

45
Years of
Leadership



the **BIG**
Bank Theory

A stylized atomic symbol consisting of three black dots (representing electrons) and three intersecting black elliptical orbits, positioned over the letter 'I' in the word 'BIG'.

- Valuation
- Investment Banking
- Advisory Services

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RBSA – Research Initiative
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Preface

Banking system acts as a catalyst in economic growth of a country. For a country like India, which aspires to become a growth engine of the world, need of developed and well managed banking system is inevitable. Banking system accelerates capital formation, mobilizes saving, finances commercial activities and also helps country to implement monetary policy. Indian government is extensively looking at financial inclusion as an effective tool in bringing millions of its citizen out of poverty.

Today, India is at a sweet spot and this does not come so often. We are probably at a stage where USA was in early forties (period of baby boomers) and China was in late seventies (period of economic liberation). Indian Economy has all the ingredients like favorable commodity prices, lowering inflation, growth oriented monetary policies and better fiscal discipline to become a formidable force in global economy

But there is a dent in this shining Indian growth story in the form of mounting stressed loans and mismanagement in the banking system. We have seen the failure of financial system in 2008 and its massive impact on global economy. India at this juncture cannot afford an ailing banking system.

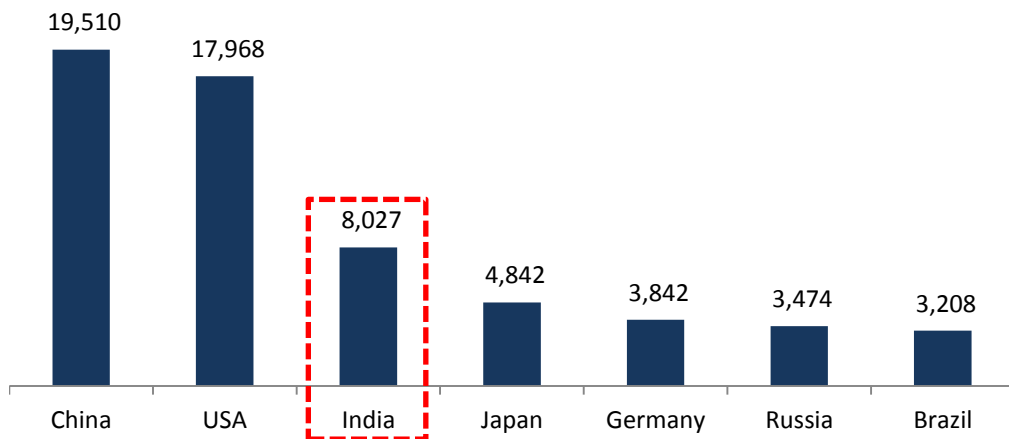
The Government of India in various forums has indicated its desire to use consolidation of PSU Banks as one of the tools to curtail the downfall of Indian Banking System. The process accelerated when Government set up Bank Board Bureau last year. Bank Board Bureau is an autonomous advisory body to recommend names for appointment of directors in public sector banks and advice on ways to raise capital, merger and acquisition etc. With the recommendation from Bank Board Bureau, SBI is expected to complete its merge process with its associate Banks and Bhartiya Mahila Bank by next financial year. Consolidation is a long drawn and cumbersome process but has an ability to transform the way we do Banking.

Need for Big Bank



No Indian Bank among Top 50

GDP in Purchasing Power Parity (US\$ in Bn)



- India ranks 3rd in terms of Gross Domestic Production in 2015 after China and USA.

Largest Banks in the World

Rank	Bank name	Country	Total assets (US\$ in Bn)
1	Industrial and Commercial Bank of China	China	3,420.6
2	China Construction Bank Corporation	China	2,826.0
3	Agricultural Bank of China	China	2,740.1
4	Bank of China	China	2,589.8
5	Mitsubishi UFJ Financial Group	Japan	2,458.7
6	HSBC Holdings	UK	2,409.7
7	JPMorgan Chase & Co.	USA	2,351.7
8	BNP Paribas	France	2,166.0
9	Bank of America	USA	2,144.3
10	Crédit Agricole Group	France	1,845.2
11	Deutsche Bank	Germany	1,769.5

- The Indian Banking system consists of 26 public sector banks, 25 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions.
- There are no banks in India which can be ranked among the top 50 Banks of the world in terms of total asset base. However, there are four Chinese Banks among top 10 Banks.

