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Bank merges are no silver bullet for India

Andy Mukherjee | September 02, 2019 businessline

The benefits won't be felt for years, while the government is staring at an economic crisis now.

With every passing day, India's economic indicators are turning a little bleaker. The situation is bad enough to warrant using the word crisis, arriving just as the governments fiscal ammunition is spent.

The announcement Friday of 5 per cent GDP growth in the June quarter showed the economy growing at its weakest pace in six years. On Sunday, the top six car makers reported a 29 per cent drop in August sales,stoking fears that the slowdown could get still worse. The ☐98,200 crore ($13.7 billion) collected in August via the goods and services tax, the main tax on consumption, was the smallest in six months.

This adds pressure on the central bank both to cut its policy rate and to ensure that commercial lenders pass them on to borrowers. To the extent that the more inefficient public sector banks are a drag on credit, New Delhi said Friday that as many as 10 of them will be merged into four.

Whether folding one weak bank into another will make the combined entity any stronger remains to be seen. What's clearer is that these lenders will spend the next six months on integration. Putting their balance sheets to work may take a back seat. Pending consolidation, the lenders might also be hesitant to issue new bank guarantees, especially to private-sector bidders for road projects. Thus, one of the few areas where there's new investment may be affected, especially with a sharp rise in debt levels of the government agency that gives out the contracts.

A hefty injection of ☐55,250 crore of taxpayers money into the merged banks will only help them provide for the bad loans that will get lumped together. Capital for growth remains elusive. State Bank of India, the largest lender, will require ☐15,000 in the current fiscal year, according to ICRA Ltd., an affiliate of Moodys Investors Service.

The benefits will only be evident in a few years. The new round of consolidation will bring down the number of public sector banks to 12 from 27 just a few years ago. These lenders will have no choice but to become more competitive because they'll have to price consumer loans by linking them to the central banks policy rate. Since they aren't very good at lending against cash flows, the government wants them to originate loans together with non-bank financiers. Currently, even the shadow banks are stressed. Over time, though, this should help boost the underwriting standards of state-controlled lenders. Credit flows to smaller firms, which supply goods and services to larger companies,will improve.

Making the most of vendor finance will require plugging India into global supply chains first. By offering the likes of Apple Inc. and Ikea less restrictive access to its billion-plus population, New Delhi is hoping for long-term sourcing wins from the rapidly deteriorating trade relations between Washington and Beijing.

But while taking much-neglected steps to position India as an alternative to China is a welcome move, the gains wont be immediate. Before committing to a new factory in India to both sell locally and to export, investors will want to see steadier final demand in the domestic economy. Maruti Suzuki, the nations biggest carmaker, is struggling to push out 100,000 cars in a month to dealers ahead of the festival season. That isn't exactly a great advertisement to dangle before new entrants.

Good things will come from all the tinkering just not now. Weakening global growth means India cant even use a weak currency to export its way out of trouble. This isn't the time to talk loudly about wanting to become the next China. A hawkish Washington won't want to see mercantile strategies being deployed by yet another large labour-surplus nation.

Prime Minister Narendra Modi's best hope will be to use the crisis to mend his governments frayed relationship with the private sector. Giving startups a reprieve from a seven-year-old law, one that was used by tax authorities to harass them with impunity, is a good move.

Admitting that there are design flaws in the consumption tax and fixing them perhaps by bringing separately taxed petroleum products into its ambit should be the next step. Like with the bank mergers, the gains will take time to become evident, even as the pain gets visibly worse.

Why we oppose merger of Banks ?

- **Banking density in India much less than many countries**:

  Compared to many countries of the world, banking density is relatively low in India and hence there is huge scope and need for expansion of banking industry. There is no need for consolidation and amalgamation of banks. India needs expansion of banking sector to cover all sections of people.

- **India needs banking expansion, not consolidation**:

  There are thousands of villages where banks have not reached. There is huge exclusion of people. Hence Banks need to be expanded. There is no need for consolidation.

- **India has a large space for further banking expansion**:

  The number of Banks in USA with just 323 million population is far more than Banks in India with a population of 1.35 billion. India is not overbanked. There is no need for consolidation.

- **India needs financial inclusion, merger will exclude small people from banking map** :

  Because banking has not reached all people, Government launched Jan Dhan Yojana. Now they have launched Jan Dhan Yoja II. This means we are yet to reach all sections of people. So we need to expand banking services. Mergers will result in shrinkage of banking. Hence there is no need for mergers.

