

SBI Consolidation – Euphoria?

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Abstract: India currently needs its largest bank, the State Bank of India, to be at the vanguard of its economy, to stimulate stagnant economic growth. Merger of SBI with its 5 associate banks and Bharatiya Mahila Bank which took place on 1 April, 2017 is the largest merger in history of Indian Banking Industry. The merger will result in a “win-win situation” for the bank and its associates – SBI’s reach and network will multiply, efficiency will likely increase with the rationalisation of branches, there will be a common treasury pooling and there will be proper deployment of skilled resources. Indeed, the SBI - associates merger would be a test case for a bigger consolidation to follow in the public sector bank space which the government is planning. It may not be all smooth sailing. There will be plenty of challenges for the merged entity and there is also a fear that management bandwidth would go on resolving these issues. The research has been conducted to understand the euphoria of such consolidation taking place and to know how far it’s going to last. The focus of this paper has been placed on reasons of this merger and after effects of merger has also been discussed.

Key Words: Merger, SBI & Associate Banks, Post Merger Scenario

I. Introduction

With an over 200-year history, SBI has its origins dating back to 1806 when Bank of Calcutta (later called Bank of Bengal) was established. In 1921, Bank of Bengal and two other banks (Bank of Madras and Bank of Bombay) were amalgamated to form Imperial Bank of India. In 1955, the Reserve Bank acquired the controlling interests of Imperial Bank of India and SBI was created by an Act of Parliament to succeed Imperial Bank of India. SBI first merged State Bank of Saurashtra with itself in 2008. Two years later, State Bank of Indore was merged with it. All the other five associates merged with State Bank of India, in the largest consolidation exercise in the banking history of India. The assets of State Bank of Bikaner and Jaipur (SBBJ), State Bank of Mysore (SBM), State Bank of Travancore (SBT), State Bank of Patiala (SBP) and State Bank of Hyderabad (SBH) were transferred to SBI from April 1, 2017.

II. Objectives

Being the largest amalgamation in history of Indian Banking Industry it attracts attention towards following objectives:

- 1) To study the reasons behind the merger.
- 2) To find out the effects of merger on shareholders, general public etc

III. Literature Review

State Bank of India (SBI), India's largest bank, became even larger with the merger of its five commercial banking subsidiaries as quoted by The Wire, <https://thewire.in/141805/sbiassociate-> Aug 19, 2016 was looked into. Impact and effects of SBI merger has been understood with reference to the interview given by the Market analyst Hemindra Hazar to NDTV on 19th August, 2016. Reasons behind the SBI-associate banks merger and its pros and cons as reasoned out by Govind Bhardwaj, Treasury Head and CEO Secretary at Noble Bank was considered. Bharat Khurana. (2017) paper on. “Analysis Of Merger Of SBI & Its Associates.” International Journal of Research - Granthaalayah, 5(5), 391-393. <https://doi.org/10.5281/zenodo.803925> was referred. Various articles in economic times were also referred to for information.

IV. Research Methodology

Data for the purpose of research has been collected from secondary sources. The data has then been analysed in order to find out reasons of merger and its effects on Indian banking system.

REASONS OF MERGER

The reasons behind the merger of SBI with its associate banks and Bharatiya Mahila Bank are listed as follows:

- 1) Government of India provides subsidy and contribution for bad debt recovery and share capital to SBI and its associate banks. It becomes easy for government to provide aid to this single amalgamated bank instead of giving it separately to SBI and its associate banks.
- 2) Profitability of SBI was going down for last few years and this merger will be able to show better position of profitability in books of SBI. Net profit of the group fell from Rs. 12,225 crores in Financial Year 2016 to Rs. 241 crores in Financial Year 2017 and the losses were mainly due to associate banks.
- 3) To recover loans which have turned bad and to reduce NPA of SBI and associate banks in future, merger of SBI with associate banks was important.
- 4) For reconstruction of SBI and associate banks in face of financial crises so that it can meet its liabilities.
- 5) With the merger, SBI has become bigger than before. Now it has a larger asset base and ranks 45th among top banks of the world.
- 6) Management of bank will become easier as earlier all the branches were managed by separate management though the holding was same and it used to make the whole process cumbersome.
- 7) Cost of managing large number of branches will reduce which will increase profitability of bank.