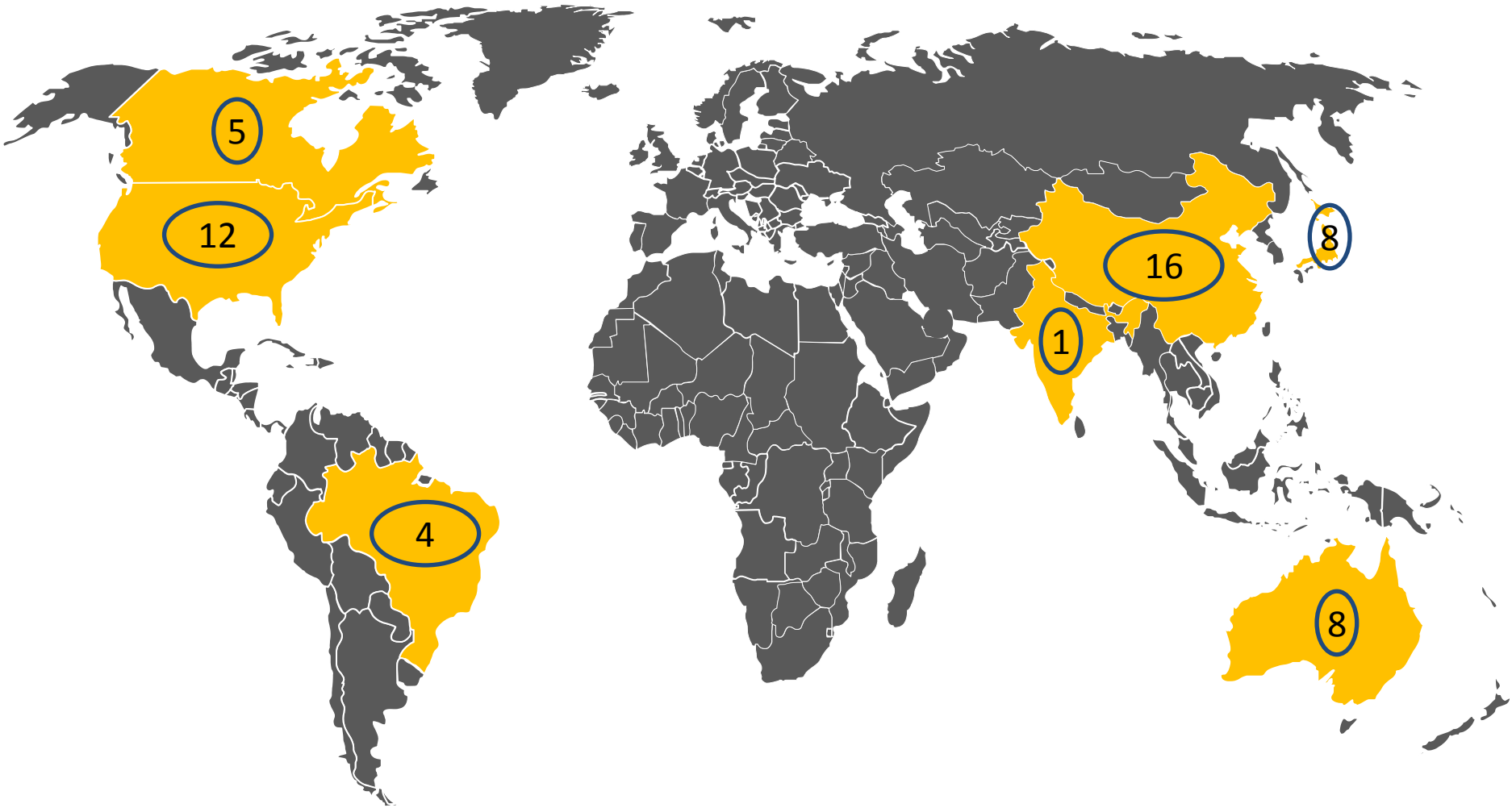
Source: IMF, S&P Global Market Intelligence

