Indian Financial Institutions and Markets

A Post Pandemic Perspective

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Bharti Publications

New Delhi- 110002 (India)

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First Published, 2020

ISBN: 978-93-89657-85-2

Published by:

Bharti Publications

4819/24, 3rd Floor, Mathur Lane

Ansari Road, Darya Ganj, New Delhi-110002

Phone: 011-23247537

Mobile: +91-989-989-7381

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Website: www.bhartipublications.com

Printed by KVS Enterprises, Delhi

Chapter

14 An Analysis of the Fact Behind the Merger of Banks

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Abstract

The finance ministry opines that the merger of the 10 public sector banks will help India to make a US 5 trillion economy. The bank merger was done under the bank consolidation plan of the union government. In order to increase the national presence of banks and to reach their global level, the merger of the banks was necessary. During this process the amalgamated bank was handed over to the Anchor Bank. The merger of the bank are expected to be completed by the end of the current financial year March 31, 2020. The study tries to analyse the next generation public sector banks, the banks to be merged with the Anchor banks, impact of merging, capital infusion in the public sector banks. In order to know the reason why certain banks are amalgamated the exponential form of the amalgamated banks are $y = 12.627\ e^{0.239x}$ and the R2 value is -3.656. After the capital infusion new funds were transferred to the merged banks which lead the R^2 value to be positive 0.975.

Keywords: *Amalgamated Bank, Public Sector Banks, Capital Infusion, Capital Risk Asset Ratio, Cash Ratio, Common Equity Tier, Gross Advances, Non Performing Asset, Provision Coverage Ratio.*

Introduction

Continuing with its thrust to achieve Prime Minister Narendra Modi's dream of a $5 trillion economy, Finance Minister Nirmala Sitharaman today announced merger of the country's top Public Sector Banks (PSBs).

While addressing a press conference, Financial Minister Sitharaman mentioned that only six banks showcased profitability in the 4th Quarter of 2018-19. However, in Quarter 1 of 2019, 14 PSBs showcased growth and profit. In order to boost the national presence of banks along with their global reach, the amalgamation of banks was necessitated. This is not the first time that the Government is merging the banks together. Earlier, under the Banks Consolidation plan itself, the Government had merged all the entities of State Bank of India into one and merged Bank of Baroda, Dena Bank and Vijaya Bank in one single entity.

In a merger, there is an anchor bank and an amalgamating bank or banks, where the latter gets merged with the former. For instance, in the consolidation that happened in April of 2019, Vijaya Bank and Dena Bank (amalgamating banks) were merged into Bank of Baroda (the anchor bank). In effect, the operations of Vijaya Bank and Dena Bank were handed over to Bank of Baroda. Essentially, retail customers of the amalgamating banks are likely to get directly affected whereas customers of the anchor bank are not likely to face much change. However, shareholders of all banks involved in the mergers are bound to be impacted.[5]

The mergers are expected to be complete by the end of the current financial year, say government officials. As per a news reports last week, Indian Bank expects to complete the merger with Allahabad Bank by March 31, 2020.

Table: 1 Details of Merged Banks

Anchor Bank	Amalgamating[1] Bank	Core Banking System	PSB Rank By Size
Punjab National Bank	Oriental Bank of Commerce United Bank of India	Finacle	2nd largest
Canara Bank	Syndicate Bank	iFlex	4th largest
Union Bank of India	Andhra Bank Corporation Bank	Finacle	5th largest
Indian Bank	Allahabad Bank	BaNCS	7th largest

Source: Finance Ministry Report

Objective

- To analyze the figure of the amalgamated Bank
- To know the capital infusion in the public sector bank
- To know the significant implication of the bans being merged
- To Analyze Motive & Objective behind Merger of PSBs

Concepts and Methodology

Capital risk asset ratio (CRAR)

Capital Adequacy Ratio is also known as Capital to Risk Assets Ratio, is the ratio of banks capital to its risk. It is a measure of bonus capital.

Cash ratio

The cash ratio sometimes referred to as the cash asset ratio, is a liquidity metric that indicates the company's capacity to pay off short term debts obligations with its cash and cash equivalents.

Common equity tier (CET)

CET ratio compares the bank capital against its risk weighted assets to with stand financial distress. The core capital of the bank includes equity capital and disclosed reserves such as retain earning.

Gross advances

Gross Advances are the total amount that is prepaid in advances of delivery. These items are subtracted from the gross advances to yield the net advances which would be your outstanding liabilities.

