Constrains in PSBs consolidation

What is the issue?

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- Recently union government announced Alternative Mechanism to facilitate consolidation among the public sector banks (PSBs).
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- Before implementing the recommendations government need to address few constrains in consolidation.
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What is the actual status of Indian banking?

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- At present, almost all PSBs are beset with stressed assets problem, with varying degrees of stress.
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- It is argued that the Indian banking system are fragmented and uncompetitive.
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- They do not capture scale benefits in risk diversification, IT and back-office processing.
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- They lack skills in risk management, IT and product innovation.
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- PSBs are mid-sized or "stuck-in-the-middle," operating with similar business models.
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What is Alternative Mechanism?

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- Alternative Mechanism (AM) will create strong and competitive banks to

meet the credit needs of a growing economy, absorb shocks.
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- The salient features of the approval framework for consolidation of PSBs under AM are:
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i) The decision regarding creating strong and competitive banks would be solely based on commercial considerations.

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ii) The proposal must start from the Boards of PSBs.

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iii) The proposals received from PSBs for in-principle approval for amalgamation would be placed before AM.

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iv) After in-principle approval, PSBs would take steps in accordance with law and SEBI requirements.

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v) The final scheme would be notified by the central government in consultation with the Reserve Bank of India (RBI).

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What are committee reports favouring consolidation?

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- **Narasimham Committee I (1991) -** Consolidation would make economic and commercial sense where the whole would be greater than the sum of its parts, and have a "force-multiplier effect."
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- It also recommended local banks whose operations would be confined to specific regions, and rural banks.
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- **Narasimham Committee II (1998) -**It emphasised that consolidation process in PSBs needed to be based on synergies, and locational and business-specific complementarities.
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- **Raghuram Rajan Committee (2008) -** This also favoured some

consolidation among banks that aim to play on a larger stage and takeover of PSBs by other PSBs should not be discouraged.
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What constrains need to be considered before consolidation?

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- Some of the smaller banks that specialise in certain areas of business or regions may have a comparative advantage over larger banks by virtue of their core competence.
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- "Too big to fail" banks create externalities for the economy, and when they fail, public authorities have no alternative but to bail them out.
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- Even after merger of a few PSBs, no Indian bank, including SBI, will be able to become an international bank in true sense of the term.
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- It cannot be said that skill-sets and managerial efficiency would improve.
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- Similarly, it cannot be said that fewer banks would be more competitive at least theoretically, they would bring down competition.
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- That would be unhelpful to the minority shareholders of the relatively stronger banks, if consolidation is done at lesser value.
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- Even after consolidation, if strong and valuable PSBs do not emerge, their capacity to raise resources from the market without unduly depending on the state exchequer would be constrained.
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- There are also major issues in merger, like resistance from trade unions, integration of human resources, culture, technological systems, business and accounting practices, etc.
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Source: Financial Express

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