International Journal of Research in Economics and Social Sciences (IJRESS)
Available online at http://euroasiapub.org/journals.php
Vol. 6 Issue 7, July 2016,
ISSN(O): 2249-7382, | Impact Factor: 6.225 | Thomson Reuters ID: L-5236-2015

Total Productivity and Cost Efficiency Dynamic of Indian Public Sector Merging Banks

CA Santoshkumar Madanmohan Ojha, Associate Professor, Vikas College of Arts, Science and Commerce College, Vikhroli, Mumbai, Maharashtra, E Mail- casantoshojha@gmail.com

Abstract

This paper examines the trends of cost efficiency in Indian public sector merged banks, as well as the convergence of their technical and allocation efficiencies. Results of the study indicate that merging banks over the study period had a positive impact on the cost efficiency levels of public sector banks in India. Also, the technical efficiency of the Indian public sector banking industry has been on the rise, while allocation efficiency has been on the decline. The Indian public sector banking industry shows an inefficient allocation of resources due primarily to technical inefficiencies, not to allocative inefficiencies. The convergence analysis shows that inefficient PSBs are not just catching-up, but are also moving ahead of the efficient ones. Thus, the less cost-efficient banks are growing more rapidly than the more efficient ones.

Keywords: Total Productivity, Cost Efficiency, Indian Public Sector Banks, Merger, Financial Inclusion.

Introduction

Public sector banks (PSBs) have proven to be more efficient than their private-sector counterparts, reflecting slower employment growth as well as cutting spending through innovative methods. Efficient banks can compete better due to lower operating costs. Efficient banks can compete better because of their marginal operating costs. On the client-side, only efficient banks can offer better services at reasonable operating costs, and only then can the regulator achieve the goal of financial inclusion (Burgess & Pande, 2005)**.**

It is better to launch products from a leaner base, and if the bank is looking for a buyer, the lower cost will also help boost the valuation. In addition, costs (especially the cost of complexity) may increase as the group seeks to increase revenue through product introductions. The cost-to-scale estimate assumes that state-owned banks are operating well above their effective scale and that savings can be achieved by reducing the volume of transactions(Burgess & Pande, 2005).

The shift from physical to digital operations, coupled with increased productivity per employee, implies improvements in the labour cost efficiency (LCE) of Indian banks. The data coverage analysis (DEA) results for the period 2005-2015 presented in this article show that the LCE has not improved. Therefore, it is difficult to substantiate the claim that the efficiency and productivity of public sector banks were lower than their counterparts in the private sector.

Empirical results do not provide conclusive evidence that less productive banks are targeted for merging.

Objectives of the study

The article examines the impact of Indian Public Sector Merging Banks on the performance of the Indian banking sector. It also provides insight into the total productivity and cost efficiency dynamic of the Indian public sector merging banks.

Research methodology

The current study is based on a secondary source of information, the researcher collected different information from different published data from different academic journals and reports. After reviewing different available literature, the author presented a systematic view on the total productivity and cost efficiency dynamic of Indian public sector merging banks.

Literature Review

Bank mergers were first introduced in India in the early 1990s when the government decided to merge several banks. Later, in order to improve the efficiency of the banking system, further mergers and consolidation of small banks were undertaken to reduce costs and expand financial services(Paradi& Zhu, 2013).

Mergers and acquisitions in the banking sector have been on the rise in recent years. This is because mergers and acquisitions offer several benefits to both the acquiring and acquired banks.

For instance, they help banks to: Increase their scale of operations, thereby reducing the cost per unit of output. Access new markets and gain economies of scale(Burki& Ahmad, 2010).

Enhance efficiency by reducing duplication in operations and increasing the pool of skilled manpower. Banks may merge to increase their size and thus improve their financial strength. In some cases, banks merge because they are having financial difficulties. Banks may merge to increase their size and thus improve their financial strength(Malhotra & Singh, 2009).

There are several reasons why banks merge or acquire other banks.The most common reason is to expand their market share and/or geographic reach. A bank may want to acquire another bank to enter a new market or gain access to new customers(Reddy, 2005).

In some cases, banks merge because they are having financial difficulties. Banks may merge to increase their size and thus improve their financial strength. In some cases, banks may merge because they are having financial difficulties(Ray & Das, 2010)

India's banking sector is undergoing a major transformation. The number of banks in India has increased from the original 16 to 27. The Reserve Bank of India (RBI) recently permitted banks to merge and increase their capital base. In order to improve the efficiency of the banking system and reduce costs, mergers are being encouraged. With more banks and greater capitalization, banks will be able to expand their business by opening new branches in more locations. This will allow the banks to expand their reach and attract more customers. Banks will also be able to lend more money, which in turn will boost economic growth(Fethi&Pasiouras, 2010).

