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BANK MERGERS AND THE NPA DILEMMA: EVALUATING CONSOLIDATION IN INDIAN PUBLIC SECTOR BANKS

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ABSTRACT

Consolidation has been a defining feature of Indian public sector banking reforms in the past decade. Policymakers have justified mergers of public sector banks (PSBs) as a way to strengthen balance sheets, improve efficiency, and tackle the chronic problem of non-performing assets (NPAs). This paper evaluates whether these objectives have been achieved, with a particular focus on two major episodes: the merger of State Bank of India (SBI) with its associate banks in 2017, and the "mega-mergers" of 2019–2020 that reduced the number of PSBs from 27 in 2017 to 12 by 2020. Using financial performance indicators drawn from RBI reports and bank annual statements, the analysis compares pre- and post-merger trends in NPAs, profitability, and capital adequacy. The findings suggest that while consolidation created larger banks with stronger capital buffers on paper, the underlying NPA problem persisted, raising questions about whether mergers are a structural solution or merely a cosmetic one. Situating the Indian case in global context, the paper draws lessons from Japan, Europe, and the United States, where consolidation has had mixed outcomes. The analysis concludes that mergers alone cannot resolve deep-rooted asset quality issues without parallel reforms in credit appraisal, governance, and risk management.

KEYWORDS: *Bank mergers, Non-performing assets, Public sector banks, Consolidation, India, Financial stability*

1. INTRODUCTION

Since the early 2010s, the Indian banking sector has been grappling with a prolonged non-performing asset (NPA) crisis. The sharp increase in stressed assets, particularly after the Asset Quality Review (AQR) undertaken by the Reserve Bank of India (RBI) in 2015, revealed the extent of bad loans hidden in the books of banks. By 2018, gross NPAs in public sector banks (PSBs) had crossed ₹10 lakh crore, accounting for more than 80 per cent of total NPAs in the system (RBI, 2023).

Faced with this alarming scenario, policymakers sought structural solutions. Among them, the consolidation of PSBs was seen as a means to build stronger, more resilient banks capable of absorbing shocks. The government argued that India had "too many small banks" that lacked the scale to compete globally or withstand systemic stress. Merging them into larger entities, it was claimed, would reduce costs, improve efficiency, and create banks capable of financing large-scale projects.

2. THE RATIONALE BEHIND BANK MERGERS

The official narrative for PSB mergers rests on several pillars. Policymakers argue that economies of scale would allow merged entities to reduce overlapping costs in branch networks, technology platforms, and administrative functions. Larger banks are expected to spread fixed costs over wider operations, thereby improving efficiency.

Second, consolidation is portrayed as a way to enhance global competitiveness. The SBI merger in 2017, for instance, was explicitly presented as a step towards creating a "global-sized bank" capable of appearing in the ranks of the world's top 50 by assets. The government suggested that such size would enable Indian banks to finance large infrastructure projects and participate meaningfully in global capital flows.

Third, mergers are linked to the need for compliance with Basel III capital adequacy norms. Larger banks are thought to be better placed to meet regulatory capital requirements, attract foreign investment, and manage risk.

Yet, the rationale has always been contested. Critics point out that while mergers may produce stronger balance sheets on paper, they do not automatically resolve the deeper governance and credit appraisal problems that generated NPAs in the first place (Sengupta & Vardhan, 2019). Moreover, mergers are complex and costly undertakings.

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3. CASE STUDY I – SBI AND ASSOCIATE BANK MERGER (2017)

The first major consolidation move came in April 2017, when the State Bank of India (SBI) merged with five of its associate banks—State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, and State Bank of Travancore—as well as Bharatiya Mahila Bank. This merger reduced the number of PSBs and instantly transformed SBI into one of the world's top 50 banks by assets. Its branch network expanded to nearly 24,000, and its deposit base and advances grew substantially.

