total Advances to Total Deposits ratio and safeguarding creditor's interest making it the better performing bank. (Matkar, n.d) reviewed the financial performance of MSC bank and concluded that it has been performing well for the past few years with increase in non-net interest income, profit per employee, capital adequacy ratio and decrease in operating expense, staff cost level of NPAs. (Gupta, 2008) made a comparative analysis of ten private sector banks using a composite ranking method. On the basis of overall performance, Karur Vysya Bank secured first rank. City Union Bank and Kotak Mahindra Bank secured second and third position respectively. Bank of Rajasthan has the lowest composite rank amongst all the bank. A good corporate governance norms, transparency and efficient management of Non-Performing Assets can act as guiding forces to bring about improvement in operations.

III. PUBLIC SECTOR BANKS IN INDIA

Mergers of Public Sector Banks in India are government directed and not self-decided by the banks. The main objective of merger in this sector is to increase the size of the banks so that they can compete on an international level. Big sized banks have large lending capacity and helps to achieve efficiencies emerging from economies of scale (Kumar, 2013). On merger with its five associate banks and BharatiyaMahila Bank on 2017, State Bank of India enters the list of top fifty global banks in terms of asset size. Many researchers view merger as a method to strengthen the banking system, increase lending capacity, control the growing Non-Performing Assets and manage capital efficiently (Madrey, 2020), (Adhana, 2020). Another objective of merger in Public Sector Banks is to safeguard the weak banks from failure caused by inefficiency in management, technological backwardness and low lending capacity. Therefore, to protect the interest of the shareholders of the weak banks, the government merges them with the stronger banks. This however contradicts the recommendations of the Narshimam Committee that suggests the merger of equal sized banks. The merger between weak and strong banks can subject the strong bank to unstable risk and can lead to reduction of its profit (Reddy, 2020), (Mubarak, 2020).

(Agarwal, 2019) states that the problem of NPA is not confined to small sized banks only and deteriorating asset quality of the banks contributes to its increase. (Das,n.d) study on sector wise distribution of NPAs and concluded that in comparison with the priority sector, non-priority sector has higher NPA. Priority sector NPA is reasonable and increases at a lower pace than the non-priority sector NPA. The study found that there has been a positive correlation between corporate debt restructuring and NPA suggesting that restructuring has failed to reduce the NPA. (Mohanty,n.d) states that the Public Sector Banks hold more stressed assets in comparison to that of Private Sector. The findings of the research states that with an increase in the Net NPA, the Net Profit decreases. The banks should focus on enhancing their credit and repayment structure and build up an efficient management system to stamp out the NPA problem. Another study by (Arasu, 2019) found that there has been a continuous increase in the Gross and Net NPAs of public and private sector banks. Gross NPA and Net NPA of both public and private sector banks showed significant positive correlation. Impact of ownership has a significant influence in the Gross and Net NPA of both banks. The study also reveals that the degrading asset quality has a significant contribution in increasing the NPA and thus regulators must take necessary steps towards the recovery mechanism.(Rajput, 2012) expresses that the reason for the gradual slumping of the quality of advances in the Public Sector Banks in India is the aggressive lending policies of the bank. The government must impose restrictive measures to suppress such weak lending policies specific to the priority sector. The use of Core Banking Solution to keep a periodic check on the NPA is a beneficial decision. Another study by (Brahmaiah, 2019) has a similar argument that identifies lenient credit policies, relaxed loan

conditions, weak regulatory system and inefficiency in management as the major causes of higher NPA in Public Sector Banks in comparison to that of the Private Sector Banks. It recommends that the regulatory policies of RBI be neutral to bank ownership.(Das, 2014) conducted a study on State Bank of India and its associates and other Public Sector Banks to find out if there is any difference in the mean variation between the banks considered for the study. It has been found that there has been no significant difference which signals that there is no effect of bank operations on the Non-Performing Assets. (Sharma, 2019) performed a comparative analysis on NPA handling in public and private sector banks for the period 2010-2015. The findings are such that Public Sector Banks have more Gross NPA than Private Sector Banks for the year 2014-2015. There is an increase in the Gross NPA to Gross Advances of Public Sector Banks and there is no significant difference in the Gross NPA ratios to Gross Advances for public and private sector banks for the period 2010-2015. (Bad, 2017) discloses that there has been a considerable climb of NPA in the Public Sector Banks whereas it is controlled in the Private Sector Banks during the period of study. By studying various reports and cases, (Rajoria, 2018)identifies various reasons for the increase in NPAs in PSBs of India. Some of them being delayed acknowledgement of asset problems and high loan loss provisions, global financial crisis, frail post-lending monitoring and loan recovery system, non-independence of the Board, willful default and corruption. It concludes that consolidation can help PSBs in dealing with the rising NPA problem. However, it is essential that the consolidation takes place voluntarily or at least the opinion of the Board and interest of other stakeholders must be taken into consideration. The PSBs need to have an efficient system for functioning and risk management, active participation in derivative instrument for restricting their risks and clear capital raising 5-year plan must be charted out. Highlighting the sectors having stressed assets on a quarterly basis, freeing itself from political influence and unbiased lending to different sectors are few ways of reducing the NPAs.Many studies favor merger activities in the Public Sector banks as they are of the view that it helps strengthen the banking system by restricting the NPA growth, enhancing credit growth and better capital management (Madrey, 2020) and these contributions will play a major role in making India a $5 trillion economy (Adhana, 2020). Another view in favor of merger given by (Singh, 2019) states that the main components that encourage merger in Public Sector Banks are operation inefficiencies, inadequate asset quality and weak loan recovery management.