Non performing asset (net-NPA)

Non Performing Asset ratio is used as a measure of the overall quantity of the bank's loan book. An NPA are those assets for which interest is overdue for more than 90 days.

Provision coverage ratio (PCR)

The Provision Coverage Ratio gives an indication of the provision made against bad loans for the profit generated. The higher is the PCR, lower the unexpected part of the bad debts.

Methodology

The study includes the data collected from the secondary sources. The secondary data were collected from journals, research papers, literature review and websites.

Review of Literature

1. Sinha Pankaj & Gupta Sushant (2011) studied a pre and post analysis of firms and concluded that it had positive effect as their profitability, in most of the cases deteriorated liquidity. After the period of few years of Merger and Acquisitions(M&As) it came to the point that companies may have been able to leverage the synergies arising out

of the merger and Acquisition that have not been able to manage their liquidity. Study showed the comparison of pre and post analysis of the firms. It also indicated the positive effects on the basis of some financial parameter like Earnings before Interest and Tax (EBIT), Return on share holder funds, Profit margin, Interest Coverage, Current Ratio and Cost Efficiency etc.

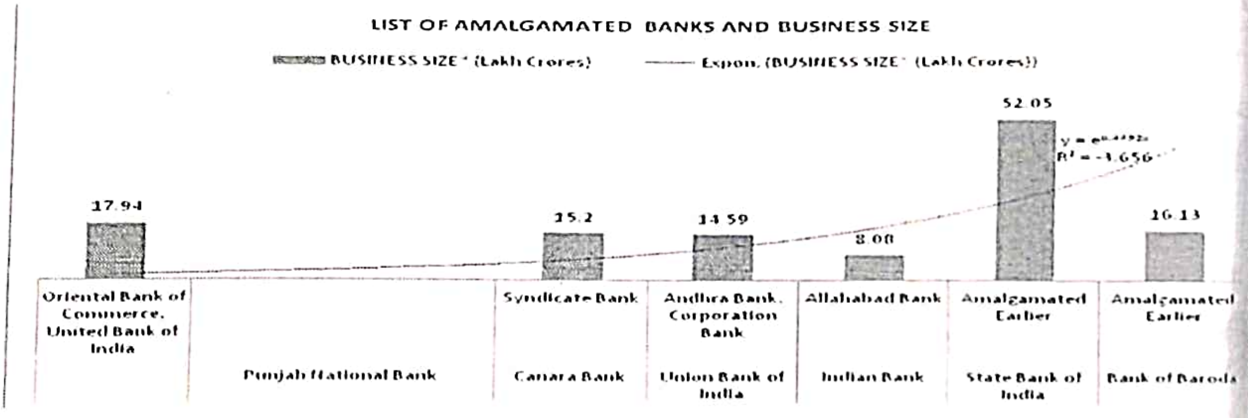
2. Aharon David Y et al., (2010), analyzed the stock market bubble effect on Merger and Acquisitions and followed by the reduction of pre bubble and subsequent, the bursting of bubble seems to have led to further consciousness by the investors and provide evidence which suggests that during the euphoric bubble period investor take more risk. Merger of banks through consolidation is the significant force of change took place in the Indian Banking sector.

3. Kuriakose Sony et al., (2009), focused on the valuation practices and adequacy of swap ratio. fixed in voluntary amalgamation in the Indian Banking Sector and used swap ratio for valuation of banks, but in most of the cases the final swap ratio is not 9justified to their financials.

Figure of the Amalgamated Bank

In place of fragmented lending capacity with 27 PSBs in 2017, now there will be 12 PSBs post consolidation.

Banks that will continue to work individually: Apart from these 10 merged entities, six banks will continue to work individually. Have a look at the details of these banks:



The above figure shows that Bank of Baroda and State Bank of Indi[a] were the banks which were amalgamated earlier.

