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STRATEGISING FUTURE 'BANKS': HYPOTHETICAL MODEL

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The banking sector is going through a phase of consolidation and restructuring in India. 'Survival of the Fittest' has become a reality in the case of public sector commercial banks, with the opening up of new branches in all districts by new generation banks such as ICICI and HDFC and the Customer Relationship Management (CRM) practices implemented by private and foreign banks.

In the era of globalisation, banks will have to be competitive in order to face challenges and leverage opportunities. With the decision taken by RBI to implement Basel Committee Recommendations on Banking Supervision in 2007 (Basel - 2), commercial banks are required to follow prudential norms and maintain sound financial ratios like higher Capital Adequacy Ratio and Low Non-Performing Assets. Also, the declared results show that the profit from treasury operations have come down drastically in the case of most banks in India in 2004, As compared to 2003 and the trend is likely to continue. The real reason for this dent in treasury profit (the source of super-profits in earlier years) is the fall in gilt prices and the rise in interest rates. It is high time that Indian banks went global and grew globally and find out ways for increasing various sources of income.

In this context, the recently organized National Bankers' Conference (BanCon - 2004) of the Indian Banks Association, held in New Delhi, and hosted by Punjab

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National Bank, has called for reducing the number of Indian Banks by way of mergers and strategic alliances to create five or six big banks, which would be in a position to open more branches abroad and compete with multinational banks. Recently, Ministry of Finances with blessings from the Governments, has also permitted 4 full time directors in banks, if required, to accommodate all the existing Executive Directors in the new entity, after the merger. These steps taken by the authorities show that 'Small is No Longer Beautiful' in the Indian banking industry.

Although a merger of banks can be considered as a barrier to 'Perfect Competition', it makes the acquiring bank a more stronger organization that can face competition from aggressive multinational banks. A bank merger could happen due to two different reasons.

A) The lack of resources, both capital and labour, that are required for competing with big players, force the 'small' one to merge with the 'big' wig. There are about a dozen 'small' banks in the Indian banking sector, which do not have economies of scale.

B) A bank's Board of Directors can agree to a merger, if their shareholders get a better price in the form of SWAP Ratio (Eg: In the case of Bank of Madura (BoM)'s merger with ICICI Bank, BoM shareholders got 1:2 Swap Ratio, which means a BoM shareholder could exchange 1 BoM share for 2 shares of ICICI Bank, even though the market price of BoM was less than that of the ICICI Bank.)

Public sector banks such as the State Bank, Bank of India, Union Bank, Dena Bank, Canara Bank, etc. have some similarities in their policies and approaches. For example, they can be classified as 'traditional' banks, when we compare them to the banks like Citi Bank, ICICI and HDFC.

Having realized the fact that banking reforms are irreversible, public sector banks are drawing plans for the implementation of 'New Age' Strategies. But, there are some issues, which these banks are required to sort out immediately, in order to compete with other banks. These are:

a) They follow the salary structure of the Indian Banks Association, a government agency, while the new generation banks link their salary structure with performance-based incentives. There is no incentive for managers to work hard and produce results in public sector banks.

b) Employee trade unions are active in public sector banks, but are not there in new generation banks.

c) A majority of employees fall in the age group of 45-60, whereas most employees in New Generation banks, fall in the age group of 20-35. Since banking is a service industry, there is a need for 'youngsters' to serve customers based on the 'Customer Relationship Management' concept. Aged people find it difficult to change the work style they followed in the 1970s and 80s, when there was a 'near monopoly' of public sector banks.

d) Non-Performing Assets (NPA) of some public sector banks are higher than that of many private sector banks. NPA has to be brought down to the maximum possible lowest percentage, to enable banks to meet the requirements of Basel - 2 Committee.

When we do a Strength, Weakness, Opportunity and Threat (SWOT) Analysis of the public sector banks in India, in the context of globalisation, we will really feel the need for merging these banks with each other, in order to maintain the public sector identity and to avoid bank crisis in the long run. The problems and prospects of public sector banks and the rationale for merger are discussed below.

1. State Bank of India has its own inherent strength as the market leader and a with lot of public sector clients banking on it. However, SBI has also reported a dip in their treasury income in the second quarter of this fiscal, July - Sept 2004 (See Table 1). The diagrams based on treasury profit levels in the year 2004 in comparison to 2003 are drawn for 10 banks and given as Diagram 1 to Diagram 5.