- **India needs good Banks, not big Banks**:

  Mergers are proposed to make our Banks bigger to cater to increasing demands for large-sized loans. Bigger the loan, higher the risk. Already Banks are suffering from big corporate defaults. Hence Banks should not be made bigger by merging them. Hence mergers are not needed.

- **Merger will not make Banks stronger**:

  Government argues that Banks would become stronger by mergers. There is no evidence to this conclusion. 2 years ago, 6 Banks were merged with SBI with this argument. But SBI has not become any bigger. Rather, problems of SBI have become bigger. Branches have been closed. Staff have become surplus. Business expansion has slowed down. NPAs have gone up. Thus Banks will not automatically become big by merger of Banks.

- **Too big to fail is a bogus theory**:

  The earlier belief that 'too big to fail' has become a myth now after the US banking crisis. Big Banks have collapsed like pack of cards. Thus big banks mean bigger risk. India cannot afford to take such risks. Hence mergers and making our banks big is to be avoided.

- **More bad loans in SBI after mergers**:

  Mergers are proposed so as to resolve the problems faced by the Banks. Bad loans are the main problem facing the Banks. Can anyone believe that merger will result in recovery of bad loans. Obviously not. After merger of 6 Banks with SBI, the NPA went up. Hence it is also a wrong presumption.

- **Don't divert public attention from NPA to mergers**:

  To resolve the problem of bad loans facing the Banks, Government should take tough measures to recover the bad loans. Instead of that, the Government is trying to divert the attention and focus by resorting to merger of banks which is unwarranted. Bad Loans in the 10 Banks proposed to be merged today are **Rs. 3,16,632 crores**. Whether these bad loans will automatically be recovered if these Banks are merged ?

- **Merger will not help to recover bad loans**:

  Merger of banks and consequent issues arising from such mergers will put the issue of bad loans in the backburner. This is what happened in SBI after merger of 6 Banks with SBI. Hence Banks will further suffer.

- **Merger will not make our Banks global banks**:

  Another argument is that Banks would become globally competitive by mergers and help to create very big Banks. All global Banks operate with much higher capital levels like $ 60 Billion, $ 70 Billion, etc. Even if all our public sector Banks in India are merged into one Bank, the combined equity capital would be only around $ 4 Billion(Rs. 30,000 crores). Thus we cannot match these global banks in terms of their capital strength. Hence mergers would not make our Banks equal to those global banks.

- **Merger of Banks means murder of branches**:

  Mergers will surely result in closure of branches, whereas we need branch expansion to make banking accessible to all. Mergers and branch expansion are anti-thesis.

  Shri Shiv Pratap Shukla, Hon Minister of State for Finance replied in Parliament on 21-12-2018 that **6950 Branches have been closed** and merged due to merger of Associate Banks with SBI.

- **Mergers are threat to job security**:

  Mergers also would result in surplus staff due to large scale closure of branches. Employees would be displaced and dislocated to other stations. In the long run this would affect our job security. When we need more job security, mergers will endanger job security.

- **Mergers will kill employment opportunities for the unemployed youth:**

  Banking expansion will result in more employment both directly and indirectly. But by merger of Banks, future employment is virtually pre-closed. In India we need more jobs for our young people. Mergers are anti-employment.

STOP MERGER OF BANKS
STOP CLOSURE OF BANKS
START RECOVERY OF BAD LOANS
DON'T DIVERT NATION'S ATTENTION

Issued in public interest by AIBEA

Will the big bank theory really work?

By FPJ Bureau/ FREE PRESS JOURNAL

Finance Minister Nirmala Sitharaman

Can merely merging 10 banks by dumping six financially tottering banks on four relatively viable ones make the four banks stronger or weaker? Though this is a matter of common sense and one need not have to be a financial expert to find the right answer, why is the government doing this and arguing that this move would create stronger banks?

If a government, strapped for cash due to fiscal crisis in a sluggish economy with revenues on a free fall, cannot afford to shell out money from the budget for recapitalisation, can a shortcut of mergers be a viable long-term solution? A section of the bank employees are also alleging that bank merger is a conspiracy to facilitate greater disinvestment and ultimate privatisation of PSBs. In what way is this so? The government is coming up with the brazen lie that the government is merging the banks to meet Basel III norms. But Basel norms are about ratios like cash reserve ratios, statutory reserve ratios and credit-deposit ratios and so on, and not about size. Then, why is the government indulging in such misleading false propaganda?

