

Benchmarking Housing Finance Companies in India: Strategies for Enhanced Operational Efficiency and Competitiveness

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Abstract

Formal system for housing finance in India is primarily dominated by two major types of institutions, viz. commercial banks (CBs) and housing finance companies (HFCs), and a very small share of the market (nearly 0.5 percent, for the last few years) goes to the third group viz. co-operative sector institutions. Of the two major groups, the HFCs which dominated the market till FY 2002 were overtaken by CBs in FY 2003 and since then CBs have been leading the market. Consequently, although HFCs are specialised institutions in housing finance, their market share and profitability are growingly under threat year after year. Thus, enhanced operational efficiency has become a vital pre-requisite for survival and growth of HFCs. In the above context, this paper seeks to (i) make an overall review of the emergence of the institutional system for housing finance in India and to trace the broad pattern of its composition over the years, (ii) study the major problems and challenges faced by HFCs, particularly in comparison with CBs, the other major group, (iii) analyse the operational efficiency of the major HFCs and to benchmark them based on their relative operational efficiency, and (iv) suggest suitable strategies for enhanced operational efficiency of HFCs in India.

Keywords: Capital Adequacy Ratio, ROE, Cost to Income Ratio, Benchmarking.

1. Introduction

Housing is one of the most basic human needs and is second only to the need for food and clothing. As such, worldwide housing has been given top priority in policy decisions by progressive governments. Though the emergence of a formal institutional system for housing finance has been quite late in India with the formation of National Housing Bank (NHB) in 1988, since then housing is being accorded high priority by the successive Union Governments. This fact is evident from the various policies of the government, which provide for many fiscal and monetary measures for promotion of housing investment, higher budgetary outlays for housing, tax incentives for the housing finance beneficiaries etc. As such, in the ongoing reforms era initiated in the early nineties there has been appreciable growth in institutional housing in India, particularly during the late 1990s when commercial banks (CBs) entered into housing finance arena aggressively. Because of the favourable governmental policies as well as regulatory interventions as noted above, there has been a significant improvement in mortgage to GDP ratio in India, which gradually increased from 3.4 percent in 2001 to 7.4 percent by

2008 (RBI, 2009a)¹. In spite of a slight moderation in housing finance growth in the recent past (FY 2006 to FY 2009), it may be noted that the housing finance sector in India has registered an appreciable CAGR (compounded annual growth rate) of over 30 percent during the preceding three years' period (FY 2004 to FY 2006)(RBI, 2009a)².

Along with the appreciable growth of institutional system for housing finance in India, there have been significant changes in the composition of the major institutional groups in housing finance. Housing Finance Companies (HFCs) that once dominated the market as the most prominent group has already been overtaken by the commercial banks (CBs) – the late-entrants into the formal housing finance market. In fact, CBs started aggressive lending to the housing sector only since 1998 following a directive from the central bank of the country viz. Reserve Bank of India (RBI) in 1998 to set aside 3 percent of their incremental deposits for lending to housing sector. Consequently, prominence of CBs has been on the rise every year and are leading the market since FY 2003. Conversely, in respect of HFCs as a group, apart from their gradually lowering market share year after year, there has been significant pressure on their profitability because of the thinning profit margins arising from competition. This has resulted in many smaller HFCs either getting liquidated, or merged with their respective parent organizations, particularly so for many of the bank-sponsored HFCs. Hence, because of the fierce competition in the market, enhanced operational efficiency has become vital for survival and growth of HFCs in India in the ongoing era of globalization, likely to be more so in the future.

2. Review of Relevant Literature

Empirical studies on operational efficiency of HFCs are quite rare in India, probably because of the fact that emergence of formal housing finance system has been very late in this country. It was only in 1988 that a formal regulatory system for housing finance emerged in India, when National Housing Bank (NHB) was founded, and a National Housing Policy was formulated for the first time in the history of the country. Most of the HFCs started functioning during that period.

3. Analytical Significance and Research Gap

It is a well recognized in the finance literature that housing as an industry can contribute immensely towards economic development of a nation, particularly because of its vast linkages with more than 250 number of other allied industries. For developing nations like India, housing is often considered as the growth engine for the whole economy. Besides, in India it is the second largest generator of employment, after agriculture. Considering the falling share of HFCs in the housing finance market in India and also the growing pressures on their profitability, studies on their operational efficiency assume high level of research significance.

In view of the foregoing discussion, considering (i) the utmost need for enhancement of operational efficiency of HFCs in India in the ongoing globalized regime for their survival and growth and also the faster development of the national economy as a whole, and (ii) the acute dearth of studies in this area, it is relevant to make a closer look into the relative position of the major HFCs in India in respect of their operational efficiency and also to benchmark them based on suitable performance parameters like ROE (Return on Equity). This would enable us to formulate pragmatic operational strategies for enhanced competitiveness of HFCs. This paper is an earnest effort in the above direction.

¹ Reserve Bank of India (RBI), Committee on Financial Sector Assessment (CFSA), *India's Financial Sector: an Assessment*, March 2009, p.192

² Ibid, p. 196.

4. Utility of the Study

Informed and rational decision making, calls for the use of findings of systematic research. At the macro level (like, governmental and administrative) as well as micro level (individual HFCs) findings of this research can be used for meaningful policy decisions and prudent business strategies.

5. Objectives of the Study

- (i) To make an overall review of the emergence of the institutional system for housing finance in India and also to trace the broad pattern of its composition over the years.
- (ii) To study major problems and challenges faced by HFCs in India, particularly in comparison with the CBs – the other major institutional group in the formal housing finance system.
- (iii) To analyse the operational efficiency of the major HFCs in India using ROE and cost-to-income ratio and also to benchmark them based on their relative efficiency; and
- (iv) To suggest suitable broad strategies for improved operational efficiency of HFCs in India, and also specific strategies for the major groups of HFCs (as categorised based on their relative position as per the benchmarking analysis mentioned above).

