The Big Bank Theory

written by Raghav Gaind | September 24, 2019

2019 brought with itself a journey full of ups and downs for the Indian economy. A glint of hope was sparked when Nirmala Sitharaman, the Finance Minister of India, while unveiling the budget for the current year, asserted ambitiously that the economy of India would reach to a prodigious $5 trillion by the year 2025. However, all the bogus hopes came crashing down when *in the weeks that followed, it was announced by the* Central Statistics Office that the gross domestic product growth rate for the April–June quarter had fallen to a six-year low of 5%. With this revelation, the hearts of 1.3 billion Indians sank deeper than the Titanic.

As an initiative to curb the economic crisis hovering over the Nation, the Reserve Bank of India cleared a surplus transfer of INR 1.76 lakh crore to the account of the Central Government. This has given rise to a big question: Will this amount serves as some magic potion and help grow the economy of India or will it merely prove to be an ephemeral relief like a few drops of rain on the sandy surface of the Sahara Desert? Only time will provide valid answer to this question.

Nevertheless, the big news that grabbed the attention of the Indians has been the announcement by the Finance Minister about the big merger of 10 public sector banks. The Central Government handed out this prescription on August 30, 2019 with the objective of reviving the dying Indian economy and rejuvenating the banking sector. According to the Finance Minister, following this merger, the number of public sector banks in India will be reduced from 27 to 12. These declarations came against the backdrop of the precarious state of the Indian economy. This mega merger, as per the Finance Minister, is likely to manage the capital more efficiently.

The history of bank mergers in India can be traced back to 1921, when Bank of Calcutta, Bank of Bombay and Bank of Madras merged to form Imperial Bank of India. A merger is a method adopted by Indian government to restructure weak banks. If any bank starts to slow down in the long race of Indian economy, the Reserve Bank of India ("RBI") imposes moratorium as per Section 45 of the Banking Regulation Act of 1949.

A similar incident was witnessed in August 2017 when the State Bank of India with the approval of the Central Government and in consultation with the RBI, entered into agreements with the State Bank of Bikaner and Jaipur, the State Bank of Mysore, the State Bank of Patiala, with the aim of rationalizing resources, reducing expenses, improving revenues, and lowering the costs of funds leading to better rate of interest for public. In addition, Dena Bank, Vijaya Bank, and Bank of Baroda also merged on April 1, 2019.

The merger includes the following:

- Punjab National Bank, Oriental Bank of Commerce and United Bank to create the second largest lender in which Punjab National bank will be the anchor bank;
- Syndicate

Bank and Canara Bank to create the fourth largest public sector unit lender in which Canara Bank will be the anchor bank;

- Union Bank, Corporation Bank and Andhra Bank in which Union Bank will be the anchor bank; and
- Allahabad Bank with Indian Bank.

Further, it has been announced that for recapitalisation of the banks, PNB will be given INR 10,000 crores, Union Bank of India with INR 11,700 crores, Bank of Baroda with INR 7,000 crores, Canara Bank with INR 6,500 crores, Indian Bank with INR 2,500 crores, Indian Overseas Bank with 3,800 crores, Central Bank with INR 3,300 crores, UCO Bank with INR 2,100 crores, United Bank of India with INR 1,600 crores and Punjab and Sind Bank with 760 crores.

This merger is an attempt by the Government of India to deviate the rise in bad loans or non-performing assets. The Finance Minister stated that the non-performing assets have come down from INR 8.65 lakh crore in December 2018 to INR 7.90 lakh crore.

The process becomes exorbitant given the heavy losses incurred by the banks in the preceding years. If we take into account the present banking procedures, the public sector banks do not have a definite path in order to clear their balance sheets. In such a scenario, the Government is left with only two resorts: either the government infuses more funds in the bank or merges the banks.

LEGAL IMPLICATIONS OF PUBLIC SECTIOR BANKS MERGER:

Section 44A of the Banking Regulations Act, 1949 (“BR Act”) provides guidance where there is a merger between banking companies.

It is to be noted that the mergers of banking companies do not require approval of the Competition Commission of India (“CCI”). In case of merger among the banking companies, a scheme is required to be approved by at least two-third of the shareholders of each amalgamating company which are present either through in person or through proxy.

CONCLUSION

The merger of PSU may be regarded as meaningful because it may lead to credit positive, the improved scale of operations and help in a competitive position. Most of the mergers done in the past have proved to be a boon for the smaller or weaker banks and it has led them straight on the path of success. Banks associated with this merger will have higher capacity to lend. Another advantage that the merging banks will get is a strong global reach. In today’s world when there is strong competition from private banks, Indian public sector banks have a lot of catching up to do.

But along with various advantages, this merger has brought with itself some issues that will require immediate attention. Firstly, these banks will need capacity building, especially in project appraisal, risk management and monitoring. According to Prabhat Patnaik, a *former economics professor at the Jawaharlal Nehru University*, “If the impression is given that the bank merger is somehow going to bring the economy out of this depression or this recession, it has no basis.”[1]

It will take a time period of about 2-3 years for the impact of this merger to become visible and to know whether this step helps in bringing back on track the derailed Indian economy.

- [1] Kaushal Shroff, More on Bank mergers will not bring the economy out of this recession(Sept. 16, 2019, 12:50 PM), https://caravanmagazine.in/economy/prabhat-patnaik-explains-india-economic-crisis

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