That mergers would bring down the non-performing assets (NPAs) is another fraudulent excuse offered by the government. Increasing the size of the banks will not decrease the size of the NPAs. Is this rather a diversionary move to deflect public attention from the NPAs and for going slow on recovery process against the corporates by bringing defaulters under Insolvency and Bankruptcy Code? Can the disruptions caused by the mergers, especially due to software incompatibility between banks, be overcome by February 2020 as the officials claim?

Merger of banks and creation of big banks is peddled as a panacea for the economic slowdown in the country. Will the merger and the associated disruptions help economic recovery or hamper it?

To get clarity on these questions, **Mr Vasant Rai, a prominent all-India leader of AIBEA, the largest union of bank employees, and the President of Karnataka Bank Employees Federation** was approached.

AIBEA General Secretary CH Venkatachalam has come out with a 15-point statement on 3 September 2019 giving a point-by-point rebuttal of government's arguments for merger and quoting from that, Mr Vasant Rai clarified these questions.

Mr Rai says, "Government argues that Banks would become stronger by mergers. There is no evidence to this conclusion. 2 years ago, 6 Banks were merged with SBI with a similar argument. But SBI has not become any stronger. Rather, only the problems of SBI have become bigger. Branches have been closed. Staff have become surplus. Business expansion has slowed down. NPAs have gone up. Bigger doesn't mean stronger. The same would repeat in this case of 10-bank mergers also." "If we go by the past instances of merger, State Bank of India still continues to face financial stress in the post-merger scenario. The merger of Dena Bank and Vijaya Bank with Bank of Baroda has not yet yielded any significant improvements. So bigger is stronger is a big lie", he adds.

Mr Rai further says, “Consolidation is a misnomer. The government’s argument that consolidation would take care of banking expansion is a myth. Consolidation would amount to shrinkage of banking. India is underbanked. The number of Banks in USA with just 323 million population is far more than Banks in India with a population of 1.35 billion. India is not overbanked. A large number of people still remain financially excluded today. In the name of consolidation, only one branch of the merged banks would be allowed within a given perimeter and other branches would be closed. Merger of banks means murder of branches and disruption for consumers. The earlier merger of six banks with SBI led to the closure of 6950 branches. Closure this time would be many times more. Why can’t the minister share these figures with the public?” Mr Viswanath Naik, former General Secretary of the Vijaya Bank union affiliated to the AIBEA asks, “Banks fulfilled a social role. Could India have achieved food security without PSBs financing the Green Revolution? Where will be Modi’s Jan Dhan scheme today without the role of the PSBs?”

VSS Sastry, a retired Canara Bank employee and formerly an AIBEA leader says, “This move is actually some kind of window-dressing to prepare conditions for greater disinvestment in these banks. Also the idea might be to prepare favourable conditions for big corporate houses like Ambanis and Tatas to take over huge banks”. He says, “The official propaganda that this is being done to meet Basel III norms is also mischievous. Ratio is ratio, no matter whether the size is big or small. If you increase the size, reserve ratios might turn adverse also.” “The bank employees have already started protests and the protests would only grow in the coming days because of increasing disruption in normal banking operation. This is because the software used by different banks is not compatible with each other, and the day-to-day transactions are to be reconciled the same day or the customers would face problems in their further transactions. Reserve ratios also need to be reconciled every month. The employees’ workload would go up due to manual repetition of work. The disruption caused by incompatibility in SBI merger has not been sorted out till date. How can they sort it out before February 2020 when 10 banks are involved? Do they have any magic wand?” Sastry asks.

Cost synergies from PSU bank mergers unlikely: Credit Suisse

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According to a report from Credit Suisse, meaningful cost synergies from public sector bank mergers are unlikely, given the limited flexibility on restructuring and rationalisation.

“While the large recap improves the capacity for banks to grow loans, recent experience of SBI and BOB indicates that focus on integration impacts near-term growth. With NBFC exposure of all four merged entities continuing to be over 10 per cent of loans, credit flow to NBFC will remain a challenge,” Credit Suisse said in the report.

“While the recap amount puts all four merged entities comfortably above the regulatory threshold of 8 per cent CET1, given the recent experience of SBI and BOB, we believe focus on integration affects near-term growth, and hence, expect growth to be impacted for them too. Coupled with the ongoing moderation in growth for private banks led by auto sector slowdown and increased cautiousness, credit growth, thus,is unlikely to be revived by PSB mergers,”it added.