Table: 2 List of Amalgated Banks

S.NO.	Anchor Bank	Amalgamating Bank	Business Size* (Lakh Crores)
1	Punjab National Bank	Oriental Bank of Commerce, United Bank of India	17.94
2	Canara Bank	Syndicate Bank	15.20
3	Union Bank of India	Andhra Bank, Corporation Bank	14.59
4	Indian Bank	Allahabad Bank	08.08
5	State Bank of India	Amalgamated Earlier	52.05
6	Bank of Baroda	Amalgamated Earlier	16.13

Source: https://m.economictimes.com/news/

The rest of the Bank amalgamated in April 2019. This amalgamation was done by the government in order to raise the business size. **This was indicated by the exponential forms and the R^2 value is -3.656.**

Capital infusion in the public sector bank

Banks to be merged together are:

1. Punjab National Bank, Oriental Bank of Commerce, United Bank of India will be merged as one
2. Canara Bank &Syndicate Bank
3. Union Bank of India, Andhra Bank and Corporation Bank
4. Indian Bank &Allahabad Bank

The Government targets USD 5 trillion economy through these bank reforms and consolidation. The Government would infuse Rs55,250 Crore of capital in these 10 big banks for their credit growth and regulatory compliance to boost the economy. A part from these merged banks, two public sector banks will continue to work as an independent body to strengthen national presence. These banks are Bank of India and Central Bank of India. Four regional banks will also continue to work independently to strengthen the regional focus. These are: Indian

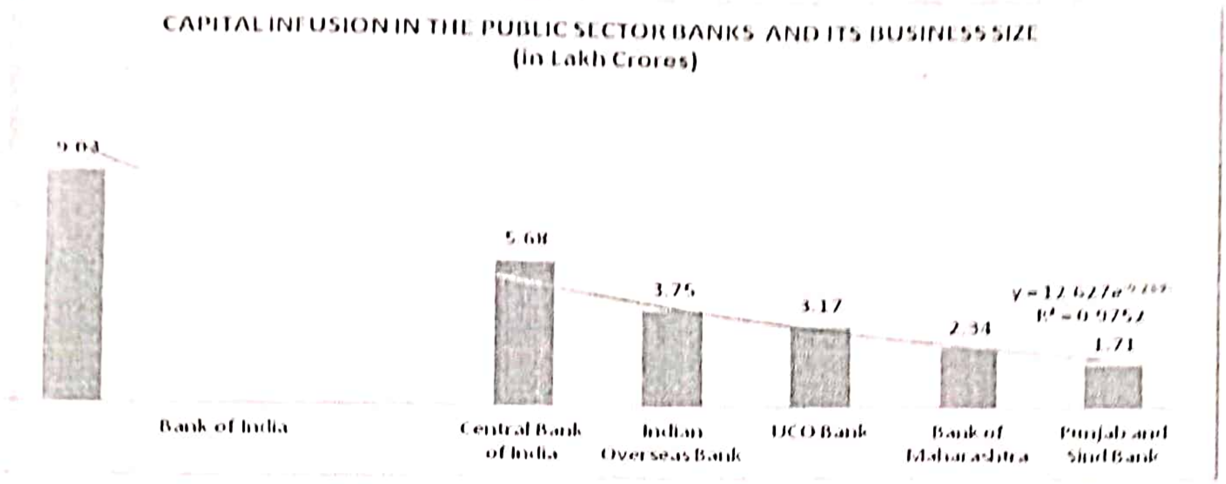
Overseas Bank, UCO Bank, Bank of Maharashtra and Punjab & Sind Bank.[3]

Finance Minister Sitharaman also announced capital infusion in the public sector banks with an aim to scale them. The Government plans to infuse Rs 55,250 Crores of capital in the PSBs. Have a look at bank wise capital infusion.

Table: 3 Capital Infusion in the Public Sector Banks

S.NO.	Bank	Business Size* (in Lakh Crores)
1	Bank of India	09.03
2	Central Bank of India	05.68
3	Indian Overseas Bank	03.75
4	UCO Bank	03.17
5	Bank of Maharashtra	02.34
6	Punjab and Sind Bank	01.71

Source:https://m.economictimes.com/news/



The above figure shows the capital infusion in the public sector banks. The list of banks and business size are quite related directly. This was indicated by the exponential forms and the R^2 value is 0.975. The business size of the bank determines the lending capacity.

After Amalgamation the Bank of India (9.03) have its business size larger than the banks. Next comes the Central Bank of India (5.68), Indian Overseas Bank (3.75) and so on.

Consolidation of Punjab National Bank, Oriental Bank of Commerce and United Bank

The merged entity would be the 2nd largest PSB with Rs 18 lakh crore business and 2nd largest network with 11, 437 branches across India. The merger would lead to a high Current And Savings Account (CASA) ratio and a high lending capacity. Same Core Banking System (CBS), Finacle, in all three banks would enable quick resolution of gains.