Note: GDP Data is as of 2015 and Total Assets of Banks are as of December 31, 2015

Need for Big Bank



Top 100 Banks in respective Countries

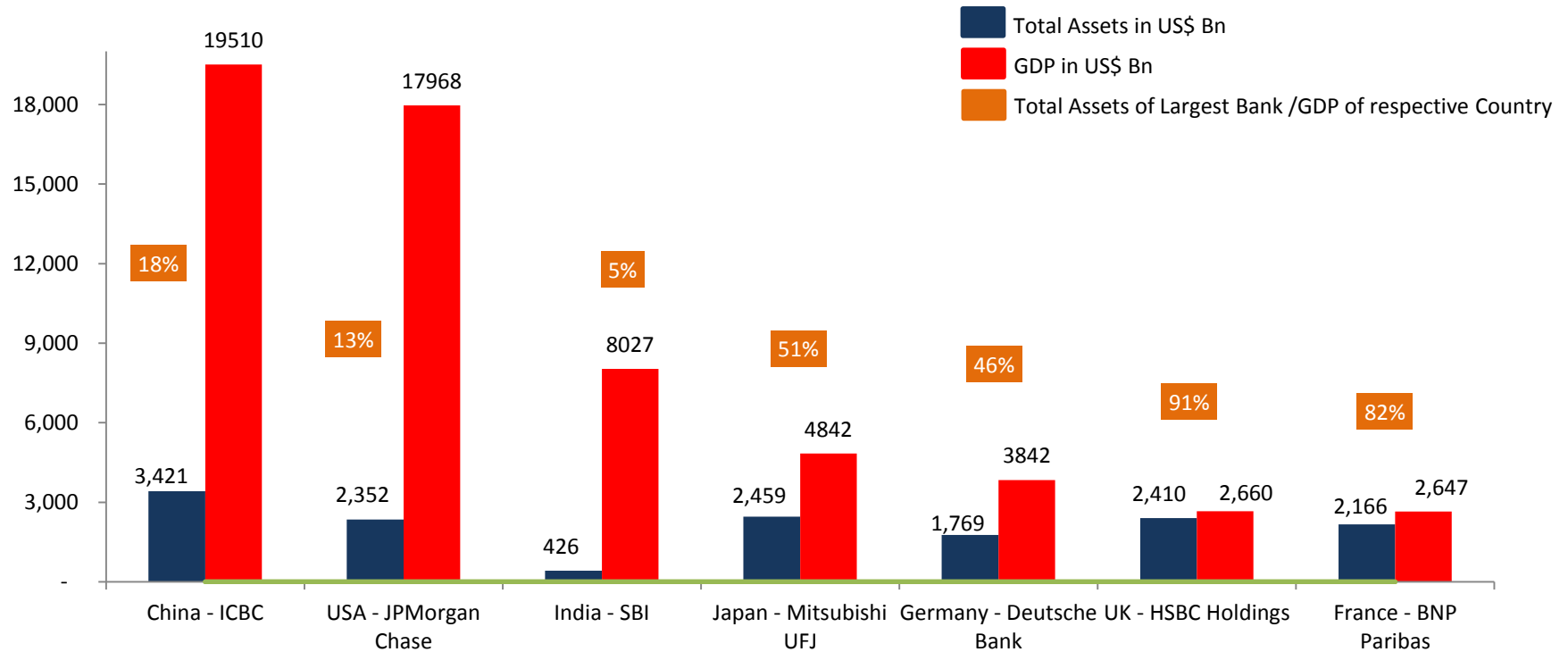


Source: S&P Global Market Intelligence

Need for Big Banks



Size of Banks w.r.t GDP



- Indian Banks are much smaller for the size of Indian Economy. SBI's (Largest Lender in India) asset size is only 5% that of Indian GDP whereas HSBC Holdings' (Largest Lender in UK) asset size is 91% of UK's GDP.
- Given the size of Indian Economy, India has a significant appetite for the large Bank.