The government, last week, announced consolidation of 10 PSU banks, combining into 4 entities and announced details of the recap plans. “Even as size and scale of operations increase, core profitability for these banks is likely to remain weak. Hence, they will continue to depend on external infusions inviting frequent dilutions,” the Credit Suisse report said.

Why PSB stocks can continue to fall post bank merger plans

Radhika Merwin September 04, 2019 BUSINESSLINE

Most public sector banks proposed to be merged with others, have lost 9-12 per cent on Tuesday. File Photo - BusinessLine

Significant dilution in book value, will hurt minority shareholders, including LIC

The big bank mergerannounced by the Centre last week, has not gone down well with investors. Most of the public sector banks proposed to be merged with others, have lost 9-12 per cent on Tuesday.

This has already eroded the Centre's holdings in the 12 PSU Banks (forming part of the merger proposal) by over ☐6,500 crore and other public shareholders by about ☐1,800 crore, in a single day. But the worst may not be over yet.

The capital infusion proposed by the Centre at abysmal valuations and shares issued to investors of the amalgamating banks in the main bank (into which bank/banks are merged), would lead to notable dilution in the book value of the merged entity. Interestingly in some of the cases, the amalgamating banks trade at a notable premium to the main bank, which will lead to more shares being issued under the swap arrangement, resulting in further dilution. A back of the envelop calculation - assuming that the swap ratio is determined based on the market price at the time of merger announcement — suggests that the dilution in book value of the merged entity could be a sharp 20-30 per cent. Hence stock prices of these PSU Bank stocks can fall further, hurting investors in the coming months.

Capital infusion

The government, being the largest shareholder, has been infusing capital into public sector banks, year after year. But with most PSU

Bank stocks trading below book value, capital infused by the government at abysmal valuations has only eroded value for investors.

In the recent merger announcement as well, the large capital infusion at some of the banks will lead to significant dilution. For instance, if one were to assume that the Centre infuses the proposed ☐16,000 crore into PNB, (likely before OBC-United Bank merger), then given that the stock trades at a low 0.6 times book value (as of June quarter), the capital infusion (at pre-merger market price) will lead to a dilution of over 12-15 per cent straightaway.

In case of Union Bank, the Centre's ☐11,700 crore would hurt investors even more, given that the stock trades at a low 0.4 times book. The market capitalisation of Union Bank pre-merger announcement was lower than the proposed capital infused. In other words, number of shares that will have to be issued in exchange for the capital will be more than the bank's outstanding shares. This could lead to a steep dilution of about 30 per cent.

In case of Indian Bank (0.6 times) and Canara Bank (0.4 times), since the Centre proposes to infuse a lower ☐2,500 crore and ☐6,500 crore respectively, the dilution would be lower at 10-15 per cent.

Merger swap

But the dilution for investors does not end there. The additional shares that would be issued to investors of the amalgamating banks, will lead to further dilution in the book value of the merged entity. We have assumed that swap ratio will most likely be based on the market price at the time of merger announcement - as in the case of BOB, Vijaya and Dena merger.

In case of OBC (trades at a slight premium to PNB) and United Bank, investors in these banks may be issued 113 shares and 16 shares respectively in PNB for every 100 shares they hold. This, alongside capital infusion could lead to about 20 per cent dilution in the merged entity over the next one-two years.

In case of Union Bank merger, the dilution would be far steeper as both Andhra and Corporation Bank that are proposed to be merged into it, trade at a premium valuation, implying more shares (about 32-34 shares for every 100 shares) to be issued under the swap arrangement. There could be a 30-35 per cent dilution in book value in this case, taking into account the substantial ☐11,700 crore capital infusion as well.

In case of Canara Bank and Indian Bank too, the dilution could be over 15-20 per cent.

LIC loses too

LIC is among the minority shareholders, that holds stakes in these PSU Banks. In PNB for instance, LIC owns 7.3 per cent stake, while in Union Bank it holds 6.4 per cent stake. In Canara Bank and Indian Bank it holds 9.2 per cent and 1.8 per cent respectively. The dilution in book value will impact LIC too. In most of these merged entities, LIC's stake would come down significantly to 3-4 per cent. The fall in stock prices on Tuesday has already eroded about Rs 500 crore worth of LIC's holdings in these 12 PSU Banks

PNB's board will consider capital infusion of Rs 8,000 cr on September 5

Our Bureau New Delhi September 02, 2019 BUSINESSLINE

It will also consider amalgamation of Oriental Bank of Commerce and United Bank of India with itself.

