Merger of Public Sector Banks : A Case of Chennai Bank Ltd. and Bhopal Bank Ltd.

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Abstract

Chennai Bank Ltd. is the leading South Indian commercial bank having more than 2,875 small and large size branches all across the Southern states of India. It was established in the year 1966 just after the nationalization of private banks in India. Bhopal Bank Ltd. is one of the oldest banks of India founded by the Nawabs of Bhopal. After nationalization, it started working under the umbrella of the Government of India. Over a decade, increase in the number of non-performing assets, declining contribution of selected public sector banks, and expanding private sector role as banks or non-banking financial companies, etc. are few points of observation, which led to a new idea of merging up of public sector banks. This case study discussed why the Government of India has strategically decided to merge Chennai Bank Ltd. and Bhopal Bank Ltd. and what changes and challenges this merger will bring such as post-merger restructuring, struggle for financial stability, difference in organizational culture, employee layoffs, difference in demographic customer database, and opening up or shutting down of branches due to increase in numbers of branches, etc.

Keywords : public sector banks, merger, strategy, corporate culture

JEL Classification Codes : G20, G21, G34, G38, M14

Paper Submission Date : December 28, 2019 ; Paper sent back for Revision : January 20, 2020 ; Paper Acceptance Date : January 25, 2020

It was around 10 p.m. when Mr. Sentail Murgun, Chief Managing Director, Chennai Bank Ltd. got a call from Mr. Pawan Gupta, Finance Secretary, Ministry of Finance, Government of India. Mr. Gupta told Mr. Murgun that day after tomorrow, he is supposed to meet him at New Delhi along with two other important dignitaries – Dr. Abhilash Saxena, Governor, Reserve Bank of India and Mr. Om Prakash Mishra, Chief Managing Director, Bhopal Bank Ltd. When Mr. Murgun tried to enquire about the agenda of this meeting, Mr. Gupta simply told him to reach on time in the morning as this meeting may stretch for a long time and disconnected the call.

Mr. Murgun was a part of Chennai Bank for the last 30 years and had reached a position of CMD due to his hard work and dedication. During his long period of service, he had seen a lot of changes in the banking sector from pre-liberalization era crises to post-liberalization competition due to the increase in foreign direct investment limits, which attracted foreign banks to India for over two decades. Under his leadership, Chennai Bank was able to maintain its growth at a good pace because he could understand the overall banking market, especially in the South Indian region. His decision to increase the number of branches in remote areas, recruitment of fresh MBAs, and 'customer comes first' policies did wonders for Chennai Bank. As expected, the following day he received an

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DOI : 10.17010/pijom/2020/v13i2/150564

official email for the meeting. He knew something big is going to happen and to know exactly what is going happen, he had to wait for one more day. Mr. Murgun prepared himself well with all important files and data which could be asked from him during the meeting.

Dr. Abhilash Saxena was briefed by Mr. Pawan Gupta about the agenda of the meeting, but was asked to maintain secrecy. On the other hand, Mr. Om Prakash Mishra also got a call for the meeting from Mr. Pawan Gupta. Mr. Om Prakash Mishra had taken over the post of Chief Managing Director of Bhopal Bank Ltd. just a year ago and the circumstances in which he took charge were quite challenging. The Bhopal Bank Ltd., which has the prestige of being the oldest nationalized bank of India, is going through a rough phase due to poor performance, increasing non-performing assets, excess staffing, and eroding customer database. He knew that Bhopal Bank Ltd. needed to go through a transformation, and only then it would be able to survive in today's banking industry. Mr. Mishra had plans, but it required some time to be translated into performance. After receiving a call from Mr. Gupta, he too was perplexed about what would happen in the meeting. He prepared himself for the meeting with the important dignitaries.

Chennai Bank Ltd.