6. Methodology of the Study

6.1. Nature of the Research

The paper is descriptive-analytical in nature to the extent that it seeks to analyse the trend and pattern of the housing finance market in India, identify the major problems and challenges faced by the HFCs, and to analyze their operational efficiency of the major HFCs, The paper is exploratory too as it seeks to formulate appropriate strategies for enhanced operational efficiency and competitiveness.

6.2. Sampling Design

The sampling design methodology followed here is ‘Purposive Sampling’, as the HFCs are selected based on their revenue (total income) generated during the FY 2008, in the descending order. Accordingly, 10 HFCs are selected out of total 43 HFCs having registration with NHB. Of these 43 HFCs, 20 alone have the permission to accept public deposits, and the rest 23 are supposed to perform lending activity only. (Appendix – I shows the list of all these 43 HFCs as of August 2009.)

The 10 HFCs so selected belong to the first type of 20 HFCs (that can perform both lending business and acceptance of public deposits) and these HFCs represent 96.62 percent of the total business by all HFCs in India. In fact, all the large and prominent HFCs are in the first type and this group represents virtually the whole housing finance market. Likewise, this sample of 10 HFCs cover nearly the whole of the housing finance market (96.62 percent) enjoyed by the HFCs in the country. Table I shows the HFCs selected and the criteria for the same (descending order of total income).

Table I: List of Major HFCs and their Individual and Cumulative Market Shares (FY 2007).

Sl. No	Name of the HFCs (along with Short their Short Forms)		Total Income	Share (%)	Cumulative Share (%)
	Name	Short Form			
01	Housing Development Finance Corporation Ltd.	HDFC	5914.86	59.108	59.108
02	L I C Housing Finance Ltd.	LICHFL	1766.60	17.654	76.762
03	I C I C I Home Finance Co. Ltd.	ICICIHFL	649.59	6.491	83.253
04	Dewan Housing Finance Corpn. Ltd.	DHFL	335.05	3.348	86.602
05	G I C Housing Finance Ltd.	GICHFL	197.15	1.970	88.572
06	B H W Home Finance Ltd.	BHWHFL	194.74	1.946	90.518
07	Can Fin Homes Ltd.	CFHL	190.01	1.899	92.417
08	P N B Housing Finance Ltd.	PNBHFL	152.84	1.527	93.944
09	Gruh Finance Ltd.	GRUH	146.63	1.465	95.409
10	Sundaram B N P Paribas Home Finance Ltd.	SUNDARAM	120.71	1.206	96.616
Total Income of 10 Large HFCs (as above)		9668.18 (ie.96.62% of the total income of all HFCs*) (*Grand total of income of all HFCs is 10006.86)			

Source: Computed from, *CMIE Prowess*, Centre for Monitoring of Indian Economy, CMIE.

Note: Since financials of all HFCs as of FY 2008 are not available, FY 2007 is taken as the basis.

6.3. Data Sources

The requisite micro level (individual HFCs) data are collected from the published annual reports of the respective HFCs, while industry level aggregates are collected from the electronic database maintained by Centre for Monitoring of Indian Economy (CMIE), viz. *CMIE Prowess*. Relevant information regarding the list of HFCs having registration are collected from the industry regulator, National Housing Bank (NHB) (as of August, 2009).

6.4. Analytical Tools

Popular tools of financial analysis (like, ROE, Cost-to-Income ratio, Du-Pont Analysis etc.) are used for analyzing the operational efficiency of the major HFCs selected for the study, and also to categorize them broadly into a few distinct groups. Besides, common tools of statistical analysis (like, Trend Analysis, Correlation Analysis, Regression Analysis etc.) are used to test if there is significant variance in the relevant performance parameters that determine their overall operational efficiency. Popular software packages like SPSS and MS Word Excel are used for making the analysis as above.

7. Housing Scenario in India and the Institutional System for Housing Finance

In spite of the fact that investment in housing is an important driver of economic development of any nation, in India housing finance remained as an activity that failed to occupy the key position that it deserved during the early days of planned development. Only during the late seventies there was any organized attempt to set up an institutional mechanism for the purpose of providing housing finance to the needy sections of the society. It was only in 1977 that HDFC (Housing Development Finance Corporation) – the pioneer development institution for housing finance in India the private sector – was set up, though a fully owned government company viz. HUDCO (Housing and Urban Development Corporation) was set up way back in 1970 to undertake housing and urban development programs. Furthermore, it was after one more decade (1988, to be specific) that a formal housing finance system emerged in India with the formation of National Housing Bank (NHB) in 1988. At that time nearly 80 percent of the housing stock in the country was financed from informal sources (RBI, 2009)³.

When NHB was formed in 1988 as a fully owned subsidiary of the RBI with a mandate ‘to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other supports to such institutions and for matters connected therewith or

³ RBI, Committee on Financial Sector Assessment (CFSA), *India's Financial Sector: an Assessment*, 2009, p.191

incidental thereto' there were about 400 housing finance companies (HFCs) in India, functioning as NBFCs (Non Banking Finance Companies) regulated by the RBI. These companies included many small ones with restricted or localized activities and also those engaged in construction / development but offering housing credit as well. The only exception in this regard has been HDFC – the pioneer HFC in India and also the largest among the HFCs in India ever since its inception in 1977. At present (August 2009), there are 43 HFCs registered with the NHB of which 20 have the permission to provide housing finance and also to accept public deposits, while the remaining 23 have permission only to provide housing finance. Housing sector has been given priority status by the successive Union Governments and is accordingly entitled to substantial allocations in the various Plans, apart from a large number of fiscal and monetary incentives. The Tenth Plan (2002-2007) sought to promote housing sector in a big way. The ongoing Eleventh Plan (2007-12) is also no exception. (Table II).

