

Management of Housing Finance Companies in India in the Emerging Scenario: Some Competitive Strategies



Economics

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ABSTRACT

It is well recognized that housing has got immense potential for economic development of any nation, apart from its social development role. The vast forward and backward linkages of housing enable it to promote rapid economic development. The fact that housing is one of the primary requisites of human life itself underlines its significance in a welfare state from the social perspective. Housing development used to occupy a prominent place in the policy decisions and budget outlays of the Governments, particularly those of developing nations, because of its vast potential for socio-economic development. In the ongoing reforms era in India, the aggressive entry of commercial banks (CBs) into the retail housing finance market has resulted in the gradual decline in the relative market share of housing finance companies (HFCs). In view of the ever-growing competition, this paper seeks to suggest a few strategies for the survival and growth of HFCs.

INTRODUCTION

Housing has got utmost significance in any society as it is a primary need, second only to the need for food. Apart from the social significance, housing has got tremendous importance as a tool for faster economic development of a nation, primarily because of its fast forward and backward linkages. Its potential to bring about vast socio-economic development has made a governmental priority in many countries, particularly developing nations, including India. Housing finance market in India used to be dominated by the housing finance companies (HFCs) with the pioneer HFC viz. HDFC as the undisputed leader. House building advances of some employers used to serve a section of the market, and that too in a limited way. The role of commercial banks (CBs) was quite limited in respect of housing finance to individuals (retail credit). However, in the ongoing era of financial sector reforms initiated in the early 1990s, there have been a lot of changes. The policy decision of the banking regulator viz. RBI – the Reserve Bank of India, to permit the CBs to enter the housing finance market and to insist on CBs to earmark 2 percent of their incremental credit to housing finance in 1991, has resulted in the aggressive entry of CBs into the retail housing finance market. This, in turn, has posed a threat to the existence of HFCs, who have been leading the market. The market share of HFCs has begun to be eaten away by the CBs, and eventually in FY 2003 the CBs have overtaken the HFCs. Since then, CBs are leading the market as the most dominant players. HFCs have relative limitations vis-à-vis the CBs, like, higher cost of funds, lesser branch network, more stringent regulatory norms of NHB (like, capital adequacy ratio) as against the norms applicable to CBs as per RBI guidelines. Customized service, and sometimes lower operating costs (say, for large HFCs) are probably the only advantages for HFCs as against CBs. In the above context, implementation of meticulously planned, clearly designed strategies are required for the continued survival and growth of HFCs, many of them having already succumbed to the pressures of competition; either merged with their parent organization or acquired by some other HFC or bank / organization. .

HOUSING FINANCE INDUSTRY IN INDIA

As noted earlier, the banking regulator Reserve Bank of India (RBI) took a strategic decision to permit the CBs also to provide onward lending to individuals for housing purpose in 1999. Many CBs aggressively entered the retail housing finance market, posing a serious threat to the HFCs which hitherto controlled the market as specialized institutional agencies for housing finance. With the entry of CBs, the competition in the industry has become very intense, the relative prominence of HFCs has gradually come down. In 2003 the banks have overtaken HFCs as the largest intermediary group and continue to lead the market since then. This has resulted in the gradual decline in the relative market share of HFCs. It may be noted that since FY 2004 CBs account for almost three-fourth of the total housing credit. (Table I)

Table I: Break-up of Home Loan Portfolio among HFCs and CBs (Amounts in Rs. billion)

Particulars	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10
HFCs	354	468	598	734	912	1082	1219
CBs	894	1347	1852	2310	2557	2724	2918
Total	1249	1815	2450	3044	3468	3806	4137
Credit Growth – HFCs	27%	32%	28%	23%	24%	19%	17%
Credit Growth – CBs	158%	51%	38%	25%	11%	07%	11%
Credit Growth – Total	100%	45%	35%	24%	14%	10%	12%
Share of HFCs in Total Credit	28%	26%	24%	24%	26%	28%	29%
Share of CBs in Total Credit	72%	74%	76%	76%	74%	72%	71%

(Source: *Housing Finance Companies and Indian Mortgage Market*, ICRA, Feb. 2010.)

LIMITATIONS OF HFCs AS AGAINST CBs

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 2.20 to 2.30 percent as of FY 2009, down from over 2.5 percent as of FY 2008. Since FY 2009, the non-performing assets (NPAs) of HFCs have been generally on the rise.

For HFCs, the cost of funds is higher than that of CBs. It is noted that lower the size, higher is the cost of funds for HFCs. 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, 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 01.6 per cent. The net NPA levels of the first two groups of HFCs were much higher than those 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). Because, HFCs generally source funds from public deposits of 3 to 5 year duration, while typically the loans are extended for higher tenors of 15 years or more. However, here, bigger players (eg. HDFC) 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.