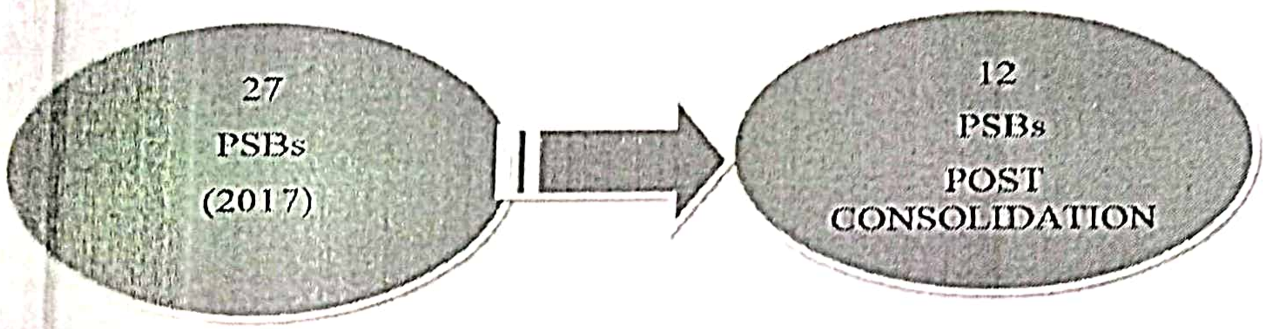


Table: 4 Consolidation of Punjab National Bank, Oriental Bank of Commerceand United Bank

Particulars	Punjab National Bank + Oriental Bank of Commerce + United Bank of India			
	PNB	OBC	UBI	Amalgamated Bank
Total Business (In Crores)	11,82,224	4,40,194	2,08,106	17,19,526
Gross Advances (In Crores)	5,06,194	1,71,549	73,123	7,50,867
Deposit (In Crores)	6,76,030	2,32,645	1,34,983	10,43,659
Casa Ratio	42.16	29.40	51.45	40.52
Domestic Branches	6,992	2,390	2,055	11,437
PCR (%)	61.72	56.53	51.17	59.59
Cet-I Ratio (%)	6.21	9.86	10.14	7.46
Crar Ratio (%)	9.73	12.73	13.00	10.77
Net Npa Ratio (%)	6.55	5.93	8.67	6.61
Employees	65,116	21,729	13,804	1,00,649

Source:https://m.economictimes.com/news/

There were 27 Public Sector Banks in 2017. After past consolidati there are 12 Public Sector Banks.

Consolidation of Canara & Syndicate Bank

The merged entity will be the fourth largest PSB with Rs 15.2 lakh cr business and third largest network with 10,342 branches. Synergi culture & common CBS platform to enable quick realization operational gains & enhanced lending capacity.

Table: 5 Consolidation of Canara & Syndicate Bank

Particulars	Canara Bank + Syndicate Bank		
	Canara Bank	Syndicate Bank	Amalgamated Bank
Total Business (In Crores)	10,43,249	4,77,046	15,20,295
Gross Advances (In Crores)	4,44,216	2,17,149	6,61,365
Deposit (In Crores)	5,99,033	2,59,897	8,58,930
CASA Ratio	29.18	32.58	30.21
Domestic Branches	6,310	4,032	10,342
PCR	41.48	48.83	44.32
CET-I Ratio	8.31	9.31	8.62
CRAR Ratio	11.90	14.23	12.63
NET NPA Ratio	5.37	6.16	5.62
Employees	58,350	31,535	89,885

Consolidation of Union, Andhra & Corporation Banks

The merged entity would be the fifth largest PSB with Rs 14.6 lakh crore business and fourth largest network with 9,609 branches in India. Strong scale benefits to all 3 with business becoming 2 to 4.5 times that of individual bank.