Table II: Investment for Housing during the various Plan periods.

Five Year Plan	Public Investment	Private Investment	Total Investment
First Plan (1951-56)	250	900	1,150
Second Plan (1956-61)	300	1,000	1,300
Third Plan (1961-66)	425	1,125	1,550
Fourth Plan (1969-74)	625	2,175	2,800
Fifth Plan (1974-78)	796	3,640	4,436
Sixth Plan (1980-85)	1,491	18,000	19,491
Seventh Plan (1992-97)	2,458	29,000	31,458
Eighth Plan (1992-97)	31,500	66,000	97,500
Ninth Plan (1997-2002)	52,000	99,000	1,51,000
Tenth Plan (2002-07)	4,15,000*	3,11,300*	7,26,300
Eleventh Plan (2007-12)	5,07,318.1@	3,73,560#	8,80,878.1

Source: (1) *Report on Trend and Progress of Housing in India, 2003*, NHB, New Delhi., p.79,

(2) Plan Documents, X Plan (2002-07) and XI Plan (2007-2012)

(3) Report of the 22nd Standing Committee on Rural Development 2005-06, Ministry of Rural Development, Government of India, New Delhi, August 2006, p.17.

* Estimates of X Plan Document.

@ From XI Plan Document on Urban Housing, p.43, investment for Urban Housing is Rs.3,61,318.1Cr. Rural housing investment is Rs.1,46,000 Cr. as per Source (3), p.17. Thus, the total is Rs.5, 07,318.1Cr.

Estimated as 1.2 times as that of the X Plan ie. 1.2 times Rs.3,11,300.00 Cr, equals Rs.3,73,560 Cr.

There has been an appreciable growth rate in housing finance by institutional intermediaries in housing finance in India, in the post reforms era. Among these agencies, commercial banks (CBs) and housing finance companies (HFCs) alone are the prominent ones. The third agency viz. ACHFs (Apex co-operative housing federations), actually the most inclusive of the three which caters to the credit needs of the common man, is becoming insignificant year after year. Roughly nearly two-third of the current market is owned by CBs and the balance over one-third by the HFCs (Table III).

Table III: Housing Loan Disbursements by various Institutional Agencies.

(Rupees in Crores)

Agency	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY: 2008
CBs	5553.11	8566.41	23553.70	32816.39	50398.00	58623.00	69859.00	78242.00#
HFCs	12637.85	14614.44	17832.01	20862.23	26000.00	30109.00	40141.00	46164.00
ACHFs	867.72	677.58	641.48	623.08	421.10	520.00	550.00@	550.00@
Total	19058.68	23858.43	42026.86	54301.70	76819.10	89252.00	110550.00	124956.00
Growth (%)	--	25.18 %	76.15 %	29.21 %	41.47 %	16.18 %	23.86 %	13.03 %

Source: (1) Report on Trend & Progress of Housing in India for 2001- 2006, NHB, New Delhi.

(2) Report on Trend and Progress of Banking in India for 2007- 2008 , RBI, New Delhi.

(3) India's Financial Sector: an Assessment, RBI, Report of CFSA (Committee on Financial Sector Assessment), March 2009.

Notes: @ Exact figures of co-operative housing disbursals are not available from the RBI /NABARD / NHB sources. Thus, 550 Crores is taken as an estimate for the last two years. However, its presence or absence is not likely to have any significant impact in the overall scenario, as it is very small. The estimate itself is an optimistic one, going by its constantly declining trend.

Estimated at 12% above FY 2007 figures, 12% being the estimated growth rate during FY 2008.

In spite of the appreciable growth of institutional finance to housing in India, the housing shortage is still on the rise, particularly since the 2000s. As of FY 2007 (viz. the end of the Xth Plan, 2002-07), the total urban housing shortage itself in India was 24.71 million units. (Besides, there is another 7 million units towards the rural housing shortage) (RBI, 2009) [1]. (Table IV).

Table IV: Housing Stock and Shortage, 1991-2007 (Million Nos.)

Year	Housing Stock (Nos in Million)				Housing Shortage
	Pucca	Semi-Pucca	Kutcha	Total	
1991	29.80	06.20	03.20	40.70	08.23
1997	40.07	06.64	03.35	50.08	07.57
1998	42.13	06.72	03.37	51.85	07.36
1999	44.28	06.80	03.40	53.67	07.18
2000	46.55	06.83	03.42	55.56	06.93
2002	41.17	08.08	02.74	55.80	10.56
2007	47.49	09.16	02.18	66.30	24.71

Source: Compiled from: *Annual Report 2006-'07*, Ministry of Housing & Urban Poverty Alleviation, Govt. of India; in *The Economic Times* dt. 13 Aug. 2007, Chennai Ed.

