



Consolidation of Banks

Some Thoughts

Dr Rupa Rege Nitsure
Chief Economist, Bank of Baroda
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International Scene in Banking Consolidation

- Global trends indicate that US, Europe and Japan lead in this regard
 - More than 25 to 30% banks in USA are closed/merged in the last 2 to 3 decades
 - Failure of business, removal of inter-state barriers, etc. have led to bank mergers within USA
 - Dismantling inter-country barriers through European Union led to bank mergers within Europe
 - Structural reforms have given rise to mega-mergers among Japanese corporates and banks

- Trends of mega-mergers very much dominate the global scene
 - The official statistics shows that acquisitions of banking firms accounted for 70% of the value of all financial mergers in the 1990s



International Scene in Banking Consolidation

- The world's biggest ever banking deal happened in October 2007 when the consortium of RBS, Santander and Fortis took over ABN Amro Bank for \$101 billion.
 - Each member of the trio will grab the bits of ABN AMRO that suit it best.
 - RBS will take over ABN's wholesale business as well as its Asian operations.
 - Santander will carry off its retail-banking franchises in Brazil and Italy.
 - Fortis will take control of the Dutch retail network and ABN's asset-management and private-banking arms.

- Asia is rapidly emerging as “the home of growth” and hence a great deal of “M& A” is taking place in Asia.
 - M & A in the financial services sector (including insurance) of Asia skyrocketed by 66.0% to \$64.5 bln in 2006 from \$38.8 bln in 2005.



Need for Bigger Size ..

- To take advantage of economies of scale and scope
 - Lower margins need higher volumes
- It facilitates both product and geographic diversification – from assets as well as liabilities' sides
 - Both the 'operational efficiency' and 'risk-absorption capacity' may improve
- To ward off threats of 'disintermediation'
- Bigger entities have an inherent advantage
 - Too big to fail



How Would Consolidation Help Indian Banks?

- As of today, Indian banks are not able to compete internationally – in terms of funds' mobilisation, credit disbursement, investments & rendering of financial services due to their relatively small size
 - Indian banking industry is highly skewed and almost 80 banks have a less than 2.0% market share in India
 - Though the top five occupy more than 50% market share in India, they are much smaller by global standards
- Many Indian banks are unprepared for Basel II implementation due to capital inadequacy
- Banks also need to consolidate to improve their risk management capabilities



Findings of Top 1,000 Banks of the World by The Banker (London), July 2007

- SBI has 70th Rank and ICICI Bank has 147th Rank in Global Rankings.
- Even within the Asia region, the Rank of SBI is 11th and that of ICICI Bank 25th.
- Thus, India's largest banks are relatively smaller compared to other leading banks in Asia.
- For instance, two Chinese Banks -- ICBC and Bank of China have arrived in 7th and 9th places in Global Rankings following huge their IPOs.
- India though the 13th largest economy of the world, does not have a decently sized bank that can compete globally.



How Would Consolidation Help Indian Banks?

- Indian corporates are fast globalising and our banks need to keep pace to service them
- A bigger player can afford to invest in requisite technology and play globally to take advantage of global opportunities
 - B'cause for going global a bank needs to upgrade its technology, MIS, “systems & processes” and strategies,. to compete effectively and “M & A” could facilitate this
- The confidence of international investors in Indian banks has increased manifold in recent times and this offers our banking sector a good opportunity to restructure itself



What Could be the Appropriate Way?

- As suggested by Narasimhan Comm. Report II, “M & A” should be entirely market driven and not government driven
- The Government & RBI have to monitor the process carefully
 - The Narasimhan Comm. has recommended a three-tier banking structure with 2 or 3 large banks of international character, 8 or 10 national banks and a few large local area banks
 - Priority to be given to co-operative banks, RRBs, etc who have survival threat in the Basel II era including NBFCs
- Mergers should ideally be among the listed entities
 - So that they can offer scope to indicate post-merger market parameters like “market capitalisation” after merger, etc.



What Could be the Appropriate Way?

- Merger process should be transparent based on a SWOT analysis, i.e., indicating to the market 'pluses' & 'minuses' of the respective entities besides the prospects for the merged entity
- Objectives and 'merits & demerits' to be specified and told to the market in a transparent fashion
- Merger process should show enough 'concern' for the minority shareholders also
- It is necessary to examine whether the technology platforms are similar (or at least compatible) in the banks with merging aspirations.
 - A due attention has to be paid to the overlapping technology costs and the costs of process integration, etc.



Risks Involved ..

- Mergers may give rise to monopolistic/oligopolistic structures and there is a possibility of lower competition
- Larger entities are likely to neglect small customers and concentrate exclusively on High Net Worth Individuals
- There is a possibility of a loss of local feel and character of a bank
- Heterogeneity of work cultures, systems & processes may become serious impediments
- Issues like the optimal number of banks, their capital adequacy & organizational structures, etc. are the matters that need to be settled carefully by the policy-makers



Role of Policymakers ...

- Stable macro environment is a major pre-condition for the success of “M & A” process otherwise there is a possibility of a panic run on the banking sector
- The prudential/statutory regulations also need to be looked at carefully in the transition period
 - CRR and SLR -resource-preemption related problems
- Creation of enabling legal environment
 - Merger of nationalized banks would require an amendment of the Banking Regulation Act and the Banking Companies (Acquisition and Transfer of Undertakings) Act
 - Corporatisation of PSBs will be a necessary step to create a level-playing field between PSBs & private banks in terms of tax benefits



Future Scenario ..

- The second phase of opening up of Indian banking sector would commence in April 2009.
 - Foreign banks will have the opportunity to own up to 74% of Indian private sector banks.
 - These banks with huge capital reserves, cutting-edge technology, best international practices & skilled personnel will create a major competitive challenge for Indian banks.
- While it is recognised that current time is the most appropriate time to facilitate consolidation amongst banks, earnest efforts in this direction have not begun so far.
- Future scenario implies new competitive threats as well as new opportunities. Internationally active banks can succeed only by acquiring decent “size” by global standards, robust risk management capabilities & internal control systems, advanced technology, skilled manpower, sound marketing practices, etc..



How to Strategise?

- Banks should start working towards a synergy-based merger plan that could take shape before April 2009
- Given that “technology”-related spending is a major component of spending –
 - if two or more banks come together and optimize the spending costs, the merger will reduce overall costs and at the same time ensure size and cost synergies as well as expand the geographical presence
- It must also be remembered that “merger” or “large size” is just a facilitator but no guarantee for improved profitability on a sustained basis.
 - Thrust should be on improving risk mgmt capabilities, corporate governance and strategic business planning.
 - In the short run, options like outsourcing, strategic alliances could be attempted in a meaningful manner.



Points to Remember ...

- Benefits of “mergers” could be realised only through rigorous evaluation of synergies, successful integration of diverse systems and cultures, and strong leadership.
- Banks operate in a fast changing environment, where product life cycles are short, time to market is critical and “first mover” advantage could be decisive.
- “Size” should not affect “agility” of the institution.
 - The aim should be to create a nimble giant and not a clumsy dinosaur.
- Also, it must be remembered that lack of size does not necessarily imply “irrelevance”.
 - In developed countries also, specialised players providing niche and boutique services have continued to thrive.



Thank you.