TABLE: 6 Consolidation of Union, Andhra & Corporation Banks

Particulars	Union Bank + Andhara Bank + Corporation Bank			
	Union Bank	Andhra Bank	Corporation Bank	Amalgamated Bank
Total Business (In Crores)	7,41,307	3,98,511	3,19,616	14,59, 434
Gross Advances (In Crores)	3,25,392	178,690	1,35,048	6,39,130
Deposit (In Crores)	4,15,915	2,19,821	1,84,568	8,20,304

CASA Ratio	36.10	31.39	31.59	33.82
Domestic Branches	4,292	2,885	2,432	9, 609
PCR	58.27	68.62	66.60	63.07
CET-I Ratio	8.02	8.43	10.39	8.63
CRAR Ratio	11.78	13.69	12.30	12.39
NET NPA Ratio	6.85	5.73	5.71	6.30
Employees	37,262	20,346	17,776	75,384

Source:https://m.economictimes.com/news/

Consolidation of Indian & Allahabad Bank

The merged entity to be the 7th seventh largest PSB with Rs 8.08 lakh crore business. Strong scale benefits to both with business doubling. High CASA & lending capacity combined in consolidated bank.

Table: 7 Consolidation of Indian & Allahabad Bank

Particulars	Indian Bank + Allahabad Bank		
	Indian Bank	Allahabad Bank	Amalgamated Bank
Total Business (In Crores)	4,29,972	3,77,887	8,07,859
Gross Advances (In Crores)	1,87, 896	1,63,552	3,51,448
Deposit (In Crores)	2,42,076	2,14,335	4,56,411
Casa Ratio	34.71	49.49	41.65
Domestic Branches	2,875	3,229	6,104
PCR	49.13	74.15	66.21
CET-I Ratio	10.96	9.65	10.36
CRAR Ratio	13.21	12.51	12.89
NET NPA Ratio	3.75	5.22	4.39
Employees	19,604	23,210	42,814

Source:https://m.economictimes.com/news

Table: 8 All Amalgamated Bank Details

Particulars	Amalgamated Banks			
	Punjab National Bank + Oriental Bank of Commerce + Union Bank of India	Canara Bank + Syndicate Bank	Union Bank + Andrha Bank + Corporation Bank	Indian Bank + Allahabad Bank
Total Business (In Crores)	17,19,256	15,20,295	14,59,434	8,07,859
Gross Advances (In Crores)	7,50,867	6,61,365	6,39,130	3,51,448
Deposits (In Crores)	10,43,659	8,58.930	8,20,304	4,56,411
Cash Ratio (%)	40.52	30.21	33.82	41.65
Domestic Branches	11,437	10,342	9,609	6,104
PCR (%)	59.59	44.32	63.07	66.21
CET-I Ratio (%)	7.46	8.62	8.63	10.36
CRAR Ratio (%)	10.77	12.63	12.39	12.89
NET NPA Ratio (%)	6.61	5.62	6.30	4.39
Employees	1,00,649	89,885	75,384	42,814

Source:https://m.economictimes.com/news/

This table shows the list of the all amalgamated banks which were merged with the core bank Punjab National Bank + Oriental Bank of Commerce + Union Bank of India have greater value in terms of Total Business, Gross Advances, Deposits, Cash Ratio, Domestic Branches, Employees and less values in terms of PCR, CET- I Ratio, CRAR, NET-NPA Ratio when compared to other amalgamating banks.

Significant Implication of the Bank Merger

If you are a customer of one or more of the banks being merged, the mergers can have a few significant implications for you. Here is a look at some of them.

Account Number, Customer IDs Likely to Change

You are likely to get a new account number and customer ID. Make sure your email address/physical address and mobile number is updated with your bank so that you receive official intimations on change of account numbers. Moreover, all your accounts will be tagged to a single customer ID. Let us say you have an account with Oriental Bank of Commerce and one at United Bank of India; the two accounts will be allotted a single customer ID.

Re-Submission of Account Details for Auto-Credits/Debits

You would have given your bank account numbers and IFSC codes for various financial transactions - auto credit of dividends via ECS, auto-credit of salary, auto debit of various bills/charges etc. Unless these accounts are seamlessly merged into the financial system of the anchor bank, you would be required to change the details of your bank account given for these purposes.

Customers who are allotted new account numbers or IFSC codes will have to update these details with various third-party entities where they had earlier given details of their accounts in the amalgamating banks. These will include the income tax department for tax refunds, insurance companies to get maturity proceeds, mutual funds to get the redemption amounts and the National Pension System (NPS), among others.

A couple of years ago, when five associate banks of State Bank of India (SBI) were merged, IFSC codes and names of 1,300 branches were changed. The banking behemoth changed the names and IFSC codes of branches of the amalgamating banks located in major cities such as Mumbai, New Delhi, Bengaluru, Chennai, Hyderabad, Kolkata and Lucknow.

