KAMARAJ IAS ACADEMY

Only IAS Academy by Grandson of "Perunthalaivar Kamarajar"

Merger of banks

Published On: 02-07-2023

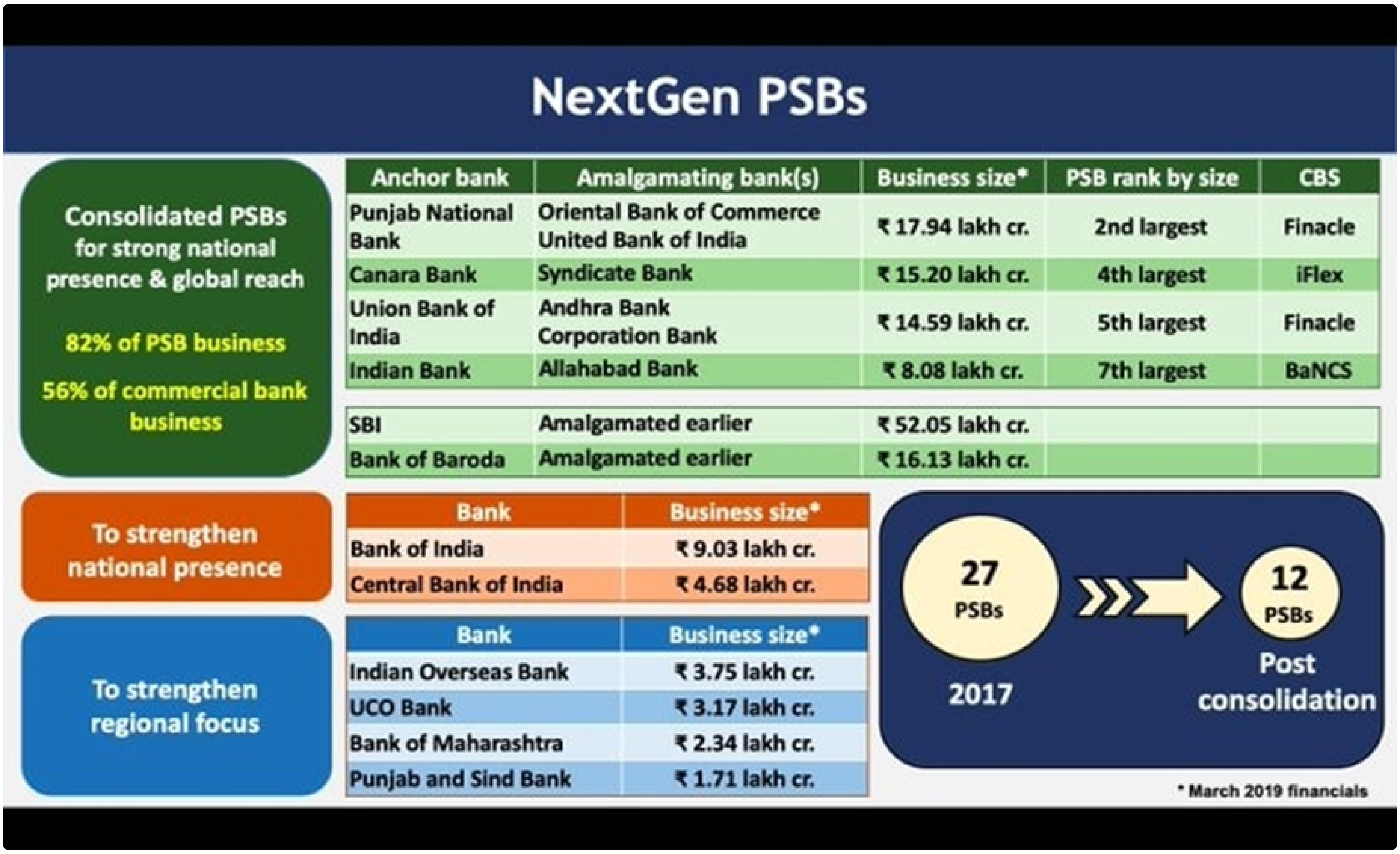
Why is in news? Merger between Housing Development Finance Corporation limited and HDFC Bank comes into effect

The merger between the Housing Development Finance Corp Ltd (HDFC) and HDFC Bank came into effect on 1st July 2023. This **created the world's fourth-biggest bank by market value** behind J P Morgan, ICBC, and Bank of America. The merger was approved by the boards of directors

The **National Company Law Tribunal (NCLT) approved the merger on March 17**.