MERGER DEALINGS

State Bank of India alone has nearly 16,500 branches, including 191 foreign offices spread across 36 countries. Out of the five subsidiary banks, SBBJ, SBM and SBT are listed. The board of SBI earlier approved the merger plan under which SBBJ shareholders will get 28 shares of SBI (Re 1 each) for every 10 shares (Rs 10 each) held. Similarly, SBM and SBT shareholders will get 22 shares of SBI for every 10 shares. The shares of the listed associates will be delisted from stock exchanges following the merger. SBI had approved separate schemes of acquisition of State Bank of Patiala and State Bank of Hyderabad. There will not be any share swap or cash outgo as they are wholly-owned by SBI. According to the scheme of merger, the pay and allowances offered to employees or officers of the five associates will not be less than what they would have otherwise drawn.

EFFECTS OF MERGER

As a result of merger SBI will be among top 50 large banks of the world. Now SBI will have an asset base of Rs. 37 lakh crores. Presently number of SBI offices along with its associates are 809 which is likely to be reduced to approximately 687 after merger. Employees will be reallocated mainly to customer interface operations of those branches which are likely to be shut down. The task has been lightened as around 13000 employees have retired this year and 3600 have taken voluntary retirement. However, bank will hire less employees in this financial year. Effects of merger on customers shall have a dual effect. Most of the continuing branches are working in the manner they used to work. Even the rate of interest they are offering on deposits is still same till the end of that contract. However NEFT/RTGS charges are applicable to SBI are being charged. Online transactions of associate banks can now be done from website of SBI using previous username and password.

ADVANTAGES OF SBI MERGER

- Post-merger, SBI will enter the list of Top 50 banks in the world.
- There will be common treasury for pooling resources and appropriate deployment of a large skilled resource base.
- Any introduction in new technology by SBI will be uniformly available to all the customers including customers of associates and subsidiaries of the Bank.
- SBI shares along with its subsidiaries will post tremendous earnings in stock exchanges. Thus it will benefit all the stake holders.
- The banking colossus would be able to match itself with the largest in the world as the asset base will reach up to Rs 37 lakh crore (Rs 37 trillion) spreading across the length and breadth of the nation.
- There will be more than 50 crore customer who will be able to access 22,500 branches and 58,000 ATMs.

But should SBI really be growing bigger? Although the question may appear silly, size is not always positive when productivity parameters rule the roost. In these days of rapid technology absorption, a large network of branches is not necessarily a source of strength.

DISADVANTAGES OF SBI MERGER

With this merger, it is expected that bank management will bear some critical challenges related to Staff Integration and rationalization of branches. Several employee unions are against the merger. They are unsecured of technical glitches which can be a roadblock in their operations.

CHALLENGES OF MERGER

There will be plenty of challenges for the merged entity and there is also a fear that management bandwidth would go on resolving these issues. Here are the key challenges.

Branches overlap

SBI today runs the largest bank in the country in terms of assets as well as branch network. They have branches in every nook and corner of the country. The associate banks are regional with good branch network in the place they are headquartered. There is going to be a huge overlap of branches in the five states of Rajasthan, Bengaluru, Andhra Pradesh, Punjab and Kerala.

Too big to handle

The merger is the biggest in the Indian banking industry. The bank is merging five associate banks with combined assets of over Rs 6 lakh crore, which is almost equal to the size of the two largest private banks HDFC Bank and ICICI Bank Ltd. The merged SBI entity would have 24,000 plus branches, 58,000 ATMs and 2.7 lakh employees. ICICI Bank has 4,450 branches, 14,295 and 97,132 employees. In a digital era, many banks are not even talking of setting up branches. The digital wallets, too, will make ATMs irrelevant in the future.

Associates are mirror image of parent

SBI associate banks are a mirror image of the parent. SBI chairman also sits on their board and MD and CEOs came from other associate banks. The product basket has many similarities with focus on infrastructure, agriculture, home and auto loans.