Various researchers have studied merger and examined its impact on the performance of Public Sector Banks. (Lakhtaria, 2013) attempted to evaluate and compare the performance of three Public Sector Banks namely Bank of Baroda, State Bank of India and Punjab National Bank using CAMEL model for a three-year period. It has been found that Bank of Baroda was ranked best among the three banks followed by Punjab National Bank and State Bank of India. Other studies that implemented this model for performance evaluation are (Prasad, 2012), (Gupta, 2014), (Vijayakumar, 2012), (Mishra,n.d). (Prasad, 2012) aimed to assess and compare the performance of twenty nationalized banks for a period of five years (2005-2010). The overall findings are such that Andhra Bank secured first rank and Bank of Baroda and Punjab and Sindh Bank secured second and third rank respectively. The worst performing bank was Central Bank of India, followed by Bank of Maharashtra and UCO Bank. (Gupta, 2014) analyzed the financial performance of Public Sector Banks for a 5-year period from 2009 to 2013 and found statistically significant difference between the CAMEL ratios of the PSBs.(Vijayakumar, 2012) aimed to evaluate the financial soundness of State Bank of India and its associate banks for a period of 14 years ranging between 1996-1997 to 2009-2010. The research concluded that SBI and its associate banks have been performing exceptionally well during the period of study. However, SBI surpasses its associate banks on the basis of overall performance. (Mishra,n.d) strived to assess the financial health of State Bank Group for 2009-2011 period. It concluded that though the banks have been ranked on the basis of their performance, there has been no significant difference in the parameters suggesting that the general performance of all the banks in the group is the same.There has been a substantial number of researches on mergers of State Bank of India with its associate banks. With the help of linear regression and trend analysis, (Jose, 2021) analyzed the merger of State Bank Group andconcluded that there has been a positive change in the revenue and will continue to remain positive for the years to come unless some unforeseeable factor emerges. As per this study, the merger was a success. (Ishwarya, 2019) stated that the merger of State Bank of India with its associate banks will reap benefits in the long run arising out of cost savings, increased bank network anduniform technological availability. However, issues relating to integration of human resource, pension provisions and regional culture adapted by the associate banks can be major drawbacks of the merger. (Krishnamurthy,2017) points out the similar drawbacks regarding the merger of SBI with its associate banks and also states that SBI Group merger should be viewed as an internal exercise and not merger. It concludes that mergers in Public Sector Banks will be more effective if the problem of increasing stressed assets be efficiently handled so that the banks can focus on gathering the economic benefits arising out of merger.(Mathur,n.d) expresses concern on the size of SBI after merger. The findings show that there has been a decrease in the Capital Adequacy Ratio of SBI post-merger even though the total capital has increased, Non-Performing Assets of SBI has increased by 11% in one year of merger and customer base has increased post-merger.

A comparative analysis of pre and post-merger performance of Bharat Overseas Bank and Indian Overseas Bank on the basis of efficiency parameters was conducted by (Kumar, 2013) for a period of three years pre and post-merger. It was found that parameters such as Business per Employee, Investment and Advances, Interest Income and Other Income showed significant improvement but Profit per Employee, Return on Advances and NPA ratios did not show significant improvement post-merger.(Kumar, 2012) evaluated the performance of public and private sector banks and drew a comparison between them using composite ranking method. The study revealed that private sector banks have outperformed the public sector banks with better financial soundness. A similar study was carried out by (Gandhi, 2020) to assess and compare post-merger financial performances of public and private sector banks. The result showed improvement in few considered parameters but found no statistically significant improvement. It was also found that the performance of private and public sector banks showed no significant difference. (Mondal, 2017) measured the effect of merger of Nedungadi Bank and Punjab National Bank using several financial ratios as parameters. The study considered two years pre and two years post-merger period. The findings showed that there was a significant improvement in most of the considered ratios post-merger and thus could be concluded that the merger was a great success.

IV. CONCLUSION

Mergers are one of the most effective strategic tools towards growth and development. In the banking sector, merger activity offers a number of benefits like efficiency in operations, cost saving, better management. Enhanced lending capabilities, capital adequacy, bigger size and larger customer base. Bigger size helps a bank compete on an international level. Narshimam committee recommended for merger of banks to establish global presence. Big sized banks also have higher capacity to absorb losses. However, merger comes with its own limitations. Merger of weak banks with stronger banks in the interest of the shareholders of the weak banks can create an irrecoverable dent on the net profit of the stronger bank. The issue of human resource management arises due to cultural and regional differences of the banks.

Increasing Non-Performing Assets has created a distressing situation in the Indian banking system. This is caused due to diminishing asset quality, lenient lending policies, lack of proper management and inadequate loan recovery mechanism. It has been observed that the NPA problem is higher in Public Sector Banks as compared to Private Sector Banks. This is because the internal management of the Private Sector Banks are stronger than Public Sector Banks. Private banks are well regulated and have stricter loan recovery policies. The problems of bureaucracy, corruption and technological backwardness are higher in case of Public Sector Banks.

The issue of NPA must be tackled with urgently because it will be difficult for the bank to focus on reaping the benefits arising out of merger if it has too much stressed assets to deal with. The government must come up with remedial measures to reduce NPA and strict regulatory provisions to recover loans.

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