Local Branches and Atms

Customers will have to deal with the branch rationalisation exercise. For instance, your existing home branch could shut shop if the new acquiring entity has its own branch in the same vicinity. Keep an eye on the new IFSC and MICR code applicable to your branch and account since you will have to quote it for funds transfer and other financial transactions. A plus point is that hopefully the branch network would become larger so access to bank branches should become easier provided the merged entity does not shut down all branches of merging banks. For instance, the combined entity of Punjab National Bank, Oriental Bank of Commerce, and United Bank of India will become the second largest PSU bank in the country with the second largest bank branch network with 11,437 branches. You may also get access to a larger number of ATMs in a manner similar to that of a larger branch network thanks to the combined entity. According to the FAQ section of Bank of Baroda's amalgamation page, "The combined entity has a network of close to 9500 branches, approximately 13000 ATMs across India. (erstwhile Vijaya Bank - ATMs approx 2000 & Branches approx 2050, erstwhile Dena Bank - ATMs approx 1500 & branches approx 1850). Customers can also choose from a broader suite of products & services." It also stated that, "You can use the ATMs of any of the 3 banks (Bank of Baroda, Vijaya Bank and Dena Bank), no ATM transaction charges will be levied."

Borrowers

Deposit, lending rates to be decided by merged entity. When a bank merger takes place, how does it impact an existing borrower? For instance, those who took a loan from Dena Bank or Vijaya Bank how will their loans get impacted? Is their existing MCLR related loan still operational or will they have to switch to BOB following BOB's terms and conditions?

Virendra Kumar Sethi, Head of Assets & Mortgages, Bank of Baroda explains, "All MCLR linked retail loans are migrated to the MCLR of the amalgamated bank. In the case of Dena and Vijaya bank MCLR linked retail loan customers have migrated automatically to the Bank of Baroda MCLR, which in this instance was 8.65 percent as of March 2019. Pre-amalgamation the MCLR of Dena Bank was 8.80% and Vijaya Bank was 8.75 percent.

Hence, customers of Vijaya and Dena benefited from the lower MCLR of Bank of Baroda." For customers of Bank of Baroda, there was no impact, but for Vijaya and Dena bank customers there was a positive impact by a reduction in MCLR.

The loan rates may change as there may be a change in the composition of deposits and cost of funds of the combined merged entity, says Gaurav Gupta, Founder and CEO, MyLoanCare. He explains what could possibly happen with an example: For example Oriental Bank of Commerce (OBC) and United Bank of India (UBI) have been merged into Punjab National Bank (PNB).Home loan rate of Punjab National Bank as on August 31, 2019 was 8.5 percent, while they were higher for UBI at 8.65 percent and OBC at 8.70 percent. Immediately, there would be no change in the interest rate of home loan customers of UBI and OBC. However, the next reset date, PNB will give an option to customers of UBI and OBC to be at par with its existing home loan customers by increasing or decreasing the spread. So, in this case, given that PNB has lower interest rate on home loan, one can.[3]

It is, however, not clear what will happen to the interest rates payable on loans taken by those who have loans running with the amalgamating banks as the MCLR rates are different for different banks.

Motive & Objective behind Merger of Psbs

The Finance Ministry opines that the merger of these 10 public sector banks (PSBs) will help India make a USD 5 Trillion Economy. The bank merger was done under the bank consolidation plan of the Union Government. Have a look at the government's objective behind the merger of these banks:

- ✓ Enhanced capacity to increase credit
- ✓ Banks with a strong national presence and international reach
- ✓ Reduction in lending cost
- ✓ Next Generation technology for the banking sector
- ✓ Improved ability to raise market resources.[4]

Conclusion

Ten Public Sector Undertaking (PSU) banks will be amalgamated into four banks from April 2020. The Government in August 2019, had announced the merger of ten public sector. banks into four bigger and stronger banks. It was widely speculated that the government may defer the consolidation due to the Novel Corona Virus pandemic that has impacted our country. The study tries to analyse the next generation public sector banks, the banks to be merged with the Anchor banks, impact of merging, capital infusion in the public sector banks.In order to know the reason why certain banks are amalgamated the exponential form of the amalgamated banks are $y=12.627e^{-0.239x}$ **and the R^2 value is -3.656. After the capital infusion new funds were transferred to the merged banks which leads the R^2 value to be positive 0.975.** When one ban is not well, or running in minimum profit, it might benefit from an infusion of new funds from the most successful running banks

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