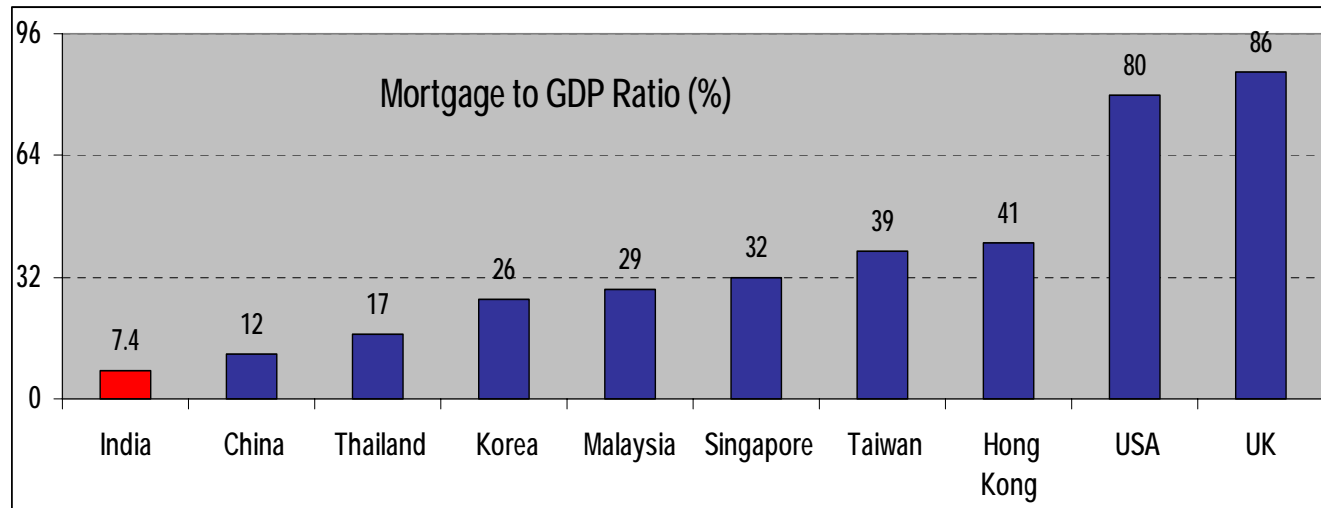
Thus, the problem of housing shortage is still acute in India, and this fact points to the need for alternate models for inclusive housing development in India – one that offers affordable houses to the masses. In fact the housing shortage grew almost 4 times during the period FY 1991– 2007. In this regard, it is noteworthy to state that the mortgage to GDP ratio in India stands at an abysmal level of 7.40% (as of 2008) (RBI, 2009) [1] which is one of the lowest among the world nations – whether developed or developing. Thus, though India's position has improved significantly from 3.4% (2001) to 7.40% (2008), its current status is nowhere when compared with other nations. (Table V) (Figure I).

Table V: Mortgage to GDP Ratio in Selected Countries (as of FY 2005).

(in Percentages)

Country	India	China	Thailand	Korea	Malaysia	Singapore	Taiwan	Hong Kong	USA	UK
MGR #	7.4 *	12	17	26	29	32	39	41	80	86

Sources: European Mortgage Federation (2007), Asian Development Bank (2007), RBI (2009)**Notes:** * As of FY 2008, RBI, (2009); # MGR stands for Mortgage to GDP Ratio.

Figure I: Mortgage to GDP Ratio in Selected Countries of the World (2007)

Sources: European Mortgage Federation (2007), Asian Development Bank (2007), RBI (2009)

As already noted, during the second phase of the financial sector reforms there has been active participation of CBs in the housing credit resulting in constant increase in their relative share in the market year after year. On the other hand, the relative share of HFCs in the housing finance market has been constantly on the decline. In fact, in absolute terms HFCs have also been growing at a fast rate over the years (Table III), but at a pace much slower than that of CBs thus resulting in their relative share constantly coming down as noted above (Table VI and Figure II). Table VII gives the growth rates of the different agencies and a gradual slow down is visible during the last three years.

Table VI: Relative Share of Major Institutional Agencies in the Housing Finance Market

(in Percentages)

Agency	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY: 2008
CBs	29.14	35.91	56.04	60.43	65.61	65.73	63.19	62.62
HFCs	66.31	61.25	42.43	38.42	33.84	33.76	36.31	36.94
ACHFs	04.55	02.84	01.53	01.15	00.55	00.51	00.50	00.44
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

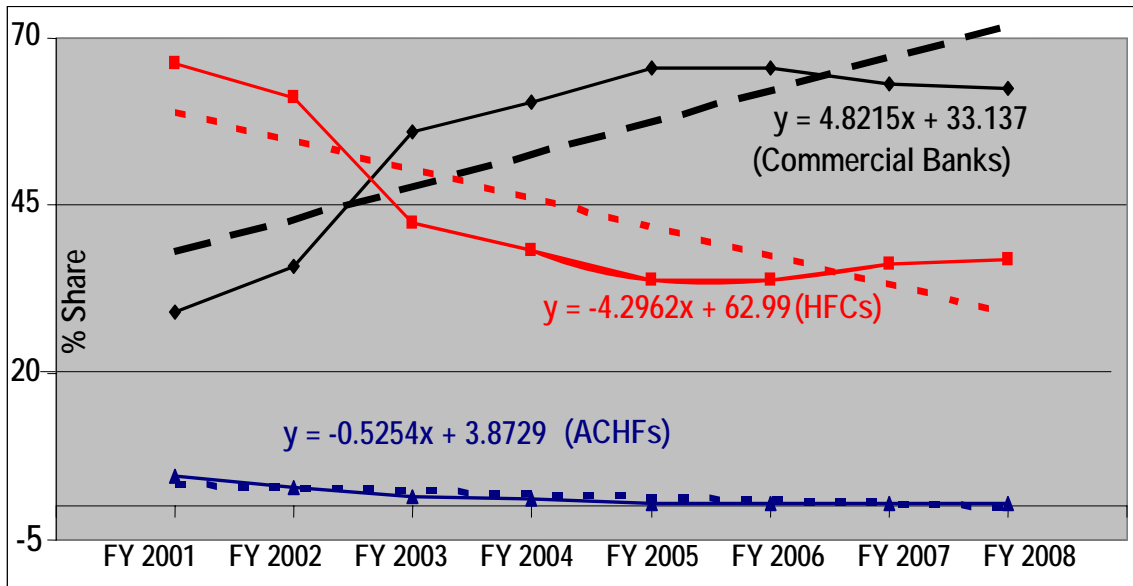
Source: Computed from Figures in Table III] [Note: Assumptions in Table III applicable

Table VII: Growth Rates (Y to Y) of the Major Players in the Housing Finance Industry.