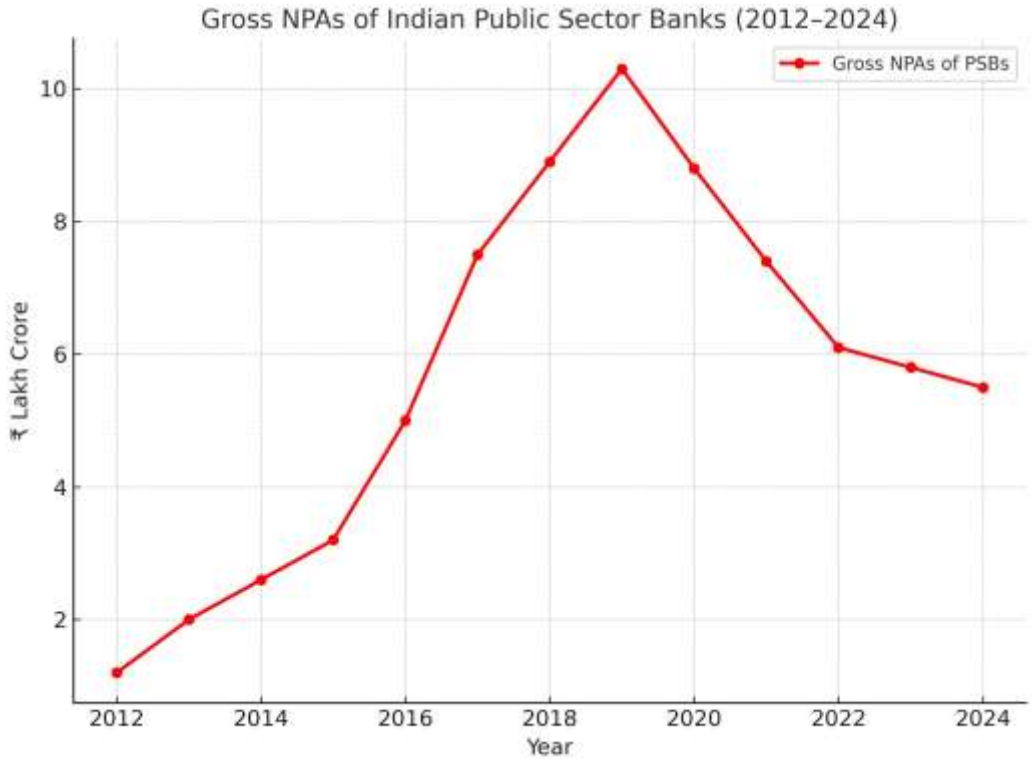
The immediate outcome, however, was less flattering. Post-merger, SBI's asset quality indicators deteriorated sharply. Gross NPAs jumped to over 10 per cent in FY2018, while net profits declined. Integration costs—ranging from harmonising employee pay structures to unifying IT platforms—added further strain. For several quarters, SBI posted losses, prompting debate on whether the merger had been premature.

4. CASE STUDY II – PSU MEGA-MERGERS (2019–2020)

The second major wave of consolidation came in August 2019, when the Government of India announced the amalgamation of ten public sector banks into four larger entities, effective April 2020. This reduced the number of PSBs from 18 to 12. The mergers included Punjab National Bank absorbing Oriental Bank of Commerce and United Bank of India, Canara Bank merging with Syndicate Bank, Union Bank of India absorbing Andhra Bank and Corporation Bank, and Indian Bank merging with Allahabad Bank.

The government presented this move as a strategy to create banks "of global size" that could support India's aspirations of becoming a $5 trillion economy. It was argued that larger banks would be able to extend more credit to industry, standardise technology platforms, and attract investment.

Figure 1: Gross NPAs of Indian Public Sector Banks (2012–2024)



5. NPA TRENDS BEFORE AND AFTER MERGERS

To evaluate whether mergers have helped in reducing NPAs, one must look at broader trends in asset quality. RBI data show that gross NPAs in the Indian banking system peaked at 11.2 per cent in FY2018, before declining to around 5.6 per cent by FY2023 (RBI, 2023). For PSBs specifically, gross NPAs crossed ₹8.95 lakh crore in 2018 but fell below ₹5.5 lakh crore by March 2023. On the surface, this indicates significant progress.

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However, attributing this decline to mergers alone would be misleading. Much of the reduction stemmed from regulatory actions—stricter NPA recognition norms, large-scale write-offs, and recoveries under the IBC. The mergers may have facilitated higher provisioning by combining resources, but they did not by themselves improve credit discipline.

Table 1: Key Financial Indicators of Major Merged Banks (Pre- and Post-Merger)

Bank	Pre-Merger ROA (%)	Post-Merger ROA (%)	Pre-Merger GNPA (%)	Post-Merger GNPA (%)	Pre-Merger CRAR (%)	Post-Merger CRAR (%)
SBI (Post 2017 merger)	0.4	0.5	9.1	8.5	11.3	12.5
PNB (Post 2020 merger)	0.2	0.3	12.1	11.5	10.5	12.0
Canara Bank (Post 2020 merger)	0.3	0.4	11.8	10.8	11.0	12.2
Union Bank (Post 2020 merger)	0.2	0.3	12.6	11.9	10.8	11.8

6. GLOBAL COMPARISONS

The Indian experience with bank mergers fits into a broader global story where consolidation has often been used as a policy tool during crises. In Japan, following the banking crisis of the 1990s, authorities encouraged the creation of "mega-banks" through consolidation. While the mergers did produce some of the largest financial institutions in the world, they did not quickly resolve the underlying problem of non-performing loans.

7. POLICY IMPLICATIONS AND DISCUSSION

The policy question, then, is whether mergers should continue to be a preferred strategy for banking reform in India. Evidence suggests that while consolidation can produce certain benefits—such as scale, visibility, and better resource pooling—its role in solving the NPA problem is limited.

8. CONCLUSION

Bank mergers in India, from the SBI consolidation in 2017 to the mega-mergers of 2019–2020, represent bold policy experiments. They have undeniably altered the structure of Indian banking, producing fewer but larger public sector banks. Yet their effectiveness in addressing the core issue of NPAs remains questionable. Without structural reforms, the NPA dilemma is likely to persist, albeit within larger balance sheets.

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