This is because more capital means that banks can lend out more money, and the higher the level of bank lending, the more money is in circulation.In order to incentivize mergers in public banks, RBI allowed the State Bank of India (SBI), the country's largest lender, to merge with its five subsidiary banks in 2017. Since then, many more such mergers have taken place between various lenders. Under this scheme, the largest merger was between two state-owned banks, the State Bank of India and the Punjab National Bank in 2008(Misra& Puri, 2011). The merger created a banking behemoth with an asset size of $450 billion. It was also the largest banking merger in history then.RBI also announced a merger between the State Bank of India and its five subsidiary banks. This move was expected to help SBI become a global-sized bank with an asset size of $500 billion. The merger is expected to create synergies of Rs.1,000 crore annually for the combined entity(Jaffry et al., 2007).

After the merger, SBI will have a total customer base of 37 crores with over 24,000 branches and 58,000 ATMs across India. The merged entity will have a business of Rs. 37 lakh crore with deposits of Rs. 26 lakh crore and advances of Rs. 18.50 lakh crore, making it the largest bank in India by assets(Kumbhakar & Sarkar, 2003).

Mukherjee et al. (2002) investigates the total productivity, cost efficiency and its dynamic performance study of Indian Public sector merging banks. The study takes a sample of 10 merging banks namely Punjab National Bank (PNB), Andhra Bank, Corporation Bank, Canara Bank, IDBI Bank Limited, Central Bank Of India, Dena Bank (formerly Deccan Grameen Bank) and United Bank Of India etc.

Lately, there have been a lot of mergers in the banking sector to create public banks. But is it worth it? After looking at the situation in Sweden and Germany, I believe that creating public banks isn't worth it, even if that means that the government has to subsidize them. Banks should not be created just because they are "public." They should be created because they will do what is best for their customers and shareholders(Zhao et al., 2010).

The merger of the banks has helped in reducing operational costs, improving efficiency and better utilization of human resources

Total Productivity and Cost Efficiency Dynamic of Indian Public Sector Merging Banks

India has one of the world's most dynamic economies, but it also has a woefully inefficient banking sector. It is also one of the most diverse. The number of banks in India has grown from a handful to more than 140 since the country's economic liberalization in 1991. The system is dominated by state-owned banks, which account for more than 70% of the assets. But foreign banks have also made inroads, and now control about 10% of the market.

India has always been the land of surprises when it comes to the economy. In the last couple of years, India has seen several mergers and acquisitions happening in different sectors like Banking, Finance and Accommodation, amongst others. The government is planning to consolidate many public sector banks into fewer ones. The newly proposed banking system is expected to bring about changes in the Indian banking scenario as well as change the way customers perceive their banks by increasing the trust factor. As per the data released by the Reserve Bank of India, there are 27 public sector banks in India, which have a deposit base of Rs.21,11,000 crore and advances of Rs.18,45,000 crore. Out of these 27 banks, four have more than 40% share of total deposits and advances. The Indian government has proposed to merge all the PSBs with less than 40% market share into larger ones for better management and monitoring. The merger is expected to bring about many changes like better employee productivity, increased customer satisfaction and enhanced governance standards across the banking system in India.

The latest proposal is part of a broader plan to consolidate the banking sector. The government has already merged several banks, and there are plans to merge some more. But it will be hard to get state-owned banks to go along with this latest plan.

The government is also trying to deal with the problem of non-performing loans.The banks have been slow to deal with this problem, and the government is now taking action.It has ordered the banks to set aside more money to cover bad loans.

It is found that the banking sector in India has shown higher levels of total factor productivity in the post-merger period, driven by technological advances. Paradoxically, performance per employee in the banking system in terms of deposits, loans and advances, investments and interest income increased over this period, suggesting improved efficiency in labour costs in the banking system.

Overall, only 4 nationalized banks experienced a production shift, while 7 of these banks experienced an increase in technical efficiency. On average, Indian public and private banks experienced negative growth in TFP, purchased solely due to the downward movement of the border. Banks in developed markets improved productivity and managed risk costs, resulting in an increase in ROTE from 6.8% to 8.9%.

Between 2012 and 2015, the average continuous return on technology performance (CRSTE) score of public sector banks in India was 0.836 and that of private sector banks was 0.912. This shows that the operational efficiency level of foreign banks in India is 92.53%, while the operational efficiency levels of public and private sector banks are 90.20 and 86.04%, respectively. We recognize that most PSBs (67%) operate at average efficiency levels. This may be due to the low base of their various banks.