(in Percentages)

Agency	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY: 2008
CBs	54.26	174.95	39.33	53.58	16.32	19.17	12.00
HFCs	15.64	22.02	16.99	24.63	15.80	33.32	15.00
ACHFs	-21.91	-05.33	-02.87	-02.88	23.49	05.77	00.00
Total Industry	25.18	76.15	29.21	41.47	16.18	23.86	13.03

Source: Computed from Figures in Table III] [Note: Assumptions in Table III applicable

Figure II: Relative Market Shares of the Major Agencies in Housing Finance – the Trend.

Sources: European Mortgage Federation (2007), Asian Development Bank (2007), RBI (2009)

8. Problems and Challenges of HFCs in India: a Closer Review

A brief review of the major problems and challenges faced by the HFCs in India, particularly in comparison with CBs is made in this section. The only relative advantage that HFCs enjoy probably is their specialized skills, being dedicated players in housing finance, unlike the CBs that are giving housing advances as one among a number of banking services that they provide.

Housing finance is a low margin, high volume business. Even the most established HFCs have got a spread (margin) of just 2.15 to 2.20 percent. For smaller HFCs, the margin is much lower. Since the early 2000s, the non-performing assets (NPAs) of HFCs have been on the rise.

For HFCs, the cost of funds is higher than that of CBs. It has been noted that lower the size, higher is the cost of funds for HFCs. Likewise, for smaller HFCs, the level of NPAs has been observed to be higher than that of the larger players. For instance, as of 2004 (during which period maximum number of consolidations among HFCs took place) HFCs with capital up to Rs 150 crore had the largest percentage of bad debts at the level of 9.4 per cent, while the same in respect of HFCs with capital in the range of Rs 150–500 crore had 5.3 per cent and that of the well capitalized (capital above Rs 500 crore) had just 1.6 per cent. The net NPA levels of the first two groups of HFCs (ie. capital upto Rs.500 crore) were much higher than the NPA levels of most of the CBs for their wholesale business.

Apart from the higher cost of funds for HFCs, there is the problem of maturity mismatches (asset-liability mismatches) also. This is because, HFCs generally source funds from public deposits of 3 to 5 year duration, while typically the loans are extended for much higher tenors of 15 years or more. However, here also bigger players (HDFC, for instance) have low-cost long-term sources of funds which can be used to offset the long-term funds deployment in the form of housing loans. This will enable such players to avoid mismatch problems and also higher profitability in operations.

Because of growing pressures of competition and dwindling profitability many smaller HFCs had to stop their business, most of them being acquired by their own parent organizations. This has been quite prominent among the bank-sponsored HFCs wherein the respective parent banks have acquired their HFC subsidiaries. In such a case, low cost funds that the banks are entitled to would be helpful for the future housing finance operations of the parent bank. Table VIII shows the major instances of consolidation that have taken place among the HFCs in India.

Table VIII: Major Consolidations among the HFCs in India – an Overview.

Name of the HFC	Kind of consolidation that has happened
Andhra Bank Housing Finance Ltd.	Got merged with its own parent bank, Andhra Bank in 2002
ViBank Housing Finance Ltd.	Got merged with its own parent bank, Vijaya Bank in 2003
BOB Housing Finance Ltd.	This is the HFC subsidiary of Bank of Baroda (BOB). It has already been merged with BOB, after getting clearance from the RBI in 2006
Ind Bank Housing Finance Ltd.	Because of huge losses, already stopped operations, both lending and acceptance of deposits. At present, engaged in recovery of overdue accounts alone. Is in the process of getting merged with its parent, viz. Indian Bank which has 75 % stake.
SBI Home Finance Ltd.	Erosion of net worth because of huge losses. Its registration was cancelled by the NHB (2005). Since stopped its operations.
Vysya Bank Housing Finance Ltd.	This HFC was promoted by Vysya Bank in 1990. Later in 2003, it was taken over by a larger HFC viz. Dewan Housing Finance Corporation. The merged entity is now DFHL Vysya Housing Finance Ltd.
Housing loans portfolio of Citibank	Taken over by LIC Housing Finance Ltd., an HFC sponsored by Life Insurance Corporation Ltd. (LIC), in 2003.
Tata Home Finance Ltd.	Taken over by IDBI bank in September 2003.
Mahrishi Housing Development Finance Corporation (MHDFC)	This HFC from the Maharishi group is in the process of getting taken over by Religare group, a Delhi-based financial services company (2009).
BHW Home Finance Ltd.	Acquired by Deutsche postbank – largest retail bank in Germany (2008).

Source: Compiled by the author, from sources like NHB, RBI, respective HFCs / parent banks etc.

Another handicap with the HFCs in India vis-à-vis the CBs is the fact that there is no parity in the capital adequacy ratio (CAR). As of 2009, minimum CAR stipulated for HFCs is 12 percent as against just 9 percent for CBs.

In short, HFCs in India are facing a number of challenges and handicaps in comparison with CBs and they have to concentrate more on operational efficiency in order to survive and prosper in this ongoing era of thinning profit margins and fierce competition.