Too big to fail

In the post 2008 scenario, the world saw the government bailing out large banks from tax payers money. SBI though is identified by the RBI as a systemically important bank, requiring additional capital in its book for absorbing any future shock. But SBI's size is not comparable with other banks. SBI, with close to Rs 30 lakh crore assets, is way ahead of the two largest private banks - HDFC Bank and ICICI Bank, which are in the region of Rs 7-8 lakh crore. Managing a bank of SBI's size will require more oversight by the regulator.

A bad bank within a bank

This huge portfolio of bad loan makes it a bad bank within a bank. The five associate banks for instance have stressed loans (gross NPAs and restructured loans) at a staggering Rs 35,396 crore level. This amount is almost half of SBI's Rs 66,117 crore stressed loans in 2015-16. It would be a huge task to resolve the bad loans given the challenging operating environment

V. Post Merger Scenario

When SBI declared its results on May 19, analysts discovered, to their horror, that the path to global greatness lay through a minefield of subsidiaries' losses, estimated at Rs 5,792 crores in the quarter ended March 2017 and Rs 10,243 crores for the full year. Excluding non-banking SBI subsidiaries such as life and general insurance, which reported annual profits of nearly Rs 2,000 crores, the losses would have been higher. SBI's recommended dividend of Rs 2.5 per share for FY 2017, will entail an outflow of Rs 2,073 crores, far exceeding the consolidated net profit of Rs 241 crores and shareholders should not approve the dividend as it will be paid from the bank's reserves. Post the results, on May 22, SBI's stock price fell by 4.6% to Rs 294 and it is currently trading Rs 288, indicating investor apprehension with the huge and unexpected losses of its former banking subsidiaries.

What was particularly disturbing was the complete lack of transparency regarding disclosing these losses in the SBI result presentations, in which the bank only focused on the far better standalone results. The only clue in SBI's press release, apart from the mandatory disclosure of consolidated abridged annual results, was a single sentence, "Net Profit (after minority interest) of SBI Group declined from Rs 12,225 crore in FY'16 to Rs 241 crore in FY'17...". In contrast, analysts polled by *Bloomberg* had estimated full year consolidated profits of Rs 6,887 crores.

It was known that SBI's banking subsidiaries were having a difficult FY'17 in anticipation of the merger, and the consolidated results for the nine month period ended December 31, 2016, revealed losses of a minimum Rs 4,550 crores in the subsidiaries. However, the additional loss of Rs 5,792 crores in the quarter ended March was a shock to the capital market, as the bank's guidance had not indicated losses of this magnitude in the concluding quarter. There is no explanation in the public domain by SBI regarding what had happened to cause such a deterioration in the final quarter – had the economy experienced a tailspin or did the parent wake up to considerable 'ever-greening' of bad loans by its subsidiaries?

The lack of transparency in publishing and discussing these losses by the SBI senior management is also compounded by potential issues of governance. After all, these banking subsidiaries had been under the direct managerial control of the parent since their takeover by SBI in 1959; they shared a common chairperson with the parent, their managing directors were on deputation from SBI, they had a common information technology platform, an integrated treasury, and most, if not all, of their major commercial and credit decisions were first vetted by SBI. The question that naturally arises: Was the banking regulator (RBI), the parent (SBI) and the chairperson (Bhattacharya) oblivious to the state of asset quality in these subsidiaries? Was the drumbeat of consolidation of creating a global bank merely a disguise to bail-out poorly-managed banks? And, finally, who is to be held accountable for these huge losses?

Unfortunately, amid a government-induced euphoria over bank consolidation, neither the majority shareholder (the government), nor the banking regulator, nor the media, nor myriad banking analysts, are raising these issues of national and capital market interest.

Another curious development was the surprising overnight management shuffle in Punjab National Bank (PNB) and Bank of India, where their chief executive officers were sent to smaller banks ostensibly for poor performance. However, in the case of PNB, its Q4 results actually showed an improvement – SBI's Bhattacharya on the other hand was given a one year extension on October 1, 2016, to provide continuity for the merger of the bank's subsidiaries which resulted in huge losses.