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 9 percent for CBs.

In short, HFCs in India are facing a number of challenges and handicaps in comparison with CBs. They have to focus more on operational efficiency so as to survive and prosper in the ongoing era of thinning profit margins and fierce competition. Because of growing competitive pressures 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. (Table II).

Table II: Major Consolidations among the HFCs in India

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.)

COMPETITIVE STRATEGIES FOR HFCs

Firstly, an objective and transparent benchmark rate is required for variable (flexible) rate loans, which accounts for more than 90 percent of the total number of existing housing loan accounts, and also the entire lot of new loans (as HFCs and CBs, of late, have stopped fixed rate loans). Going by the PLR, which is often the practice, the existing borrower (older loan accounts,

those sanctioned prior to the introduction of PLR-linked variable rates) are bound to lose by paying a 1.5 to 2 percent higher interest. In short, more transparency is required in interest rate fixation.

Secondly, HFCs should go for cheap, long term sources of funds for (i) enhanced profitability, and (ii) effective ALM (asset-liability management). The current practice of relying on large wholesale funds may affect their profitability. Over-dependence on relatively short-term sources (eg. public deposits) will lead to asset-liability mismatches. It may be noted that the ongoing tightness in liquidity at the systemic level is affecting the cost of funds of the HFCs. The cost of funds is on the rise since FY 2006, the cost of smaller HFCs being around 0.5 percent higher than the average cost of all HFCs). Access to cheap long term lines of credit (LOC) is most desirable in the long run, notwithstanding the fact that only the most progressive and large HFCs (eg. HDFC) can go for that, given the stringent conditions stipulated by the RBI for external debts. (eg. FCCBs – Foreign Currency Convertible Bonds, Term loans from international financial institutions etc.).

Thirdly, use of RMBS (Residential Mortgage Backed Securitisation) mode of financing can help HFCs to cleanse their balance sheets by minimizing relatively illiquid assets for raising finance. Though there are some regulatory handicaps in the Indian scenario for adoption of RMBS, it may be noted that RMBS has got excellent potential for improving the quality of assets and reducing cost of finance. It has both micro and macro level benefits.

Fourthly, use of scientific credit scoring models can significantly improve the objectivity of credit decisions. This in turn improves the asset quality, reduces NPA level and provisioning and hence improves profitability. While the most progressive HFCs (like, HDFC, ICICI Home Finance etc.) are already using such advanced credit scoring models, most other particularly the smaller HFCs are yet to use such models.

Fifthly, use of higher-end technological platforms can reduce operational expenses and can bring about enhanced profitability. It is well recognized that technology can improve the quality of customer service, apart from enhancing operational efficiency. Embracing technological advancements is fast becoming an imperative for survival and growth, rather than an option.

Sixthly, customer centricity is fast emerging as the most essential ingredient in a typical business model for financial intermediaries like HFCs. More importantly, technology-driven tools for enhanced customer-centricity are fast being incorporated by firms in their service delivery. Modern data mining softwares can predict the credit worthiness of customers based on their repayment track record over the years. Use of such platforms makes credit decisions scientific and instantaneous.

Seventhly, augmenting the core business income with supplementary businesses (like, loans for purchase of consumer durables, furniture items etc.), fee-based activities etc. is quite desirable for enhanced profitability and also for risk diversification. Technology can play a vital role in providing such additional and 'add on' services.

Eighthly, focusing on some emerging niche areas of housing finance that are really promising in terms of profitability and business volumes is a really meaningful strategy. These areas include housing microfinance (HMF), specialized schemes for affordable housing particularly as a tie-up arrangement with leading developers, providing housing finance linked to income generating activities (like, PHIRA – productive housing in rural areas – scheme of the NHB, for instance) etc. are a few examples. It may be pointed out here that Gruh Finance, a subsidiary of HDFC – the largest and pioneer HFC in India, is doing very well in the rural housing front, its operations being basically in Gujarat. Equally good is the commendable performance of HMF wings of SEWA, SKF and similar microfinance entities.

CONCLUDING REMARKS

In view of the foregoing, it may be pointed out that though the entry of CBs has posed threat to the very existence of HFCs particularly the smaller HFCs, prudent management of finance and carefully thought-out business models can help many HFCs to survive and prosper. The market for housing finance is quite vast in India, given the very low level mortgage penetration. Use of advanced technology, modern credit scoring models and

sophisticated data mining tools can significantly improve management of credit risk, and hence improve profitability and operational efficiency. Making use of RMBS mode of financing and cheap external sources for long term financing are other meaningful strategies. Above all, the inherent strengths of HFCs (viz. much more specialized services vis-à-vis services of a general nature of CBs) should be taken advantage of by them.

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