Chennai Bank Ltd. is the leading South Indian commercial bank having more than 2,875 small & large branches all across the Southern states of India. It was established in the year 1966 just after the initiation of nationalization of private banks in India. During that time, the biggest challenge was to instill the confidence of people in the banking sector which would motivate people to deposit their savings in the banks. As largely people had a bad experience of private banking, it was very tough for public sector banks to bring the change in the thinking process of the people that banking is something which they can trust with their savings. Most of the private banks before nationalization were placed mainly in urban areas or as per their choice of a region which led to regional biases. The first branch of Chennai Bank was opened in Madras (later renamed as Chennai) and with the hard work of the founding members, it was on the path of success for many years to come. Chennai Bank has a team of 19,604 dedicated staff and with a total profit of ₹ 420 crores in the last financial year. Also, all the branches are under the core banking solution system. The bank is financially strong, and the same is reflected in the financial figures of Chennai Bank Ltd. (refer to Table 1).

Table 1. Important Figures for the Last 4 years – Chennai Bank Ltd. (Amt. in ₹ Cr.)

	Mar – 19	Mar – 18	Mar – 17	Mar – 16
Total Liabilities and Assets	280,065.27	252,715.82	218,233.15	203,710.38
Total Income	21,067.70	19,519.48	18,251.12	18,025.20
Total Expenditure	20,745.75	18,260.49	16,845.44	17,313.82
Net Profit / Loss	321.95	1,258.99	1,405.68	711.38
Profit / Loss Brought Forward	98.15	97.11	96.36	95.04
Total Profit / Loss	420.1	1,356.10	1,502.04	806.42
Basic EPS (₹)	6.7	26.21	29.27	14.81
Gross NPA	13,353.45	11,990.14	9,865.14	8,827.04
Net NPA	6,793.11	5,959.56	56,096.57	5,419.40
Other Additional Information				
Number of Branches	2,875.00	2,820.00	2,682.00	2,565.00
Number of Employees	19,604.00	20,065.00	20,924.00	20,140.00

Note. Names changed to maintain confidentiality.

Chennai Bank Ltd., over the last few years, has increased its income from various sources, but due to sudden increase in net non-performing assets in the last two financial years, that is, 2018 – 2019 and 2017 – 2018, the bank's profit margins declined. Earnings per share also declined on account of increase in non-performing assets. Even then also, Chennai Bank Ltd. was still able to earn profit and looks promising to earn more in the future.

Bhopal Bank Ltd.

Bhopal Bank Ltd is one of the oldest banks of India founded by the Nawabs of Bhopal. After nationalization, it started working under the umbrella of the Government of India. At the start, the performance of the bank was good, but due to the challenging environment and various factors such as increasing non-performing assets, excess staffing, and eroding customer database, the bank lost its fame and name with the passage of time. As the name suggests, its first branch opened in Bhopal and they have 3,299 branches in Northern - Central India with a workforce of 23,210 staff. During the last financial year, the performance of the bank was very poor as its total loss for the last year was ₹ 13,624 crores (refer to Table 2). The bank is struggling to enter into the "orbit of large banks," and it seems a difficult feat to achieve in the coming days.

Bhopal Bank Ltd.'s total expenditure against total income and gross non-performing assets have been increasing year by year, which has led to an alarming situation. The bank has carried forward huge losses every year, which has, in turn, increased the overall losses. Due to its unplanned expansion and recruitment, the costing per branch and costing per employee has also been increasing.

Table 2. Important Figures for the Last 4 years – Bhopal Bank Ltd. (Amt. in ₹ Cr.)

	Mar – 19	Mar – 18	Mar – 17	Mar – 16
Total Liabilities and Assets	248,575.77	252,714.31	237,037.88	235,828.38
Total Income	18,564.50	19,051.05	20,304.72	20,795.07
Total Expenditure	26,898.46	23,725.42	20,618.24	21,538.38
Net Profit / Loss	–8,333.96	–4,674.37	–313.52	–743.31
Profit / Loss Brought Forward	–5,290.69	–616.32	–360.08	383.23
Total Profit / Loss	–13,624.65	–5,290.69	–673.6	–360.08
Basic EPS (₹)	–65.34	–59.63	–4.36	–12.68
Gross NPA	28,704.78	26,562.80	20,687.83	15,384.57
Net NPA	7,419.31	12,229.10	13,433.51	10,292.51
Other Additional Information				
Number of Branches	3,229.00	3,245.00	3,246.00	3,210.00
Number of Employees	23,210.00	23,967.00	23,944.00	24,137.00

Note. Names changed to maintain confidentiality.

