Banking Sector Consolidation

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The trends

The recent spurt in banking sector consolidation worldwide was kicked off in late 1997, in Europe, by the move to merge two of Europe's largest banks, United Bank of Switzerland and Swiss Bank Corp.

In the United States, the Citicorp - Travelers Group deal in early 1998 was quickly followed by deals between BankAmerica Corp. and NationsBank Corp., and between BancOne Corp. and First Chicago NBD Corp. Later that year, German banking major, Deutsche Bank decided to takeover Bankers' Trust.

In Japan in 1999, Industrial Bank of Japan, Dai-Ichi Kangyo Bank and Fuji Bank proposed to forge a new alliance, Mizuho Financial Group, which will be the world's biggest financial group with assets of $1.3trillion. Sumitomo Bank and Sakura Bank plan a merger that would create the world's second biggest banking group with assets of over $900billion. Current leader, Deutsche Bank has assets over $700billion.

Europe too witnessed hectic merger activity last year. In France, the agreed merger between Societe Generale Bank and Paribas was upset by a hostile takeover of the latter by Bank Nationale de Paris. Recently ING, the Dutch banking and insurance group, offered to buy the entire share capital of Credit Commercial de France, only to withdraw its offer later. NatWest in the United Kingdom has received hostile bids from Bank of Scotland and Royal Bank of Scotland.

Back home in India, HDFC Bank has taken steps to takeover Times Bank. Speculations on Centurion Bank being taken over by ICICI Bank refuse to die down. A merger of the seven associates of State Bank of India with the parent bank too is being considered.

The contributing factors

The factors driving the international consolidation trend are as follows -

1) Globalisation outside the banking sector

- Mergers and acquisitions in other industries / sectors of the economy have spurted. Banking is a critical lifeline for business. In order to retain increasingly globalised client relationships, the banking sector too has to replicate the new economic structure.
- Clients travelling across geographical zones and expecting the same banking service need to be served any place any time - through branches or correspondent relationships.

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2) Economies of scale This manifests itself in several ways:

- "Brick and mortar" banks have a higher incidence of fixed costs. Higher volumes would boost earnings growth.
- "Click" banks need to operate beyond geographical boundaries on account of higher set-up costs and service expectations of clients.
- Big participant benefit helps large banks close better deals in the financial markets.
- Higher size of assets / liabilities tend to be inherently diversified and thus minimise risks.

3) From products to relationships

There is a perceptible change in banking philosophy from pushing products to retaining relationships. They need to offer wider range of service to expand the relationship. This makes it imperative to acquire or have strategic alliances with organisations that offer complementary products and services or possess different strengths.

4) Search for inter-sector synergy

The push to "bancassurance", seen in the Citibank-Travelers Group deal and the failed bid by NatWest for Legal and General group; the attempt to combine commercial banking and investment banking, seen in the deals that brought together Deutsche Bank, Morgan Grenfell, Bankers Trust and BT Alex Brown are typical examples.

5) Blurring industry boundaries - an emerging trend

Wal-Mart, the world's largest retailer is seeking to establish a banking network to complement the retail reach that it already possesses. Net companies outside the existing banking framework have been trying to offer quasi banking services through the net. Soft Bank of Japan started operations with no physical facilities. Thus, the banking landscape is going through a transformation.

6) New technology paradigm

Advances in technology have made it possible to stretch comfortably and effectively the reach across time-zones and the relationship across products and services. Further, there is an increase in both the critical mass and the level at which diseconomies set in. All this has created a totally new technology paradigm that banks seek to exploit through consolidation.

Challenge for the Indian banking sector

Indian banks have a long way to go before they reach the size of their international counterparts. Even the biggest Indian bank, State Bank of India, is nowhere on the international scale, with assets in the range of $50billion. Absence of significant scale benefits and higher implicit costs of several services are perpetuating the poor ranking of Indian banks in the international league tables.

Shareholding structure, government regulations and sheer size of the country ensure that the existence of Indian banks is not at stake at this stage. What is at stake is the banking support that is available for Indian economic activity, and thereby the international competitiveness of various sectors. What is also at stake is the scope for the banking industry to earn superior returns through differentiated wider services.

Further, it is quite conceivable that with passage of time, as government holding in banks is progressively divested, regulatory authorities will be unable to hold back the international giants from buying out Indian banks. Even economies with a "domestic mindset", such as France and Germany, have been forced to bow before the international capital market forces.

It would be a shame if painstakingly built retail strength is offered on a platter to some predator. The challenge can be met through some concerted action -

1) Government

   The Government needs to do away with artificial fragmentation of the financial sector. A case in point is the segregation of banks and financial institutions induced by policy. If this is changed, we may well see mergers between the two sectors to create organisations of size. Why not a merger of Industrial Development Bank of India with Bank of Baroda, or even better with State Bank of India? This would definitely lead to a merger between ICICI and ICICI Bank and for that matter between HDFC and HDFC Bank. The possibilities are interesting and numerous.

2) Domestic Banks

   Domestic Banks - private as well as public - need to continuously explore options to acquire or merge with other institutions to enhance their size, service or skill-set. This could also mean looking beyond the national boundaries as truly global corporations do.

3) New Initiatives

   The recent crisis in the far-East has demonstrated the need for a robust banking sector. Therefore the whole structure of Regional Rural Banks (RRBs) and Urban Co-operative Banks (UCBs) needs to be strengthened.

   The focus that FMCG companies such as Hindustan Lever have given to the rural sector proves that private sector interest is not limited to the cities and major towns. Technological changes (such as wireless communication, net etc.) have drastically changed the communications scenario.

   This may be the time to come out with interesting initiatives with regard to structure of RRBs and UCBs so that private sector organisations - banks as well as non-banks - play a greater role in meeting the needs and aspirations of hitherto neglected parts of the country.

4) Social considerations

   The full benefit of mergers can only be realised if they are followed up with some hard measures such as re-location / closure of branches, rationalisation of employee strength etc. It would be a welcome change if the management and unions collaborate in seeking appropriate social security from the Government - financed out of the divestment of stake in these banks.

Indian banking has to operate with a global mindset even while fulfilling local banking requirements. By joining in the effort to make this happen, we will get the banking service we need. Else, we will deserve the banking service we get.