Alternative Mechanism for Mergers

Why in news?

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The union Cabinet, recently, approved a framework to speed up mergers of public sector banks.

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How does it work?

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- The framework will address mergers of state-owned banks, planned privatisation in state-owned companies, minority stake sales, and the Centre’s new exchange traded fund.
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- Under this, the Cabinet approved an “alternative mechanism” by which an inter-ministerial panel will be set up to supervise merger proposals.
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- Under this, any proposal to amalgamate banks must be initiated by the boards of state-owned lenders.
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- After getting in-principle approval, the banks will take steps in accordance with the law and SEBI requirements.
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- The final scheme of amalgamation will be notified by the Central government in consultation with the Reserve Bank of India.
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- It also emphasizes that a merger must be based purely on commercial considerations.
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What created the need for this?

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- Gross bad loan ratio of PSU banks are already close to 10 per cent.

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- The RBI’s latest Financial Stability Report shows that this could be as high as 14.2 per cent by March 2018 if there is no economic rebound.
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- Also, the credit rating agency, Moody’s has cautioned that the government would require huge sums if capitalisation of banks are the only option.
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- Additionally, the twin balance-sheet problem of over-leveraged corporate balance-sheets and banks weighed down by bad loans is a cause of concern.
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- The Alternative Mechanism is seen as an attempt to avoid the options of infusing capital for banks or divesting some of these weak banks.
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What lies before the government?

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- The mechanism aims at creating strong and competitive banks that can absorb shocks and have the capacity to raise resources.
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- Through consolidations, public sector banks will benefit from operational and functional synergies, resulting in better efficiencies.
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- However, though significant, mergers of state-owned banks are not the whole solution.
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- Over and above this, the balance-sheets must be strengthened and governance issues with banking must be addressed.
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- Government should also take note of the experiences of the past mergers especially the recent SBI and its associates' merger.
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Source: Indian Express

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