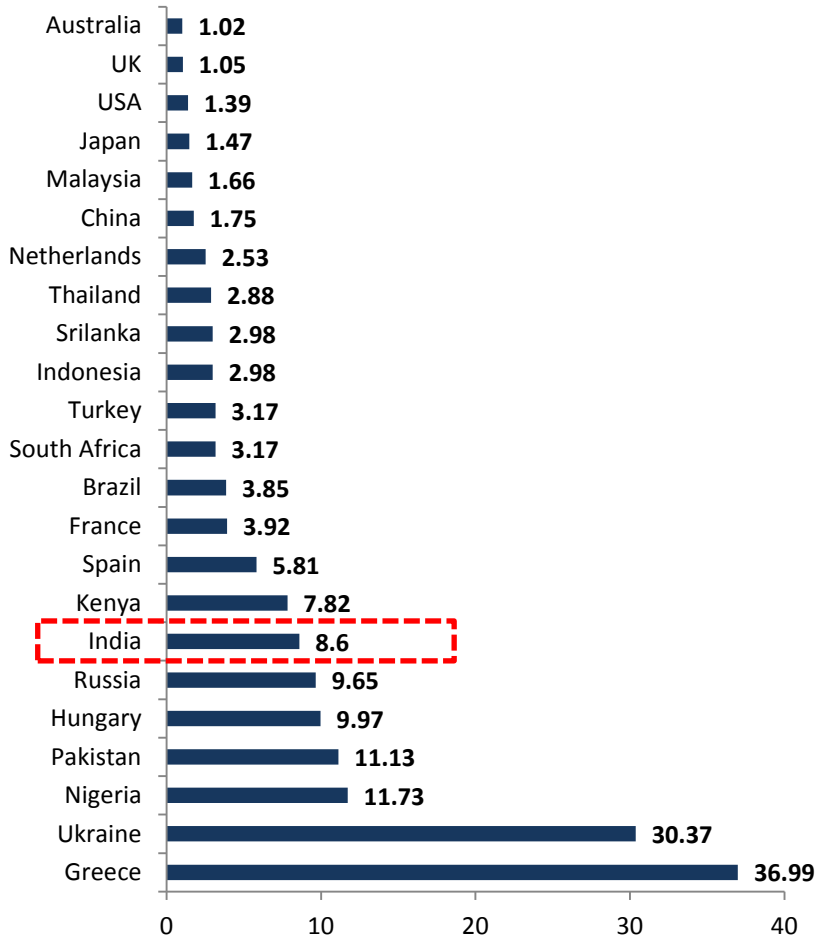
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Downward Spiral of Indian Banking System