9. Operational Efficiency of Major HFCs in India: an ROE Approach

In this section, an attempt is made to analyse the operational efficiency of top ten HFCs in India. As already noted, these ten HFCs represent over 96 percent of the total market share and also 50 percent of the total number of HFCs (viz. 20) granted registration by the NHB with powers for both lending of housing loans and acceptance of deposits. (Table I shows the details).

Table IX shows the cost to income ratio⁴ and ROE of the selected sample of 10 HFCs. Using these parameters, the 10 HFCs are benchmarked in the plot shown in Figure III. It may be noted HDFC – the pioneer HFC and also the industry leader is undisputedly the best HFC with its lowest cost to income ratio and highest ROE. The second best is GRUH Finance Ltd. (GRUH) which, in fact, is a subsidiary company of HDFC⁵. In respect of both ROE and cost to income ratio, GRUH is quite superior to other HFCs, but it distantly follows HDFC. After the above two HFCs (both being from the HDFC group, private sector), a set of 5 HFCs (PNBHFL, CFHL, LICHFL, GICHFL and DHFL) may be seen to have quite similar performance. Of these five HFCs, the first four are HFCs sponsored by two major CBs and two major insurance companies in India – all the four parent organizations being in

⁴ Cost to income ratio is the inverse of operating margin and is given by the ratio of operating expenses to operating income. In profitability analysis of banking and financial services, this ratio can be used more meaningfully than the ‘operational efficiency’ component (viz. net income by revenue) under Du-Pont Analysis.

⁵ Gruh Finance Ltd. (GRUH) is an HFC floated by HDFC. This subsidiary company of HDFC incorporated in July 1986 has been concentrating on rural housing finance. This HFC was initially functioning in the state of Gujarath in India, but subsequently expanded to other neighbouring states in India like Maharashtra, Karnataka, Rajasthan, Madhya Pradesh etc.

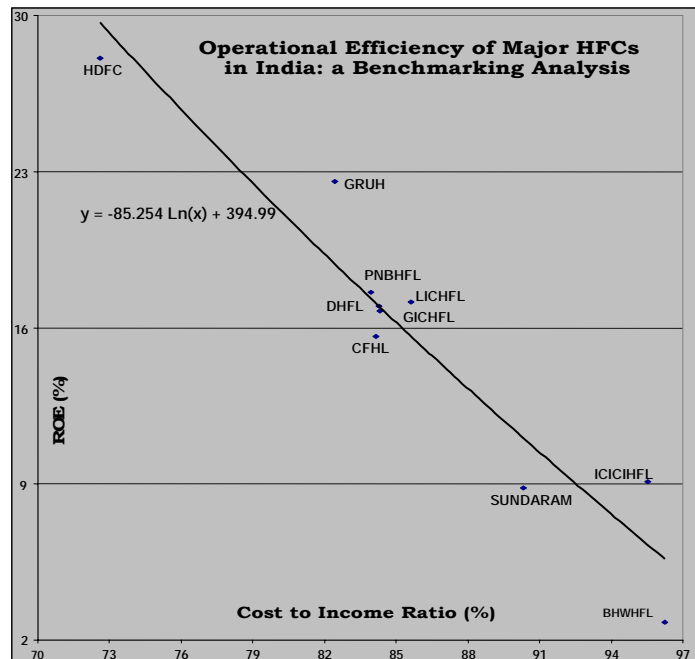
the public sector (government owned) while the fifth HFC (DHFL) is a major private sector company⁶. The seven HFCs as noted above represent nearly 87 percent of the total market of HFCs (See, Table I).

Table IX: Performance Parameters of Major HFCs in India (ROE and Cost-Income Ratio)

	Sundaram	PNB	ICICI	HDFC	GICH	CFHL	GRUH	LIC	DHFL	BHW
Cost to Income (%)	90.32	83.92	95.53	72.59	84.33	84.14	82.43	85.61	84.26	96.23
ROE (%)	8.83	17.60	9.09	28.09	16.76	15.62	22.58	17.17	16.98	2.79

Source: Computed from published *Audited Financial Statements* of the respective HFCs).

Figure III: Relative Operational Efficiency of Major HFCs in India - a Benchmarking Study



Source: Computed from published *Audited Financial Statements* of the respective HFCs

The seven major HFCs as above are followed by two HFCs (viz. ICICIHFL and SUNDARAM) having quite similar position in operational efficiency. While ICICIHFL is one of the largest HFCs by size and market share, SUNDARAM is quite small in this regard⁷ (Table I). These two HFCs are rather distantly followed by BHWFL which is the weakest among the 10 HFCs under study, in terms

⁶ Of the five HFCs (PNBHFL, CFHL, LICHFL, GICHFL and DHFL) first four are sponsored by four major public sector (government owned) organizations in India – two commercial banks (CBs) and two insurance companies respectively. That is to say, the first two HFCs (PNBHFL and CFHL) are those sponsored by two major CBs in India viz. Punjab National Bank and Canara Bank respectively. Likewise, the next two (LICHFL and GICHFL) are those promoted by two major insurance companies in India viz. Life Insurance Corporation of India and General Insurance Corporation of India. The fifth HFC (DHFL) is a prominent private sector HFC in India, one of the oldest ones in its class (incorporated way back in April 1984 – quite before the birth of all the other four HFCs mentioned above). LICHFL was incorporated in June 1989, and GICHFL in Dec. 1989. PNBHFL was incorporated in Nov. 1988 and CFHL in Oct. 1987. LICHFL – the second largest HFC in India, second only to HDFC, is quite larger than all the other four companies mentioned above though its share is not even one-third as that of HDFC. Next comes DHFL by size, which is just one-fifth as that of LICHFL. The remaining three HFCs (GICHFL, CFHL and PNBHFL) have small shares of 1.5 to 2 percent (Table I).

