

Will PSB mergers alter the banking scenario?

PARLEY

Consolidation will cause disruption in the short run, but could lead to speedier decision-making in future

Last week, the Centre announced a sweeping consolidation that would see 10 public sector banks being merged into four. While the government has touted the move as one that will enhance credit capacity, there are concerns that more large banks could make the banking system vulnerable. In a conversation moderated by Suresh Seshadri, T. T. Ram Mohan and V. Srinivasan look at the challenges to successful integration. Excerpts:

How does this merger benefit the economy?

T.T. Ram Mohan: How it benefits the economy remains to be seen. Because I think the case for the merger has not been articulated properly enough. We have some reference to Indian banks becoming global in size. But that sort of talk needs to be discounted. Because, even if you take the largest of the mergers that have been proposed, which is PNB combining with two other entities, it's going to give you a bank which is about one third the size of the 50th largest bank in the world, which is not saying much.

Second, the correlation between size and efficiency is suspect beyond a certain minimum size. And that size is quite low: say \$10 billion in assets or so you get the necessary scale of economy. Beyond that, the empirical evidence does not suggest there are many great advantages to simply growing bigger. And we have seen this in the Indian context where the large public sector banks underperform in relation to private banks, which are much smaller. And of course, the classic comparison is between HDFC Bank and the consolidated State Bank of India, which is many times its size. The price to book value ratio of HDFC Bank is close to 4, whereas the price to book value of SBI is around 1.25. Therefore, the suggestion that getting bigger is going to, in itself, give you some benefits is not validated by experience, either internationally or within India.

Srinivasan, as someone who is from within the industry, is integration going to be something which ends up in

some way impacting the so-called benefit that the integration move aims to provide? Is the timing going to end up getting the management of these banks to focus on integration itself rather than on using the balance sheet to lend to the economy, especially when investment pickup is crucially required?

V. Srinivasan: I would agree with the argument that, from a timing point of view, this does not seem an ideal time for going ahead with these mergers. Because, as all of us are aware, the economy is clearly going through a major slowdown. And it requires all hands on the deck. And whenever a merger of such scale happens, I think the senior management gets distracted in terms of trying to make sure who gets what. I think there's a lot of work to be done. Even though that may be done by several teams, ultimately human emotion will come into play here, where people are going to be looking at saying, "What's in it for me? Where am I headed as far as this action is concerned?" And therefore, in the short term, I think there is going to be some amount of disruption. That is something which you could have avoided in this sort of time. Consolidation is good, because from an administrative perspective, as people retire, you would see some economies of scale getting through, but just sort of putting banks together is not going to solve the problem as far as the credit flow is concerned.

There's also this other issue, that from a structural perspective, fewer larger banks might increase the risks to the banking industry.

TTR: The way to look at that question is to see the share of the top three or the top five banks in assets. And if that share is very large, then you have a concentrated banking system. If the share is too low, then you have a highly fragmented banking system. And I think it's fair to say that in India we were tending towards a high degree of fragmentation rather than concentration. So, I



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think so far as the increase in systemic risk is concerned, it's not going to be an immediate problem. Because if you look at the share of the top three or four banks in assets it was about 30-32%. That is not a very high degree of concentration.

But I do know that regarding the point that Srinivasan made, which is that in order to make a success of a merger, you need two conditions to be satisfied – you need a very high degree of managerial ability, and at least one of the entities in the merger must be financially strong – I'm afraid I can't see either condition being satisfied in the mergers that are being proposed. If you're not able to make a success of your operations and deliver the performance of your existing level of assets, how does the management propose to make a success of a much bigger and more complex entity? The question is not answered simply by citing the theoretical scale economy. Making a success of merger is a huge challenge.

Another concern is that as earlier mergers haven't yet given the benefits, why then this rush to announce a whole host of mergers.

VS: As far as Bank of Baroda (BOB), Vijaya Bank and Dena Bank are concerned, it's still very early days... I don't think the merger integration is complete. And clearly we have not seen much in terms of how exactly they have put things together and gone to the market, with a single value proposition. The way I look at it, this was something which has been on the table for a long time. I think they tried out BOB and just decided to go ahead.