The bank had received the first okay from the **Reserve Bank of India** in July 2022 which was followed by **other regulators** like the Securities and Exchange Board of India (SEBI), shareholders of HDFC and HDFC Bank, the Pension Fund Regulatory and Development Authority (PFRDA) and the Competition Commission of India (CCI).

The government has approved a scheme for the amalgamation of 10 state-owned banks into four. After the process is complete, **India will have 12 PSBs instead of 27 back in 2017**.



Anchor bank	Amalgamating bank(s)	Business size*	PSB rank by size	CBS
Punjab National Bank	Oriental Bank of Commerce United Bank of India	₹17.94 lakh cr.	2nd largest	Finacle
Canara Bank	Syndicate Bank	₹15.20 lakh cr.	4th largest	iFlex
Union Bank of India	Andhra Bank Corporation Bank	₹14.59 lakh cr.	5th largest	Finacle
Indian Bank	Allahabad Bank	₹8.08 lakh cr.	7th largest	BaNCS
SBI	Amalgamated earlier	₹52.05 lakh cr.		
Bank of Baroda	Amalgamated earlier	₹16.13 lakh cr.		

Bank	Business size*
Bank of India	₹9.03 lakh cr.
Central Bank of India	₹4.68 lakh cr.

Bank	Business size*
Indian Overseas Bank	₹3.75 lakh cr.
UCO Bank	₹3.17 lakh cr.
Bank of Maharashtra	₹2.34 lakh cr.
Punjab and Sind Bank	₹1.71 lakh cr.

<u>**Committees with regard to merger of banks**</u>:

Narasimham committee (1991 and 1998) suggested merger of strong banks both in public sector and even with the developmental financial institutions and NBFCs.

Khan committee in 1997 stressed the need for harmonization of roles of commercial banks and the financial institutions.

Verma committee pointed out that consolidation will lead to pooling of strengths and lead to overall reduction in cost of operations.

<u>Concerns associated with merger</u>:

Problems to adjust top leadership in institutions and the unions.

Mergers will result in **shifting/closure of many ATMs, Branches and controlling offices**, as it is not prudent and economical to keep so **many banks concentrated in several pockets**, notably **in urban and metropolitan centres** .

Mergers will result in **immediate job losses** on account of large number of people taking VRS on one side and slow down or stoppage of further recruitment on the other. This will **worsen the unemployment situation further** and may create law and order problems and social disturbances.

Mergers will result in **clash of different organizational cultures**. Conflicts will arise in the area of systems and processes too.

When a big bank books huge loss or crumbles, there will be a **big jolt in the entire banking industry**. Its repercussions will be felt everywhere.

<u>Advantages of Merging of Banks:</u>

A bank merger helps the **merged entities scale up quickly and gain a large number of new customers** instantly. It also provides a broader geographic footprint to operate.

Every bank has an infrastructure in place for compliance, risk management, accounting, operations and IT – and now that two banks have become one, **it will be able to more efficiently consolidate and administer those operational infrastructures**.

Business Gaps Filled: Acquiring a smaller bank that offers a unique revenue model or financial product is sometimes easier than building that business unit from scratch.

The **synergy created by the merger is powerful** enough to enhance business performance, financial gains, and overall shareholders value in long term.

The **merger results in improving the purchasing power of the company** which helps in negotiating the bulk orders and **leads to cost efficiency**. The reduction in staff reduces the salary costs and increases the margins of the company. The increase in production volume causes the per unit production cost resulting in benefits from economies of scale.

The combined talent and resources of the new company **helps it gain and maintain a competitive edge.**

The **market reach is improved** by the merger due to the diversification or the combination of two businesses. This results in **better sales opportunities**.

<u>Disadvantages of Merging of Banks:</u>

Systemic risk: It is the possibility that the **failure of one bank to settle net transactions with other banks will trigger a chain reaction**, **depriving other banks of funds** and, in turn, preventing them from closing their positions. The consequence is frequently loss of confidence in the whole banking system.

"Too big to fail" factor: As a result, any substantial disruption in the particular institution's operations would be likely to **have a serious effect on a country's financial markets**, either preventing the markets from operating properly or raising questions about their integrity. The consequence of the "too big to fail" factor is that countries extend protection to large institutions and their customers that is not granted to others

Problem to ordinary people: The move would result in closure of large number of branches as it happened in the case of State Bank of India, affect banking services and reduce employment opportunities.

Bad banks merged with Good Banks: Narasimham Committee in the late 1990s recommended consolidation through a process of merging strong banks. It also recommended that weaker banks should be shut down and they should not be merged with strong Banks. But in the current merger decision, weak banks are being merged with the strong banks.