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Why PSU Bank Mergers May Not Be A Good Idea

The sharp rise in bad loans in domestic banking system has weighed on economic development and forced the government to explore measures to revive state-run lenders. Finance Minister Arun Jaitley last week said that the government was looking at consolidation in the banking sector, hinting at merger of smaller state-run banks with bigger, strong ones.

But Munish Dayal of Baring Private Equity told NDTV Profit that consolidation of public sector banks may not be a great move, as it has not worked in the past. (Watch)

According to Mr Dayal, consolidation of weak banks, with almost no net worth, may not help in creating large world-class banks. He said both Punjab National Bank (which merged with NBI in 1997) and Oriental Bank of Commerce (which merged with Global Trust Bank in 2004) had to suffer because of mergers.

"Making the weaker banks a part of big profit-making banks cannot work," Mr Dayal said.

Combining weak banks within themselves is also not a viable option, he added. The government should either downsize by closing the tap of capital or clean up the balance sheets and then privatize weaker banks, he suggested.

Mr Jaitley has set aside Rs. 25,000 crore for recapitalisation of state-run banks in the 2016-17 fiscal year, but analysts say more funds are needed to rejuvenate PSU lenders.

According to Mr Dayal, the government's decision to lower its stake in IDBI Bank below 50 per cent will be an "acid test" as to how it intends to look at some of the other weak banks. IDBI Bank had last month posted a record net loss of Rs. 2,184 crore for the December quarter, hit by higher provisioning for bad loans.

Mr Dayal also said the government should identify the root causes that have pushed the banks to the situation they currently find themselves in.

"Got to look at the political interference, got to look at social objectives, got to look at directed lending," he added.

The government needs to first initiate policy reforms before considering consolidation, he said, adding that operating control of these banks should be handed over to professionals.

"Ownership and management can be divorced," Mr Dayal said.

If the government sticks to its consolidation plan, it must be prepared to face the wrath of nearly 8 lakh bank employees, he said. PSU bank employees are highly unionized and thus it is "not going to be easy to unwind," he added.