The feedback from the BOB exper-

The most important rationale for the mergers is that the multiplicity of banks was making enormous demands on the bandwidth of the Finance Ministry

iment was that things were not falling apart. And things seemed to be broadly business as usual, not very different from what was happening in the past. And they decided that this is something which we can go ahead with and do the rest of the previous plan, which was actually already, I think, part of the blueprint. I think that's how they have gone ahead with these mergers. The only thing here is, I don't think there's any identity which they have tried to create for each of these merged entities in terms of trying to say, one will be focusing on Corporate, one will be on Small and Medium Enterprises, one will be Retail. There's been no thinking in terms of any or each of these banks' focus on a particular theme, particular skill set and developing expertise in a space which is important as far as the overall economy is concerned. Basically, I think they've said, every bank falls broadly in the same template, and there's not much to choose from in terms of who goes with whom.

From an underlying logic perspective, there are those who fear that bank NPAs could worsen, at least in the interim, while this process of integration is on.

TTR: In terms of resolution of NPAs there is some merit in having the merger because there are coordina-

tion problems involved when you have multiple banks trying to resolve NPAs which are common to all of them. So, you have the middle and senior management deputed for meetings, where they have discussions with their counterparts from other banks. And then they have to go back to the top management for a decision, come back again for a meeting, and it goes on and on. Therefore, the resolution of NPAs becomes difficult when you have so many banks trying to arrive at an understanding amongst themselves. So, to the extent that the discussion is happening among fewer banks, I think the resolution of NPAs will be facilitated. That could be one argument for the merger.

But I think the most important rationale is that the multiplicity of banks was making enormous demands on the bandwidth of the Finance Ministry in terms of appointments of chairmen, managing directors, executive directors, independent directors. Even though they have the banks board bureau to advise them on appointments, the process is extremely time-consuming. There were long delays in making the senior appointments, as a result of which these banks have been incurring substantial costs. When you don't have a person at the top or persons at the top, or even directors in play, it exacts its own cost on the bank. And so, collapsing the number of banks makes it easier for the Ministry to monitor the banks on its watch. I think that is probably one argument for the merger which I can sort of relate to.

The other argument is that having bigger entities enables people to make bigger loans, which would give them a degree of pricing power vis-a-vis corporates because corporates have been playing one bank off against the other under the multiple banking system. To the extent that you combine banks and they do a bigger amount of funding, it does improve the bargaining position of the bank. Again, fee income that the banks get from selling mutual funds and insurance products can go up, because now the banks can command a much larger network and therefore demand a bigger commission from the people whose products they're selling.

The fundamental issue is a managerial issue with making a success of the merger, which is a challenge

even in a developed economy, where you have a lot of flexibility in terms of laying off people, rationalising branches. Here, even if you rationalise the branches, a commitment has been given that people will not be laid off. That is one of the assurances given by the Ministry. And therefore, it's not clear how any cost economies will be effected... if people are to be retained and yet be redeployed for other purposes.

There are those who say "we were comfortable with a small bank, are we going to be lost in the larger scheme of things once this bank becomes owned by some bank from Mumbai?" How does this really pan out for the customers?

VS: I would think it is more the lending side which can get impacted on account of this rather than the customer on the deposit side. The deposit side, however weak the government-owned banks, they didn't face any risk of deposits sort of unwinding and they continued to have reasonably decent deposit growth, irrespective of whether they were figuring in the top quartile or the bottom quartile because the sovereign guarantee was clearly there. It will be business as usual. I don't think things will change as far as these banks are concerned. From a lending perspective, the impact will be felt more for the SMEs and small businesses, who have a lot to gain from the personal contact they have with a local person. And as that becomes a lot weaker, that can impact... That is something which we will know only as we go along. But there would be some amount of transition issues as things change.

Is this announcement going to make a large difference to the banking industry?

VS: Clearly, a lesser number of banks means, hopefully, speedier decision-making across banks. That's the upside one can hope for. And the other thing which it can trigger is some consolidation in private sector banks. Because the private sector banks would now be falling behind in terms of scale compared to some of these banks. And therefore, to some extent, this can force the private sector banks to think of a similar consolidation.