Table 1: Half Yearly Treasury Profit of Selected Indian Banks (Rs. Crore)

Bank	Sept 2003	Sept 2003	% Change
Union Bank of India	272.00	298.86	9.88
State Bank of India	2659.81	1029.78	-61.28
Corporation Bank	176.36	76.63	-56.55
Syndicate Bank	251.00	220.00	-12.35
Canara Bank	755.67	343.46	-54.55
ICICI Bank	557.39	302.83	-45.67
Dhanalakshmi Bank	28.20	0.57	-97.98
Federal Bank	97.53	-47.13*	----
IDBI Bank	23.16	-11.63*	----
South Indian Bank	74.69	18.23	-75.59

*indicates loss amount

Source: Business Standard, Nov. 4, Issues & Insights, Page 8

Treasury Proft of Selected Indian Banks (April - Sep. 2003 and April - Sep. 2004)

Diagram 1: Union Bank of India & State Bank of India

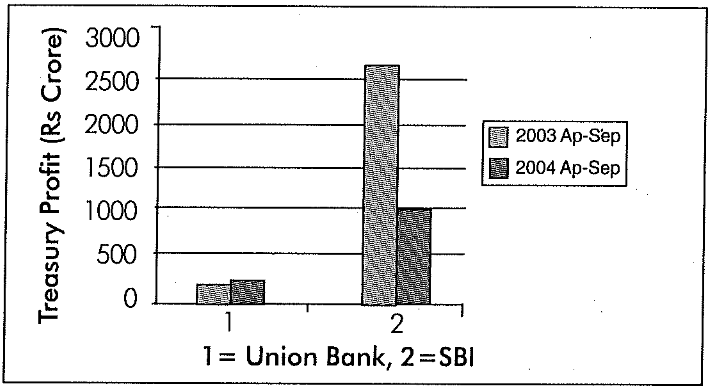


Diagram 2: Corporation Bank & Syndicate Bank

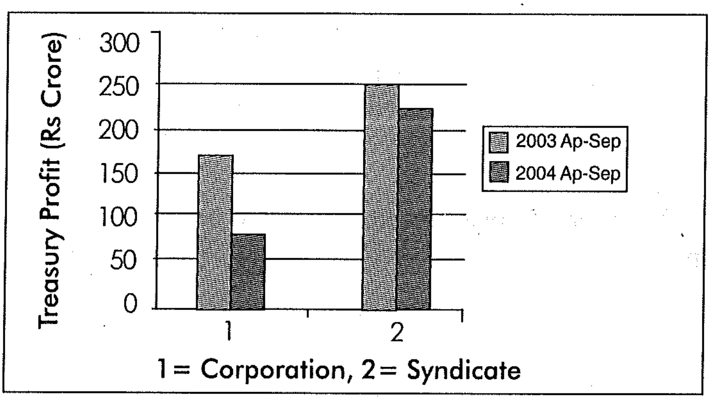


Diagram 3: Canara Bank & ICICI Bank

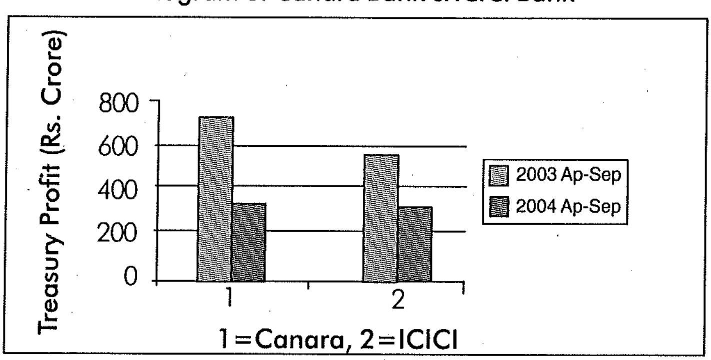


Diagram 4: Dhanalakshmi Bank & Federal Bank

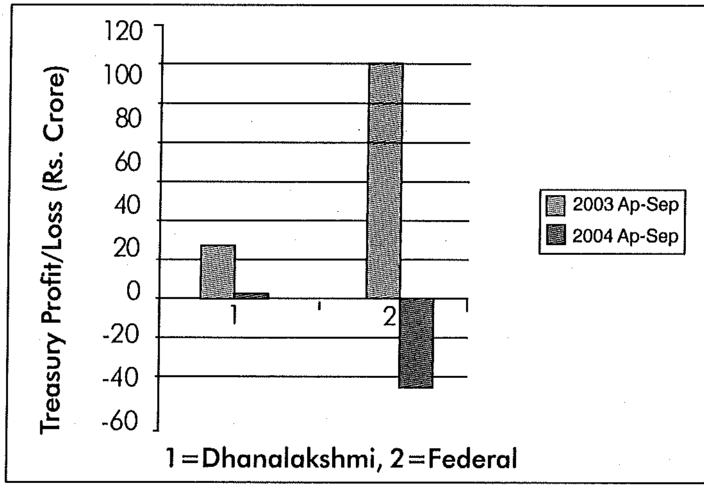
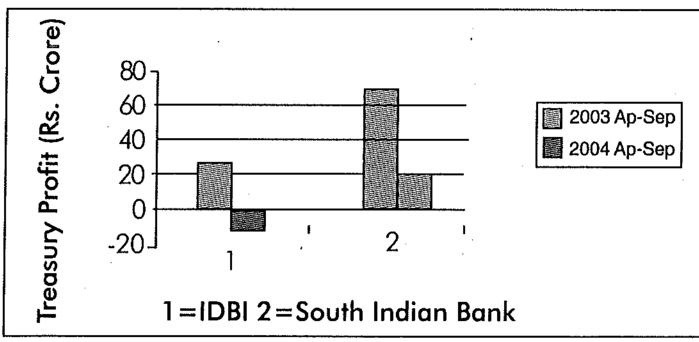


Diagram 5: IDBI Bank & South Indian Bank



2. Although most public sector banks have been maintaining around 35% to 40% of the net demand and time liabilities in Government securities (much above the requirement of 25% Statutory Liquidity Ratio), they have started investing more and more in equity and mutual fund markets to manage their assets and liabilities. But, some public sector banks lack the expertise and economies of scale in investment and international banking operations. As compared to multinational and new generation banks, which pay handsome salaries to professionals in these two strategic departments.

3. Public sector banks still follow a frequent transfer policy, which is a hindrance to individuals specializing in specific departments. On the other hand, private sector banks do permit employees to work in a branch or department for a long period, provided their performance is upto the mark.

4. Mergers between public sector banks is the need of the hour because they can explore more avenues for profit generation in the global market, if they have a presence in other countries, and economies of scale.

5. The Government is on the way to removing the restrictions put on foreign banks in terms of the number of branches they can open in a given year, as part of the implementation of the General Agreement on Trade in Services (GATS), of the World Trade Organisation. Once foreign banks start opening more branches, Indian banks will find it difficult to maintain their market share. Hence, it would be ideal for public sector banks to come out with possible mergers and strengthen its base.