Meeting Day

Mr. Murgun reached Mr. Gupta's office half an hour before the scheduled time and he was surprised to see Mr. Om Prakash Mishra sitting there anxiously. On seeing Mr. Murgun, Mr. Mishra greeted him with curiosity to know the agenda of the meeting, which Mr. Murgun also was not aware of at that time. Both sat there, waiting for the meeting to commence. Dr. Abhilash Saxena and Mr. Pawan Gupta arrived on time, and as expected, they were keen to share the agenda of the meeting with the other two.

Mr. Pawan Gupta : Thank you for coming on a very short notice. I have already discussed the agenda with Dr. Saxena as his opinion is important to Hon'ble Finance Minister. The Government is keeping a close eye on the functioning of the overall banking system in India. Over a decade, the increase in number of non-performing assets, declining contribution of selected public sector banks, and expanding private sector role as banks or non-banking financial companies, etc. are a few points of observation, which led to a new idea of merging up of the public sector banks. Recently, seven public sector banks merged with India's leading public sector bank – State Bank of India. I guess this successful merger has set a foundation for the government to take more bold steps ahead. This will make our public sector banks stronger on the international platform.

As Mr. Gupta was about to finish his first point, both Mr.Murgun and Mr. Mishra looked at each other and were interrupted by Dr. Saxena.

Dr. Abhilash Saxena : The Hon'ble Finance Minister has hinted at the government's plan to merge Chennai Bank Ltd. and Bhopal Bank Ltd., and this would soon take place. The selection of both these banks has been done strategically and we have to ensure that the merger process is to be completed smoothly and without much hassle. Please make sure that whatever challenges or barriers emerge in the future, these need to be handled carefully and without displacing the trust of the people in the public sector banks.

Mr. Mishra nodded in agreement to whatever Mr. Gupta and Dr. Saxena had said and added his point of view.

Mr. Om Prakash Mishra : I very well understand that whatever the government has planned will be in our favor and our existing customers. How are we expected to move ahead ? Will there be a new bank after the merger or one bank will be merging into another bank?

Mr. Pawan Gupta : Mr. Mishra, Bhopal Bank will be merging into Chennai Bank.

Mr. Pawan Gupta looked at Mr. Murgun, who was still silent and assessing the decision taken by the government. His vast experience in the banking system enabled him to foresee the upcoming days of unrest and organizational restructuring storm. He was into a dilemma regarding which fact he will have to face first, that is, restructuring, struggle for financial stability, the difference in organizational culture or demographic customers' database, opening up or shutting down of branches, layoffs, and communicating & implementing the given suggestions in a short period of time, etc.

Mr. Sentail Murgun : Sir, by what time are we expected to complete this merger ?

Mr. Pawan Gupta : By March 2020. You both have approximately 9 months for completing this merger.

Mr. Om Prakash Mishra : Only 9 months!!!

Mr. Sentail Murgun : Sir, with this expected time duration, we won't be able to execute this big plan with ease and can't be sure about the success of same.

Dr. Abhilash Saxena : Mr. Murgun, if this had been an easy task, the Government could have selected different banks. The time duration is the challenge and we all are looking at you and Mr. Om Prakash Mishra to execute in this expected time duration.

Mr. Pawan Gupta : We know that the time is limited, but please look at the longer impact of this merger. Mr. Murgun, Chennai Bank has captured a good market in South India but how long do you think it will be able to maintain the growth rate in a limited market area ? Your bank needs to expand its geographical limits from South to other parts of India. Mr. Mishra, I guess the situation in which Bhopal Bank is today will get worse if nothing is done today. You have excess staff, number of branches, and increasing NPAs, etc. Both the banks can be a plus for each other. I know the poor asset quality of Bhopal Bank will reduce the profit figures of Chennai Bank, but after 5 years, mark my words, this merger will be a good step.