Has the government misstepped in compelling SBI to merge all five of its banking subsidiaries in a single stroke? After all, India currently needs its largest bank to be at the vanguard of its economy, to stimulate stagnant economic growth. Instead, its attention is now largely directed inward, trying to resolve the asset quality of its former subsidiaries and addressing the far more complex issues of integrating human resources and realigning organizational structures and career paths of its mammoth staff. Before the government continues on its ill-advised strategy of more government bank mergers, it should pause and evaluate how SBI is digesting its former subsidiaries. Merging other government banks will be far more complex than the SBI merger as the SBI group had common policies in human resources, information technology, accounting, basic banking systems, a similar culture and SBI bank subsidiaries were always subservient to the parent and its authority. The commonality within the SBI group cannot be assumed to be prevalent amongst the nationalised banks, especially when senior management's attention is engaged in firefighting huge non-performing assets in the industry.

To bridge the gaping hole the former subsidiaries have blown in SBI's consolidated balance sheet, the bank is finalising an equity issue of nearly Rs 10,000 crores. As many investment banks will eventually participate in the issue, it is unlikely that their research analysts will release critical reports on SBI or on the ills of bank consolidation. However, as the immediate experience of the SBI merger has shown, reality can be very different from the visions of grandeur eloquently articulated by proponents of consolidation. **CONCERNS**

SBI gaining global size is a good thing for Indian banking sector in relation to the global industry. But, back home, this would also mean SBI will grow in size at least four times bigger than its nearest competitor—HDFC bank—which has assets of Rs 7.4 lakh crore as on March 2016. The third largest bank will be ICICI with asset size of Rs 7.2 lakh crore. Beyond HDFC Bank and ICICI, most other lenders will look too tiny in comparison to State Bank. The combined entity will have over 23,000 branches and two and half lakh employees.

Is SBI, often dubbed as the elephant among Indian banks, growing too big in relation to its competitors in the domestic market creating a monopolistic situation and a too-big-to-fail banking institution? Such a big difference in the asset sizes of the largest bank and other competitors have worried the banking regulator in the past.

For instance way back in 2013, the then RBI governor, D Subbarao, had highlighted this issue. "Presently, (there is) significant skewness in the size of banks. The second largest bank in the system is almost one-third the size of the biggest bank. This creates a monopolistic situation," Subbarao said.

The problem has grown even bigger since then. Instead of creating one big giant among several relatively tiny rivals, it is good if we have 3-4 large sized banks so that the spirit of competition will be sustained, experts have suggested in the past.

The concern of policymakers worldwide about 'oversized' financial institutions is justified since if something goes wrong with them, this can have serious ramifications on the whole financial system. This is something that prompted the US federalreserve to finalise a rule in November, 2014 that prohibited any financial company from acquiring another, if the resultant entity's liabilities exceeded 10 percent of the total liabilities of the financial services system.

The rule - Section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act - says once a particular entity reaches the specified concentration limit, that bank cannot acquire control of another entity. Logically, the new rule intends to shield the US financial system from the foibles of 'too big to fail' banks, which could then spark a crisis like the one in 2008 following the collapse of Lehman Brothers, which triggered a

global financial meltdown. That meltdown showed that when banks become too big, they can bring down the whole financial system when they lend or invest imprudently.

True, there is no comparison between US and Indian banking systems in terms of size. But, the concerns apply here as well. In July, 2014, the central bank released a framework to identify domestic systemically important banks (D-SIBs) and later classified both SBI and ICICI as systemically important banks. In SBI's case, given the enormous size of the bank compared to its domestic peers, there is an obvious concentration risk that is building up. This is what the RBI has to monitor.

If anything goes wrong with SBI, it would have repercussions not only for the bank, but the whole financial system. In a worst case scenario, if a major crisis grips the domestic banking system, a fiscally-constrained government may find it difficult to capitalize SBI. Considering its size and appetite, the elephant is not easy to feed. It is a matter of pride for India to have a global sized bank but it brings with itself ominous challenges.

VI. Conclusion

In view that profitability of SBI was going down, and it needed reconstruction, this step of merger seems to be a smart step. It has brought SBI in list of top 50 banks in the world which is a big deal. However, profitability of the bank after merger has fallen by approximately Rs. 3000 crore. This was mainly because of accumulated losses of associate banks which were shown in balance sheet of the amalgamated entity and it reduced the enthusiasm of investors. Still, investors should not lose hopes as such bold steps have effects in long run and they take time to become visible.

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