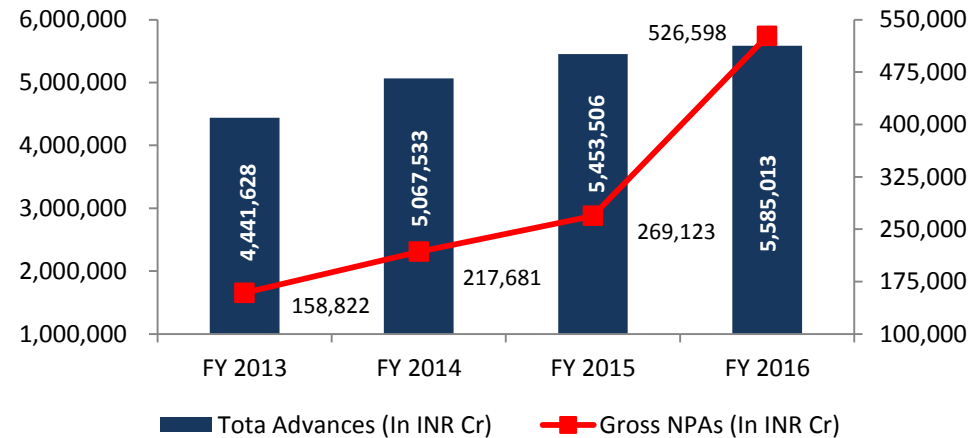
Deteriorating Asset Quality

Non performing Loan as a % of Total Gross Loans

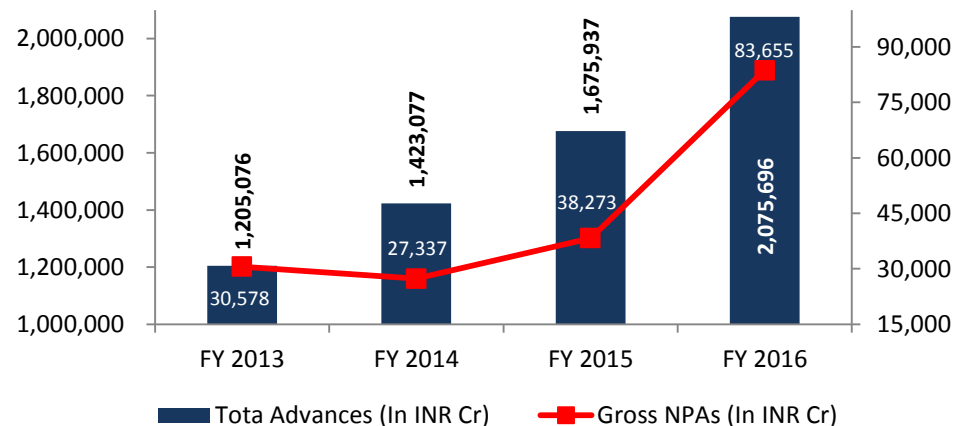


Source: Mint, Nov 17, 2016

Gross NPA Movement: Listed Public Sector Bank



Gross NPA Movement: Listed Private Sector Bank



Source: RBI, RBSA Research 1. RSA= Restructured Standard Advances

Downward Spiral of Indian Banking System



Declining Performance

FY16 financial numbers reported by Indian banks are one of the worst in the last few years. Performance of Indian public sector banks deteriorated significantly as all listed public sector banks cumulatively reported PAT level loss of INR 16,215 Cr during FY 16. Public sector banks reported muted revenue growth of 2%.

Private sector banks performed better compared to public sector banks though performance was muted when compared to their historical performance.

in INR Cr	Total Income			Operating Profit			Profit after Tax		
	FY 16	FY 15	Var % YoY	FY 16	FY 15	Var % YoY	FY 16	FY 15	Var % YoY
<u>Sample Public Sector Banks</u>									
Allahabad Bank	21,003	21,874	-4%	(724)	631	Loss in FY 16	(724)	631	Loss in FY 16
Andhra Bank	19,911	18,788	6%	1,007	1,223	-18%	542	642	-16%
Bank Of Baroda	51,791	50,364	3%	(6,233)	5,983	Loss in FY 16	(5,053)	3,833	Loss in FY 16
Bank Of India	45,764	47,963	-5%	(8,058)	1,852	Loss in FY 16	(6,335)	1,748	Loss in FY 16
State Bank Of India	272,871	257,290	6%	18,177	25,855	-30%	12,743	17,517	-27%
All Listed Public Sector Banks	805,993	787,318	2%	(20,866)	57,372	Loss in FY 16	(16,215)	40,009	Loss in FY 16
<u>Sample Private Sector Banks</u>									
Axis Bank Ltd.	51,364	44,566	15%	12,690	11,284	12%	8,358	7,448	12%
DCB Bank Ltd.	1,919	1,588	21%	261	208	26%	195	191	2%
Dhanlaxmi Bank Ltd.	1,281	1,369	-6%	(209)	(241)	Loss in FY 16	(209)	(241)	Loss in FY 16
HDFC Bank Ltd.	74,373	60,212	24%	19,511	16,080	21%	12,817	10,700	20%
ICICI Bank Ltd.	101,396	90,216	12%	14,304	18,339	-22%	10,927	12,942	-16%
All Listed Private Sector Banks	350,165	299,356	17%	68,859	63,101	9%	46,988	42,937	9%