Until 2015, when QRA was first launched, there was a huge difference in the performance of public sector banks, and as a result, almost all public sector banks had to deal with excess non-performing assets. We find significant and negative effects of relative size on performance indicators, which is consistent with existing literature (Galán et al., 2015)**.**

In terms of the impact of non-discretionary variables on performance, even when comparing studies that analyzed banks with similar functions, the results remain mixed. In the current Indian banking market, when 10 IDBs merge, PVB (Yes Bank) is rebuilt and further FRBs cannot grow their business, this study examined the technical performance (TE) together of CBO, PVB and FRB, so a comparison can also be made between these three banking groups. A comparison of technical performance metrics based on three different results revealed the degree of technical inefficiency in the banking sector, indicating that a bank's performance, be it an investment, interest income, or advances, can be enhanced by eliminating the drivers of inefficiency.

Conclusion

We can conclude that merging banks in India is the best way to improve the productivity and cost-efficiency of the banking industry. Due to the increased global competition in the current financial environment, there is a need for Indian banks to focus on cost efficiency and productivity improvement. The Indian banking industry is still far behind in terms of efficiency and productivity when compared to the developed countries. Therefore, it is necessary to merge the banks in India.

The merger of banks will result in a more efficient and productive banking system. It will also help the banks to meet the challenges of globalisation. Mergers of weak banks with strong ones will strengthen the financial sector in India.

Thus, the aforementioned findings suggest that the banking reforms process so far has been successful in improving the efficiency of public sector banks in India to a great extent. There is no doubt that the deregulation process has improved the efficiency of a majority of PSBs. There are several factors, including enhanced price and non-price competition among banks, rationalizing the labour force, increasing exposure to off-balance sheet activities, applying information and communication technology, and better recovery of nonperforming loans, that contributed to the observed efficiency gains. Empirical findings reveal that public sector banking in India performs poorly in terms of efficiency. The deterioration of cost efficiency in these banks is a major concern for policymakers, requiring the creation of adequate strategies to prevent further declines in inefficiency. Overall, this study indicates that competitive practices and technology in the Indian banking industry have played a key role in improving cost efficiency and enabling PSBs to meet their efficiency goals during the post-reform period. The 1992 banking changes appear to have given a significant economic incentive for bankers to structure inputs in a way that minimises waste as well as expenses. In conclusion, the banking reforms practise in India has achieved the desired results to a great extent and thus provide a positive story that other emerging nations enduring banking reforms can emulate, not only because an increase in the cost-effectiveness of PSBs has been witnessed in the majority of PSBs. In the light of empirical findings, future reforms in the banking sector should be directed towards strengthening competitive and market-oriented policies.

Reference

Burgess, R., & Pande, R. (2005). Do rural banks matter? Evidence from the Indian social banking experiment. *American Economic Review*, *95*(3), 780–795.

Burki, A. A., & Ahmad, S. (2010). Bank governance changes in Pakistan: Is there a performance effect? *Journal of Economics and Business*, *62*(2), 129–146.

Fethi, M. D., &Pasiouras, F. (2010). Assessing bank efficiency and performance with operational research and artificial intelligence techniques: A survey. *European Journal of Operational Research*, *204*(2), 189–198.

Galán, J. E., Veiga, H., & Wiper, M. P. (2015). Dynamic effects in inefficiency: Evidence from the Colombian banking sector. *European Journal of Operational Research*, *240*(2), 562–571.

Jaffry, S., Ghulam, Y., Pascoe, S., & Cox, J. (2007). Regulatory changes and productivity of the banking sector in the Indian sub-continent. *Journal of Asian Economics*, *18*(3), 415–438.

Kumbhakar, S. C., & Sarkar, S. (2003). Deregulation, ownership, and productivity growth in the banking industry: evidence from India. *Journal of Money, Credit and Banking*, 403–424.

Malhotra, P., & Singh, B. (2009). The impact of internet banking on bank performance and risk: The Indian experience. *Eurasian Journal of Business and Economics*, *2*(4), 43–62.

Misra, S. K., & Puri, V. K. (2011). *Indian economy*. Himalaya Publishing House.

Mukherjee, A., Nath, P., & Pal, M. N. (2002). Performance benchmarking and strategic homogeneity of Indian banks. *International Journal of Bank Marketing*.

Paradi, J. C., & Zhu, H. (2013). A survey on bank branch efficiency and performance research with data envelopment analysis. *Omega*, *41*(1), 61–79.

Ray, S. C., & Das, A. (2010). Distribution of cost and profit efficiency: Evidence from Indian banking. *European Journal of Operational Research*, *201*(1), 297–307.

Reddy, A. (2005). Banking sector deregulation and productivity change the decomposition of Indian banks. *Finance India*, *19*(3), 983–1001.

Zhao, T., Casu, B., & Ferrari, A. (2010). The impact of regulatory reforms on cost structure, ownership and competition in Indian banking. *Journal of Banking & Finance*, *34*(1), 246–254.