⁷ SUNDARAM (viz. Sundaram BNP Paribas Home Finance Ltd since Nov. 2007, originally incorporated as Sundaram Home Finance Ltd. in July 1999) is one of the youngest HFCs in India incorporated in July 1999 by the Sundaram group. Still, the company has got a reasonable market share of 1.2 percent (Table I). ICICIHFL on the other hand is having a much larger market share of almost 6.5 percent, though it is also a young HFC (incorporated in May 1999) as the subsidiary of ICICI Bank – the largest private sector bank in India.

of ROE, though it has got a reasonably high market share of 1.95 percent⁸ (Table I). Its cost-to-income ratio, however, is by and large comparable with ICICIHFL and SUNDARAM.

The relative position of the ten HFCs is given by the trend line (Logarithmic) fitted to represent the (ROE, ie. y) in terms of the cost-to-income ratio (x) given by: $y = [(-85.254)\text{Ln}(x) + 394.99]$. It may be observed that there are three distinct groups of HFCs (Figure III) based on the value of their cost-income ratio as shown in Table X.

Table X: HFCs Categorised into Three Groups Based on Cost-to-Income Ratio

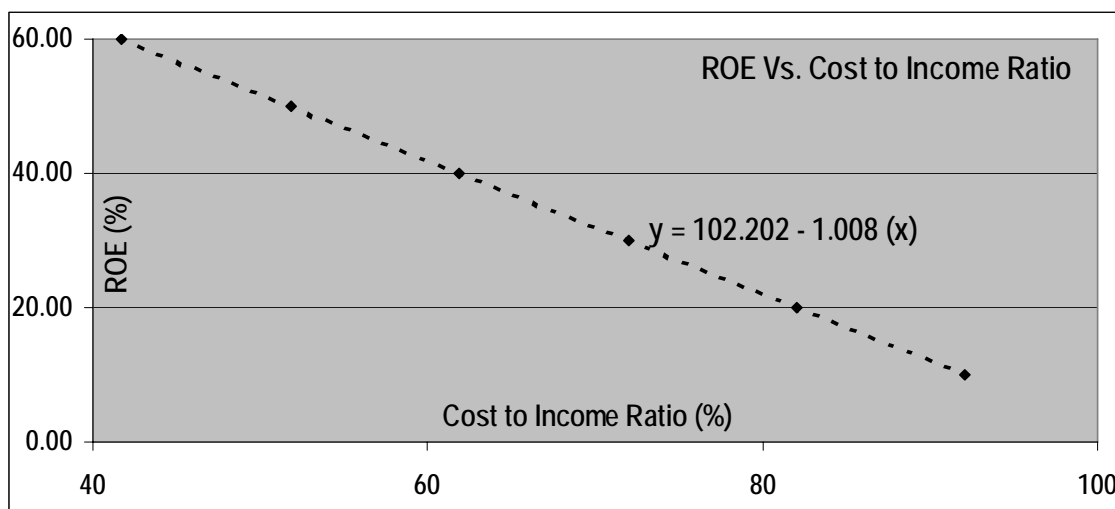
Group	Names of HFCs in the Group	Average Cost-to-Income Ratio	Average ROE
Group I	HDFC	72.59	28.09
Group II	GRUH, PNBHFL, CFHL, LICHL, GICHFL and DHFL	84.12	17.79
Group III	ICICIHFL, SUNDARAM and BHWHL	94.03	06.90

Source: Computed from published figures given in Table IX above

Further analysis of the data (Table IX) using statistical tools like correlation and regression shows that:

- (i) there is significant negative correlation between ROE (the dependent variable, y) and cost to income ratio (independent variable, x), with a high correlation co-efficient of (-95.7) percent.
- (ii) there exists a clear relationship (negative) between ROE (the dependent variable) and cost to income ratio (independent variable, x) with $R = 0.957$, $R^2 = 0.916$, an acceptable D-W co-efficient = 1.881, and a t-value = 10.975 which is significant. The regression equation is thus given by: $y = 102.202 - 1.008(x)$ where y the dependent variable is ROE and x the independent variable is cost-to-income ratio.
- (iii) it may, further, be noted that every 1 percent reduction in cost to income ratio will lead to roughly 1.01 percent increase in ROE, going by the regression pattern as above (Figure IV).

Figure IV: ROE of HFCs predicted in terms of Cost to Income Ratio



Source: Based on regression analysis of the ratios given in Table IX).

⁸ BHW Home Finance Ltd., incorporated in June 1989, is a part of Deutsche postbank – the largest retail bank in Germany – since Nov 2008. Though it has got a reasonable market share of 1.95 percent among the HFC segment (Table I), its operational efficiency is the worst among the largest 10 HFCs (Table IX and Figure III).

It may be mentioned here that cost-to-income ratio (which is the inverse of 'operational efficiency' parameter under typical ROE decomposition analysis) is a better measure for profitability analysis of banks, HFCs and other financial services. (See End Note 4). Being a vital determinant of ROE of HFCs, it needs constant control in to enhance operational efficiency of HFCs.

10. Strategies for Enhanced Operational Efficiency of HFCs in India: an Analysis

In this section, an attempt is made to chalk out the major strategies that could be adopted by the HFCs for enhanced operational efficiency. These are given below in Table XI

Table XI: Strategies for HFCs for Enhanced Operational Efficiency and Competitiveness.