Source: ACE Equity, RBSA Research

Need for Big Banks - Advantages

- Indian Banks are much smaller for the size of Indian Economy. SBI's (Largest Lender in India) asset size is only 5% that of Indian GDP whereas HSBC Holdings' (Largest Lender in UK) asset size is 91% of UK's GDP.
- Given the size of Indian Economy, India has a significant appetite for the large Bank.
- Consolidation of banks will lead to a banking system that is competitive, profitable and well-capitalised.
- The Indian banking scene is extremely fragmented at present and it would be better to have fewer strong banks rather than a numerically large number of weak banks. Large banks reap certain advantages which are detailed below:



Large Scale Infrastructure

- India is the fastest growing major economy in the world. To sustain this growth, there is a need for mega banks that will ensure investments into the large scale infrastructure projects.
- India needs over \$1.5 trillion in investment in the next 10 years to bridge infrastructure gap as the government intends to connect seven hundred thousand villages with roads by 2019 as part of a massive modernisation plan. (Finance Minister Arun Jaitley – June 2016)
- The banking system would need sufficient lending capacity to fund large corporates and infrastructure projects of above size as India Inc expands and extends its global reach.



Better NPA Management

- Banking sector is suffering from non-performing assets (NPAs) problem.
- PSU Banks are suffering from acute problem of ballooning of NPAs. As of June 30, 2016 Gross NPA % to total lending of IOB, UCO Bank and BOI 20.3%, 18.7% and 16% respectively.
- Consolidation of banks will improve the ability of banks to recover bad loans. Currently large projects are financed by consortium of Banks where smaller Banks have very little/no say in decision making. Once consolidated, Banks will have more lending and better decision making power.

Need for Big Banks - Advantages



Economies of Scale

- The consolidation will help in leveraging the benefits of economies of scale. Consolidation will help in leveraging the synergies among the banks that have diverse portfolios, focus areas and coverage areas.
- Consolidation would result in cutting down branches, particularly in urban areas where there are too many branches of different banks in a same area which would ultimately result in cost savings and increasing profits.
- The integration of human resources and their culture will also be easier if banks are merged from same geographies. This will again pave the way for lot of cost benefits.



Cheap Credit

- On consolidation of banks, the merged entity will have more leg room to raise capital.
- Large banks can make optimal use of their capacities to raise funds at internationally competitive rates which in turn can benefit the retail borrowers / business large.



World Class Services

- Consolidation will lead to expansion of financial services to remote areas.
- Indian companies are going global, we are home to many multinational companies that have presence in various sectors of the economy. Bank consolidation will enable large banks to deliver world-class financial services to them and fund large corporates as India Inc. expands and extends its global reach.

Need for Big Banks - Challenges



Bank Unions

- One of the toughest challenge in consolidation of banks is an opposition of bank unions.
- Bank unions have opposed the idea of consolidation of banks due to fear of job losses. Once consolidated, there would be fewer branches and rationalisation of staffs across central divisions like Treasury, Human Resources, IT, Compliances etc.
- The unions have already started opposing the proposed privatization of IDBI and merger of SBI with associated banks and Bhartiya Mahila Bank.



Poor Financial Health

- All most all the public sector banks have huge NPA with them and lot of them have reported record losses in last few quarters.
- Most of the banks are not in position to takeover another troubled bank on account of its own poor financial health



Political Opposition

- Some Banks have very strong customer loyalty based on banks regional identity. E.g. Bank like Bank of Maharashtra have strong roots in Maharashtra and there would be political opposition for merger with bigger bank.

Need for Big Banks - Challenges



Technical Challenges

- Banking relies on technology for its day to day operations. Banks have invested heavily in last two decades in information technology and communication technologies.
- Unfortunately, different banks have different Information Technology architecture and systems bought from different IT vendors.
- Integrating different IT systems post consolidation will remain a key technical challenge.



Political Support

- Demonetization of high currency notes has put government on back foot. To successfully manoeuvre the sensitive task of consolidation of PSU banks requires political will and power. Without the support from south block, the consolidation of PSU banks is difficult feat to achieve considering potential opposition from employees and political parties.

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