Mr. Sentail Murgun : Apart from financial stability, there are some other points too, such as restructuring of banks, differences in organizational culture and demographic customer database, etc. It will be very difficult for us to implement the same. I am not saying it is impossible, but it will be quite tough for us.

Mr. Om Prakash Mishra : I agree with whatever Mr. Murgun is saying. We have seen during the merger of State Bank of India also, there were lots of organizational conflicts post-merger such as seniority of employees and HR policies, etc.

Dr. Abhilash Saxena : Mr. Murgun, restructuring of both the banks will have a good impact. There will be a better current and savings account ratio (CASA), and I think, your bank will be more cost profit-centric. I mean those branches which are not able to generate profit for a long time should be shifted or closed. Excessive staffing can be avoided. You will have a good number of employees which you can reallocate as per your requirement. Organizational culture and different demographic customer database, such things have to be handled with utmost care. For smooth functioning of the bank post-merger, it is important not to have too many shuffles at the branch level. Lower level and middle-level employees should not be highly exposed to a new environment. Employees who are not performing as per expectations and not willing to improve their performance either may be asked to leave the bank. The existing customers of the branches will be uncomfortable if we change the whole staff of the concerned branches. We need to work more on the branding and communication areas and should circulate various benefits of the merger to the customers of both the banks.

Mr. Mishra, you are correct that there will be a difference in the HR policies, but we have to bring all the employees on a common platform. Employees from both the banks should not be scared of the merger, but they should see it as a positive step for their development.

Mr. Pawan Gupta : We have the financial reports of the banks and it will be good for both the banks only if we take this merger process considering all factors and points mentioned by Dr. Saxena. The Government is willing to support the merger process monetarily just to ensure smooth integration. Please remember that the success of this merger largely depends upon coordination and execution of processes by both of you - Mr. Murgun and Mr. Mishra.

Mr. Om Prakash Mishra : We will take into consideration all the factors and points as discussed. I will have a meeting with Murgan Sir too, so that we may be able to complete our merger process within the time frame.

Mr. Sentail Murgun : We do understand your point of concern and we both will coordinate and execute this merger process as soon as possible.

The conclusion of this meeting left piles of questions such as post-merger restructuring, financial stability, differences in organizational culture, layoffs of employees, differences in demographic customer database, and opening up or shutting down of branches, etc. in the minds of Mr. Murgun and Mr. Mishra. They knew that the answer to those questions lay in the future and in the successful completion of the merger process.

Managerial Implications

The strategic decisions related to the mergers and acquisitions are not new in the banking industry. It started well before our independence and then during the nationalization of banks. The motives for mergers changed with the passage of time. Survival, elimination of regional biases, liberalization, privatization, and globalization, etc. are a few reasons for the merger of public sector banks. The mergers have made our banks stronger and capable to face today's dynamic global environment.

Teaching Notes

(1) Teaching Objectives : This case focuses on the merger of two hypothetical public sector banks. These banks operate in different regions of India and the government has decided to merge these banks. At the end of the case exercise, participants should have an understanding of the following issues :

- The merger of public sector banks.
- The merger project implementation and control.
- Challenges related to the merger of public sector banks.
- Role of stakeholders in strategy implementation/merger.
- Impact of a merger.
- Role of the government in mergers of banks in India.

(2) Potential Audience : Graduate and post graduate students, mid-level executives, and anyone interested in mergers of public sector banks are the potential audience.

- **Relevant Programmes :** Graduates and post graduates of management, commerce, banking, and finance.

(3) Number of Teaching Sessions Needed : 2 lectures of 50 minutes each.

(4) Authors' Analysis of Each Question Raised :

Q-1) Why go for merger of public sector banks ?

