SBI – MERGER OF ASSOCIATES

The cabinet approved the merger of the subsidiaries--State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore-- and Bharatiya Mahila Bank Limited with SBI.

The approval does not come as a surprise given the government's stated intention of encouraging consolidation among state-owned banks (this came in the this year's union budget) even as it looks to address the issues of rising bad debts in the banking system and, at the same time, ensure efficient utilization of capital.

A finance ministry spokesperson confirmed the cabinet's decision though there was no mention of this in the official cabinet briefing.

The merger will see the combined entity's balance sheet at a whopping Rs 37 trillion, making it one of the top 50 banks in the world.

"The merger of SBI and its associate banks is a win-win for both. While the network of SBI would stand to increase, its reach would multiply. One can expect efficiencies to be created from rationalization of branches, common treasury pooling and proper deployment of a large skilled resource base," State Bank of India chairman Arundhati Bhattacharya said in a statement. "Currently, no Indian bank features in the top 50 banks of the world. With this merger, some visibility at global level is likely to increase," she said.

Shares of SBI and its subsidiaries zoomed after the cabinet's decision. SBI's shares were up 3.9% at Rs 215.65 apiece at close of trade on Tuesday. State bank of Bikaner and Jaipur shares rose 19.9% to Rs 599.6 each, State Bank of Mysore's stock was up 20% at Rs 547.9 and State Bank of Travancore shares rose 19.9% to Rs 478.9 each.

In an interview last week, Bhattacharya said that the bank would try to complete the merger as quickly as possible.

"The swap ratios should come soon and we should be able to make progress this year," she said.

The merger of SBI's subsidiaries is the first and probably the easiest phase in the government's consolidation process. Going ahead, the government will be faced with the daunting task of finding the right matches between banks to ensure a smooth merger. The government has indicated that the consolidation process will be guided by the aim of making the combined entity stronger and more competitive.

SBI had seven associates, of which it has merged two—State Bank of Saurashtra and State Bank of Indore—with itself over the last 10 years. The parent bank, had advances of Rs.15.09 trillion and deposits of Rs.17.31 trillion as of the end of the March quarter.

"Branch rationalization, if executed well, would be one of the key synergy benefits from the merger. Cost savings on account of treasury operations, audit, technology, etc would lower cost-to-income ratio in the long term.Immediate negative impact would be from pension liability provisions (due to different employee benefit structures) and harmonization of accounting policies for NPA recognition," said Alpesh Mehta, deputy head of research , institutional equities, Motilal Oswal Securities Ltd.

According to Mehta the biggest challenge in the merger will be integrating over 70,000 employees from the associate banks.

Bank consolidation was proposed by the government in March at a congregation of bankers and government officials where various issues pertaining to banks were discussed. Jaitley had said that all bankers supported the idea of consolidation among state-owned banks and that the country needed a handful of large banks instead of a large number of small banks.

What has strengthened the case for such mergers at this stage is the need to infuse capital in state-owned banks that are burdened by a large pile of non-performing assets (NPAs)—the result of imprudent borrowing and lending practices and an economic downturn that made it difficult for many over-extended corporate borrowers to repay debt.

The Reserve Bank of India (RBI) carried out an asset quality review in 2015-16 and pushed banks to classify visibly stressed assets as NPAs. As a result of the review, bad loans of the 40 listed banks surged to Rs.5.8 trillion.

Bankers have indicated that there may still be stressed accounts in the system which could slip into the bad loan category in coming quarters.

The surge in bad loans has meant that banks have had to set aside a lot more capital as provisions against these loans, leaving a number of lenders under-capitalized.

Public sector banks will see their capital ratios deteriorate as provisions increase due to prolonged asset quality pressures, global ratings agency Moody's Investor Service said in a note last week.

“We expect the capitalisation profile of the PSBs (public sector banks) to further deteriorate, unless the government provides additional capital support,” the agency said. Moody’s estimates that 11 banks will need capital of Rs.1.2 trillion by 2020.