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Re-engaging the Iran regime

Unless hardliners are isolated in the U.S. and Iran, the nuclear deal cannot be revisited

GARIMELLA SUBRAMANIAM

During the G7 summit in Biarritz, U.S. President Donald Trump told French President Emmanuel Macron that the U.S. is not looking for leadership change in Iran. "This country has been through that many times before; that doesn't work," he said. This is a hopeful sign for the proposed dialogue between Washington and Tehran, after months of increasing tensions. The U.S. President, who had once sought to cut Iran's exports to zero, even suggested that the U.S. and its allies could offer Iran loans or some credit as incentive for reaching a new nuclear deal.

Reaching out

These overtures signal a marked departure from Mr. Trump's position on Iran in the past. In May 2018, the U.S. withdrew from the 2015 nuclear agreement reached between the P5+1 countries, the European Union, and Iran, which Mr. Trump once derided as the "the worst ever deal". That move was in disregard of the opinions of the International Atomic Energy Agency and Mr. Trump's own top advisers that the Joint Comprehensive Plan of Action had proved effective. If followed through with action, Mr. Trump's recent comments could strengthen the efforts of the U.K., France and Germany to secure relief for Iran from U.S. sanctions and prevail upon Tehran to desist from its recently revived uranium enrichment activity.

Iranian President Hassan Rouhani was not impressed by Mr. Trump's remarks. He ruled out talks with the U.S. until all sanctions were lifted, though he has immense stakes in rebuilding the agreement and reasserting his moderate position at home. He added that he was not interested in photo opportunities, an apparent swipe at Mr. Trump's high-profile summits with North Korean leader Kim Jong-un, which yielded few concrete outcomes.

His condition for talks is understandable, however. Iran has had no relief on the sanctions front, despite opposition from the European Union, Russia and China to the punitive measures. The European payments channel, Instex, launched after much

delay to circumvent U.S. sanctions, serves a limited purpose, as the system does not include oil sales, a major source of Iran's foreign exchange earnings. Tehran's crude exports are said to have plummeted to 300,000 barrels per day (bpd) or less since April 2018 levels (more than 2.5 million bpd), according to estimates. Corporations that continue to do business with Iran face the risk of being cut off from the dollar system.

There has not been any let-up from the U.S. strategy of exerting "maximum pressure" on Iran so far. Earlier this month, the administration imposed sanctions against Iranian Foreign Minister Mohammad Javad Zarif. In June, Iran reacted to sanctions against Ayatollah Ali Khamenei, Tehran's Supreme Leader, as "outrageous and idiotic". And in April, the country's Islamic Revolutionary Guard Corps was designated a terrorist organisation.

In retaliation to these measures, Iran demonstrated its ability to paralyse Western maritime operations by seizing oil tankers off the Gulf of Hormuz. While Mr. Trump held back from a counter-offensive following the downing of a U.S. drone, the missile attack amplified the risk of conflict in the region.

Moving forward

Neither Secretary of State Mike Pompeo nor National Security Adviser John Bolton would easily reconcile to Mr. Trump's remark that regime change in Iran is off the table. But Mr. Trump, not for the first time, has come close to pushing back against the hardliners in his administration. Following through on his proposal, France has confirmed the finalisation of a \$15 billion credit line backed by France, Germany and the U.K., subject to Washington's approval. While this initiative will boost Iran's confidence in the West's intentions, the ultimate goal must be to revive the 2015 nuclear deal. President Rouhani's position has weakened in Iran as hardliners have become more assertive in the country. Unless he is also able to isolate them, moving forward on the deal will not be possible.

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NOTEBOOK

A matter of recording

Reporters are caught in a bind when officials request them not to be quoted

DENNIS S. JESUDASAN

"Don't quote me." These are the three words that journalists dread the most and also hear frequently. While reporting the statements of people in public service is only one aspect of journalism, it is a crucial and challenging one.