6. Since the interest income has come down drastically, Indian banks will have to focus on a fee-based income in future, to survive and succeed in the era of globalisation. As a strategic merger can be considered as the best possible way for expansion and growth without a waiting period, the bank in the post-merger stage would become a significant player in the market. Therefore, mergers between Indian banks will help create better 'brand equity' and increase its reach geographically. This would also help them increase their fee- based income. They would become strong player in the Foreign Exchange market that is witnessing a surge in volume because of globalisation.

7. Having increased the percentage of stake a foreign institutional investor can acquire in Indian banks, the Government of India has given the green signal for possible acquisitions and mergers.

Considering all these aspects, if we have to make sure that public sector banks, are to be protected, there should be some permutations and combinations to be worked out. In short, they can succeed only in the short-run with a 'STAND ALONE' strategy, but it may not be possible for them to survive in the long run. A merger decision is to be taken after considering the strategic and financial factors into account in any case.

It is to be noted that more numbers of branches/ATMs of most Indian Banks, are located in home towns or nearby states from where the banks' origin dates back.

Strategically, it would be more fruitful, if a bank can take the initiative for a merger or acquisition of a bank that has a carger customer and geographical base in other parts of the country. It would be in the better interest of customers if region-based banks can merge and form 'big' banks. For example, if Hyderabad based Andhra bank and Mumbai based Bank of Baroda can join together and decide on a strategic merger, the customers of both the banks will get better access to more numbers of branches, ATMs, and other facilities under one roof. Similarly, it makes sense for the Syndicate Bank, which has got a strong branch network in South India, to think about a strategic merger with Oriental Bank of Commerce or Punjab National Bank that holds a good market share in North India. A hypothetical model for proposed bank mergers in India is given in Table 2.

Table 2: Hypothetical Model of Best Combination of Bank Mergers in India

Andhra Bank & Bank of Baroda
Dena Bank & Corporation Bank
Punjab National Bank & Vijaya Bank
Oriental Bank & Syndicate Bank
Canara Bank & Uco Bank
Bank of India & Union Bank of India
Central Bank of India & Indian Bank
State Bank of India & Subsidiaries

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