TOPIC OF THE WEEK

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Merger –a new economic strategy?

A division of a country's population based upon the economic area in which that population is employed. Many economists recognize the following five economic sectors; the primary sector which includes agriculture, mining and other natural resource industries; the secondary sector covering manufacturing, engineering and construction; a tertiary sector for the service industries, the quaternary sector for intellectual activities involving education and research and the quinary sector reserved for high level decision makers in government and industry.

Driven by globalization of competition, technological developments, & economic or strategic barriers to normal growth, mergers & acquisitions (M&As) have dramatically become the primary means by which many companies around the globe are quickly attempting to grow revenues . All companies in almost all industries are being increasingly faced by new challenges amid the intensifying competition locally & internationally. It is becoming a daily challenge to keep up with new competitors, technological breakthroughs, & ever-more demanding & sophisticated customers. It is widely documented that mergers & acquisitions are the primary methods of consolidation for quick corporate expansion & growth. Most of the M&As literature has used the two terms interchangeably despite the formal distinction that has been drawn between them which has been widely considered as somewhat vague. Both terms are used to refer to transactions involving the combination of two independent firms to form one or more commonly controlled entities where a change of control takes place through a transfer of ownership. The last couple of years have seen record levels of merger and acquisition (M&A) activity but also increasing concern about industry concentration and its negative effects. And while much has been written to speculate about whether mergers improve or harm economic welfare, there is little empirical evidence supporting either side of the argument.

When Narendra Modi became India's prime minister in spring 2014 the Indian economy was in the doldrums. There was a clear policy paralysis in India's central government, in large part due to the high profile corruption cases that involved the central government bureaucracy and politicians at the time. Modi promised Indians that "acche din" (good days) were coming. And there was expectation that the Indian economy would do well under a pro-business political regime, headed by a politician known for acting strongly and decisively.

On last Friday, Finance Minister Nirmala Sitharaman announced the government's decision to merge 10 state-owned banks to create four large entities or lenders. Under the plan, Oriental Bank of Commerce and United Bank of India will be merged with Punjab National Bank; Canara Bank with Syndicate Bank; Andhra Bank and Corporation Bank with Mumbai-based Union Bank of India; and Allahabad Bank with Indian Bank. That will mean a consolidation of banks in India from 27 before 2017, to 12 after the merger goes through. What are the upside and downside of this move?

As per studies conducted until now most of the mergers done in the past, have proved to be an overall success for the weaker banks although there are no concrete parameters to verify this observation. India is the fastest growing major economy in the world. To sustain this growth, there is a need for mega banks that only will ensure investments into the large scale infrastructure projects. At present, there are a total of 27 public sector banks (PSBs) in the country. Apart from the SBI, all the remaining banks are regional banks. Hence, consolidation helps in leveraging the benefits of economies of scale.

Along with that, at present, there is not a single Indian bank in the top 50 global banks list. The consolidation is expected to fill this gap, and, consequently, help build the 'Brand India' among international investors. International experience is also favorable towards consolidation. Banks in Japan gained a lot as a result of large scale merger and acquisition process between 1990 and 2004.

Merging of banks has its side effects too. Managing Director of Federal Bank, V.A. Joseph is of the view that Co-existence of the big, medium and regional banks would be preferable in the present scenario. According to him, most acquisitions in India were borne out of compulsions and over 90 per cent of past acquisitions had failed to achieve the objectives. With the merger, the weaknesses of the small banks are also transferred to the bigger bank.

Also, so far small scale losses and recapitalization could revive the capital base of small banks. Now if the giant shaped SBI books huge loss or incurs high NPAs as it had been incurring, it will be difficult for the entire banking system to sustain. Customer dissatisfaction is one more important parameter because there is always a risk of alienating the customer base during a merger. First of all, there is the trepidation about the security of money, especially in those days when cyber-crimes are rampant. Secondly, banking policies may change, along with technological platforms, and that may not go down well with the total customer base, especially with long term and elderly customers, who often react emotionally to such changes. Banks must be prepared to lose some customers during such a transition. Irrespective of the difficulties, it is up to the banks to manage everything smoothly.

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Additional Readings:-

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- https://www.theguardian.com/commentisfree/2019/sep/02/the-guardian-view-on-good-business-profit-is-not-enough
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