Strategy Variable	Strategy Suggested	Remarks
Operating Cost – Interest costs	Interest costs need to be closely monitored and brought under control. In the current scenario, the following strategies are good: (i) Use of external sources of funds (like, Foreign Currency Convertible Bonds) (ii) Cheap public deposits (core deposits)	Cheap external sources are, however, accessible only to the large HFCs like HDFC because of stringent norms (minimum capital of the HFC, minimum loan amount etc.)
Operating Costs – Staff Costs	Adoption of modern ICT tools to cut down the cost and enhance the service quality, like, (i) "Single Window" service delivery by integrating the operating subsystems like advances (credit), deposits etc. (ii) Interconnecting branches for better service delivery, minimum paper work (iii) Skilled and techno-savvy labour force for enhanced productivity and cost savings.	ICT adoption has become an imperative rather than an option for the HFCs. Apart from the tremendous cost savings this would ensure high quality service delivery, fast responses. Of late, ICT has been proving to be a vital tool for high operational efficiency.
Operating Costs- Establishment Expenses	Close control of establishment costs through: Reducing paper work, say by ICT adoption Reducing legal / processing charges by going for common legal scrutiny (eg. in financing of Projects)	While interest costs of HFCs are by and large market determined and beyond their control establishment costs can be controlled to a large extent.
Balance Sheet Management	For cleaning the balance sheet, by reducing the relatively illiquid assets RMBS (Residential Mortgage Backed Securitization) is quite desirable as a means of financing for HFCs.	RMBS is only slowly picking up in India because of a few persisting problems in the legal and regulatory systems.
Asset Liability Management (ALM)	Proper ALM is one of the crucial pre-requisites for the long-term survival and growth of HFCs because of the long-term nature of home loans and relatively short-term deposits (sources)	Close monitoring of various sources and uses of funds is essential for avoiding asset-liability mismatch problems.
Management of receivables/NPAs (non-performing assets)	Timely repayment of advances is to be ensured for minimizing the problem of NPAs (non performing assets). High level of NPAs has got a direct adverse impact on profitability.	NPA management starts right from the stage of processing of credit proposals. Due emphasis on credit quality is essential.
Credit Quality / Due Diligence	Business is important. Equally important is the need for ensuring quality of advances. Dilution of due diligence for increasing business may ultimately lead to high NPA provisions and hence low profitability and efficiency.	Ensuring high quality of credit is gaining importance day by day. Because of the fierce competition in the market, this is quite challenging as well.

Source: Suggestions of the Author, based on analysis of the emerging market scenario in India

11. Concluding Remarks

In view of the foregoing, it may be observed that there exists quite significant difference in the operational efficiency of major HFCs in India, primarily because of the difference in the cost structure of the respective HFCs. While large HFCs (like, HDFC) have an advantage over smaller ones in sourcing cheap funds, size alone is not the sole criterion for better efficiency. Equally important is the need for ensuring credit quality. Large HFC like ICICIHFL is lagging behind in operational efficiency because of its high cost-to-income ratio, primarily because of high level of NPA provisioning, poor credit portfolio and poor recovery management systems. Asset Liability Management (ALM) is growingly becoming significant for HFCs these days. So also, is the case of RMBS (Residential Mortgage Backed Securitisation) and such other strategies for balance sheet management. By adopting the strategies as suggested, HFCs in India irrespective for sizes and track record, can perform far better.

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Appendix I

List of HFCs in India Granted Certificate of Registration by the NHB

Type I: HFCs that Provide Housing Finance and also Accept Public Deposits	
01.	Can Fin Homes Ltd.
02.	Cent Bank Home Finance Ltd.
03.	Deutsche Postbank Home Finance Ltd. (Formerly, BHW Home Finance Ltd.)
04.	Dewan Housing Finance Corporation Ltd.
05.	DHFL Vysya Housing Finance Ltd.
06.	GIC Housing Finance Ltd.
07.	GRUH Finance Ltd.
08.	Housing and Urban Development Corporation Ltd.
09.	Housing Development Finance Corporation Ltd.
10.	ICICI Home Finance Company Ltd.
11.	IDBI Home Finance Ltd
12.	Ind Bank Housing Ltd
13.	LIC Housing Finance Ltd.
14.	Manipal Housing Finance Syndicate Ltd.
15.	National Trust Housing Finance Ltd.
16.	PNB Housing Finance Ltd.
17.	REPCO Home Finance Ltd.
18.	Sundaram BNP Paribas Home Finance Ltd.
19.	Vishwakriya Housing Finance Ltd.
20.	AIG Home Finance India Limited (Formerly, Weizmann Homes Ltd.)
Type II: HFCs that Provide Housing Finance, but Cannot Accept Public Deposits	
01.	GE Money Housing Finance
02.	Haware's Housing Development Finance Corporation Ltd.
03.	HBN Housing Finance Ltd
04.	Inara Housing Finance Limited.
05.	Indiabulls Housing Finance Limited
06.	India Home Loans Limited
07.	Jahnavi Home Development and Finance Ltd.
08.	Kerala Housing Finance Ltd.
09.	Maharishi Housing Development Finance Corporation Ltd.
10.	Mahindra Rural Housing Finance Ltd
11.	MAS Rural Housing and Mortgage Finance Ltd.
12.	Micro Housing Finance Corporation Ltd. (MHFCL)
13.	Orange City Housing Finance Limited.
14.	Rose Valley Housing Development Finance Corporation Limited
15.	Sahara Housing finance Corporation Ltd.
16.	Satyaprakash Housing Finance India Ltd.
17.	SRG Housing Finance Ltd.
18.	Swagat Housing Finance Company Ltd.
19.	Utkal Housing Finance Ltd.
20.	Vastu Housing Finance Corporation Ltd.
21.	Reliance Home Finance Pvt. Ltd.
22.	India Infoline Housing Finance Limited (IIHFL)
23.	Tata Capital Housing Finance Limited (TCHFL)

Source: Official Website of National Housing Bank (NHB), India, www.nhb.org.in.(August 2009)