Reporters are always keen to know what those in charge of administration and public policy think. They are eager to report the statements and opinions of officers, but they are bound by the ethics of reporting – such views can be published only with the consent of the persons in question. Sometimes, there is a grey area that is difficult to negotiate, and we grapple with many dilemmas: Should we report the news or not? And if yes, how? And therein lies the rub.

A senior officer, who was in charge of disaster man-

agement in a northern State, was once invited to a research institute in Chennai as the chief guest for a function. During his speech, the official let it slip that the India Meteorological Department's weather alerts were reaching him late. He said he would rather prefer tracking weather updates from Western countries than wait for the IMD's alerts.

Now, this was a big admission and was definitely worth a report. However, it turned out that the officer was not informed that there were journalists in the audience who were recording his comments. Once he was informed of this, he requested every reporter at the event to refrain from publishing or broadcasting these comments. An important story was, therefore, automatically killed. Even though the comments were made before a gathering, we

could not write about this as we had to honour the officer's request.

Sometimes, even diplomats, who are careful with their words, tend to be candid. A few years ago, a diplomat from a South Asian country launched a tirade against China at an event in Chennai. He said his country disagreed with the Asian power on sea traffic in the South China Sea. Again, on realising that there were reporters in the audience, he requested us not to quote him.

In yet another incident, one of the country's top scientists, who was involved in the preparation of a report on the protection of a well-known mountain range in south India, said that a religious body was wielding a lot of influence in the region. This, he said, was affecting the report. When we asked if he could be quoted, he refused.

Those holding important positions understand and recognise the hurdles in their jobs, but they refuse to let the media and the people know about these issues, which are of public interest. Sadly, they also do little to resolve these issues, given their limitations. One wonders if the extra caution in seeking the non-publication of public statements is due to the burgeoning of outlets in the media space or simply denotes the keenness of the officials to secure their careers.

The journalist then is forced to accept the source's request, or argue and reason with him, or request the source to be quoted anonymously. This is a compromise of sorts, but does not serve the purpose of public interest in a substantive way as this avoids mention of the position and post that the source holds.

The Hindu

FROM THE ARCHIVES

FIFTY YEARS AGO SEPTEMBER 6, 1969

Suggestion to shift capital

Mr. C. Chatterjee, Director-General of the Geological Survey of India, suggested here [Tenughat (Bihar)] yesterday [September 4] that the capital of India should be shifted from Delhi to some other place. Delivering his presidential address at the fourth annual general meeting of the Indian Society of Engineering Geology here, Mr. Chatterjee said the growing population and mounting pressure of urbanisation would be an ever-increasing phenomenon in the capital of India. "We must consider," he said, whether Delhi as seat of capital will be able to cope with the future demands of urbanisation and development. He said this aspect of the question had attracted the attention of the Government of India immediately after independence. In fact, even some sites had been examined in central India but for some reason or other the preliminary investigations were not followed up. Mr. Chatterjee said that he felt that a centrally located place like the Betul plateau in Madhya Pradesh should be considered as a site for the capital.

A HUNDRED YEARS AGO SEPT. 6, 1919.

Mr. Gandhi's Birthday.

Sir, – Some time ago I saw a letter in your journal from Mrs. Arantika Gokhale regarding the proposal to present a purse to Mahatma Gandhi on his birthday which comes on the second of October. I learn that Bombay is trying to celebrate the event in a fitting manner and I know that Bombay can present a lac of rupees and more to the Mahatma. But I wonder whether Madras will respond to an appeal, if one such is made by the public leaders of this place. Here an appeal has already been made on behalf of the forlorn families in the Punjab. I would humbly request the public to read again the moving speech of Mr. Kasturi Ranga Iyengar at the Madras Provincial Conference held recently at Trichinopoly. The appeal on behalf of the suffering people in that Province has been made by Swami Shradananda, Pundit Madan Mohan Malaviya and Mahatma Gandhi himself. Let us not therefore be slow in responding to the cries of the poor mothers and children in Punjab. Our contributions, however small it be, if done quickly will please Mahatma Gandhi's heart very much, and I am sure he will value more the help to such a cause just now than to presenting a purse.

V.A. Sundaram.
Triplicane, September., 3.