The board of directors of Punjab National Bank (PNB) will on Thursday (September 5), consider the proposal for capital infusion of up to Rs 18,000 crore in the bank by the government.

The board will also consider the amalgamation of Oriental Bank of Commerce and United Bank of India with PNB.

PNB had earlier said that its board would consider capital infusion of Rs16,500 crore by the government in its board meet on Thursday.

"The board will consider capital infusion of up to Rs 16,500 crore by the government by way of preferential issue of equity shares and fixing the date of Extraordinary General Meeting (EGM) for obtaining shareholders' approval in this regard at a price determined in terms of SEBI (ICDR) regulations," PNB had said in a BSE filing. However, PNB has now informed the stock exchanges on September 2 that the capital infusion could be up to Rs 18,000 crore.

This proposed capital infusion of up to Rs 18,000 crore would come as a big booster dose for PNB, which has turned the corner in recent years after the Rs 13,000-crore Nirav Modi and Mehul Choksi-perpetrated scam that shook the bank in 2018.

It may be recalled that PNB has, with the approval of the RBI, made provisions (over several quarters) for the entire Rs.13,000 crore that the bank lost in the Nirav Modi scam.

Manufacturing growth slows to 15-month low in August: PMI

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The Nikkei Manufacturing Purchasing Managers' Index declined to 51.4 in August from July's 52.5, its weakest since May 2018.

Reflecting the slowdown in the economy, the results of a private survey presented a dismal picture of the manufacturing sector on Monday. Manufacturing has a 17 per cent share in GDP (Gross Domestic Product).

The survey, known as the Manufacturing Purchasing Sectors' Index (PMI), is conducted by IHS Markit. It slipped to 51.4 in August from 52.5 in July. Though still in expansion mode, the index has fallen to its lowest since May 2018. This index is prepared on the basis of a survey which is conducted among purchasing executives in over 400 companies. These companies are divided into eight broad categories: basic metals, chemicals and plastics, electrical and optical, food and drink, mechanical engineering, textiles clothing, timber and paper, and transport.

An index of over 50 shows expansion, while an index below 50 means contraction. The index is prepared by IHS Markit and released along with a detailed report. This index is widely quoted to explain the latest industrial situation.

The PMI Survey report has been released three days after it was announced that GDP growth dropped to a 25-quarter low of 5 per cent during the April-June quarter (first quarter) of fiscal 2019-20.

At the same time, auto sales remained in reverse gear during August, when companies' domestic sales dropped by up to half when compared to sales during the same month last year. All these make a strong case for fiscal stimulus by the Government, apart from a policy rate reduction by the Monetary Policy Committee (MPC).

Commenting on the latest survey results, Pollyanna de Lima, Principal Economist at IHS Markit, said August saw an undesirable combination of slowing economic growth and greater cost inflationary pressures in the Indian manufacturing industry. Most PMI indices moved lower, including key health-check measures for new orders, output and employment. In the former two cases, rates of expansion were particularly weak when one looks at the survey history.

"Another worrying sign was the first drop in input buying for 15 months, which reflected a mixture of intentional reductions in stocks and shortages of available finance. Until manufacturers are willing to loosen the purse strings, it is difficult to foresee a meaningful rebound in production growth on the horizon. Another factor restricting quantities of purchases was a pick-up in the rate of increase in input prices. While not alarming, the acceleration in cost inflation may restrict central bank stimulus to the economy in the near-term," she said,

The report accompanying the index said although economic growth in the Indian manufacturing industry was sustained in August, most survey indicators fell since July to signal a widespread loss of momentum. With sales expanding at the slowest rate in 15 months, production growth and job creation were tamed, while factories lowered input buying for the first time since May 2018. One survey indicator that moved up was the measure of input costs. Inflation accelerated to a nine-month high, though it remained moderate and below its long-run average. The only other upward movement was seen for business confidence, which strengthened to a 16-month high.

Firms that noted sales growth commented on successful marketing and the receipt of orders in bulk. Anecdotal evidence indicated that competitive pressures and challenging market conditions restricted the upturn. New orders from overseas also increased at a slower rate in August, with growth the weakest seen since April 2018. Subdued sales to domestic and international clients in turn curbed output growth, which softened to the weakest in a year.

Some survey members also reported cash-flow problems and a lack of available finance. Despite remaining in expansion, employment rose only marginally, and to a lesser extent than in July. Some panelists indicated that weak sales prevented them from replacing retirees and voluntary leavers.