Ans-1) Indian banks are categorized in different heads such as scheduled banks, non-scheduled banks, commercial banks, and development banks, etc. The role of commercial banks, by and large, is very important and something which every individual who has a bank account can connect with it. Post LPG, commercial banks' contribution and involvement in the economy has increased manifold. Commercial banks can be from both public sector and private sector. Banks are into integration mode, and due to that, instead of opening new branches, the focus is more toward strengthening whatever they have with them. The government also wants to limit the number of public sector banks in India and it has started the merger of public sector banks. It started with the merger of State Bank of India and its associates and Mahila Bank, the second merger will be of 10 public sector banks by the next financial year. This step will ease the controlling process of the government and RBI. Also, this will strengthen our public sector banks on the international platform. With the merger of the public sector banks, we can place our banks in the world's top 50 strongest banks.

Q-2) What are the challenges faced by the two banks ?

Ans-2) When two different banks come together for the merger, they face different types of challenges such as :

(i) Post-Merger Restructuring : As the number of employees in one organization increase due to the merger, this will lead to an important need for generating different posts for different levels of management. Capital restructuring or closing of some branches may also be required.

(ii) Financial Stability : Here, Bhopal Bank Ltd. has high NPAs and losses in its balance sheet and it will be merged with Chennai Bank Ltd. This will impact the financial performance of Chennai Bank Ltd. Chennai Bank Ltd. has to bear NPAs and different types of losses.

(iii) Differences in Organizational Culture and Work Ethics : One bank is from South India and another bank is from North India. Both will face difference in the work culture, language barrier within the organization, and work ethics.

- **Layoffs :** Post-merger, as the number of employees will increase much above from the required figure, this will lead to employee layoffs just to avoid overstaffing & excessive cost, etc. Employees who are not keen to perform well will be the first to get forceful removal or voluntary retirement scheme etc.

- **Difference in Demographic Customer Database :** South Indian branch managers may not be able to communicate properly in Hindi with the North Indian customers and vice versa will be the case with North Indian branch managers when they deal with the South Indian customers. There will be an important need to make sure that customers' needs should be given priority and accordingly they can appoint or transfer employees in the respective branches.

- **Increased Cost per Branch and Cost per Employee :** As Bhopal Bank Ltd. is a loss-making bank ; so, once the merger process is initiated, Chennai Bank Ltd. will have to bear the losses of the other bank and, in turn, increase the cost per branch and cost per employee.

Q-3) What will be your suggestions for the overall merger process to be smoother ?

Ans-3) Both the banks should start the restructuring under the supervision of the top management committee. The committee may have Executive Directors from each bank. This will enable them to take better decisions in matters related to HR policies, closure or sharing of branches, and various other resources like ATMs and bank e-corners etc. It is suggested to recover as much as possible bad loans so that post integration legal issues related to recoveries are less in number. Synchronization of all activities during the merger process is very important. If this lacks, then it may result in dissatisfaction of customers and employees. Communication plays an important role in building confidence ; so, customers, as well as employees, should be communicated well in advance about the merger and integration of banks. In case of any confusion or dilemma, things should be cleared off on a priority basis. More emphasis can be given on the cost of branches. Those branches which can earn more profits in operations should be promoted and non-performing branches may be shifted to some other potential areas.

(5) Suggested Further Readings

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Authors' Contribution

Dr. Sarvesh Mohania conceived the idea and wrote the case study under the supervision of Dr. Rajesh K. Yadav and provided data for Table 1 and Table 2 for analysis. Dr. Rajesh K. Yadav analyzed the tables and wrote the teaching notes. Both authors reviewed the final manuscript.

Conflict of Interest

The authors certify that they have no affiliations with or involvement in any organization or entity with any financial interest or non-financial interest in the subject matter or materials discussed in this manuscript.

Funding Acknowledgment

The authors received no financial support for the research, authorship, and/or for the publication of this case study.

Disclaimer

This case was prepared by the authors for the sole purpose of aiding classroom discussion. The case is not intended to serve as endorsements, or sources of data, or illustrations of effective or ineffective management. This case is based on a hypothetical strategic merger problem faced by two public sector banks, which is a very relevant area to be managed successfully for the growth of public sector banks. The decision results may or may not be envisaged by the stakeholders of public sector banks. Names are changed to maintain confidentiality.

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