A STUDY ON FACTORS INFLUENCING THE PERFORMANCE OF HOUSING FINANCE COMPANIES IN INDIA

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ABSTRACT

The housing finance companies have been the major players in the residential financing sector owing to favorable government policies and regulations. The performance of such finance institutions has experienced a steep decline in the past decade owing to the intrusion of commercial banks into the housing finance market. Since then the marketshare of housing finance companies has been in constant decline leading to liquidation of several smaller firms. To survive in such a competitive predatory market, Housing finance companies must retrospect on the factors that are affecting its performance and take steps to remedy the shortcomings. The study attempts to review the growth of housing finance sector to understand the factors that have led to the rise and fall of HFC's in India, identify factors influencing the performanceand analyze the shortcomings to make suitable suggestions to improve the performance of housing finance companies.It was observed that among several factors that affect performance, the lending rates, Quality of assets, Income generated and expenses directly affected the financial performance of housing finance companies while factors such as services and financial productsoffered to the customers and appropriate marketing of their financial products had a great influence on the market share of housing finance companies.

Keywords: Cost to Income Ratio, Benchmarking, Housing finance

1. INTRODUCTION

The Indian economy is a fast-growing economy with a major chunk of its population coming under the middle-income class of the society. Owning a house remains the greatest dream for most middle-class Indians which is made possible by housing loans through banks or housing finance companies. The demand for residential housing in the real estate industry has increased drastically owing to urbanization making India one of the biggest housing market around the world. The Housing market remains one of the most influential factors in the government's policy making. The National housing bank (NHB) was established only in 1988 and since then numerous formal housing finance institutions have come up owing to increased demand.An increase in the population of urban regions has also promoted the growth of housing finance companies in India.

A look at the government policies towards housing and housing finance will make it evident that housing remains an inevitable priority for any government in its decision making. A huge number of monetary benefits and tax incentives given by the government has catapulted the growth of housingfinance companies. According to a report by the RBI in 2009, the mortgage to GDP ratio has risen from 3.4 percent to 7.4 percent from 2001 to 2008. The reason for this is the favorable policies and regulations set by the incumbent governments. The housing finance sector has shown a considerable improvement of more than 30 percent in its compounded annual growth rate. More and more institutions are targeting the housing sector which has led to the increase in housing loans through commercial banks pushing aside the Housing finance companies (HFC's) that used to be the dominating institutions of the housing sector. The market share of commercial banks in the housing sector has been on the rise since 2003 compared to the HFC's whose market share has been constantly declining. Many Housing finance companies have been pushed to the brink of liquidation due to Non-performing loans. The study attempts to analyze the factors that are directly or indirectly affecting the performance of housing finance companies. The growing competition in the housing finance sector with more and more financial institutions entering the market makes enhancement in the operational efficiency of Housing finance companies mandatory for survival.

1.1 STATEMENT OF THE PROBLEM:

The housing sector has become a rapidly growing market attracting many financial institutions towards housing finance. The housing finance companies(HFC's) used to be the dominant players in the field offinancing for residential properties. But the intrusion of commercial banks under the directive of RBI has led to the decrease of market share for the HFC's. This has put the operational efficiency of housing finance companies under question. The HFC's whose business model is based on housing finance are struggling to compete against the commercial banks who contribute only 3 percent of their deposits towards housing finance. Numerous factors influence the efficiency of finance institutions. These factors need to be studied in detail and analyzedfor ways of improving the operational efficiency of housing finance companies as the survival in an intensely competitive market depends on it.

1.2 OBJECTIVES OF THE STUDY

The study focuses on the following objectives based on the statement of the problem and its scope.

1. To review the direct and indirect factors that influence the performance of housing finance companies.
2. To identify the factors that have a major impact on efficiency of HFC's
3. To make suitable suggestions for improvement of operational efficiency.

2. REVIEW OF LITERATURE

Kumaraswamy and Nayan (2014) conducted a study on the marketing strategies of housing finance. The author stressed on the importance of marketing campaigns to improve the market share of financing companies. The author also compared the marketing strategies of housing finance companies and commercial banks belonging to both public and private sector. The study concluded that while commercial banks are marketing their housing finance products vigorously, Housing finance companies are lagging in promoting their products. Housing finance interest rates are rapidly coming down due to favorable policies of the regulators while housing finance companies are still lending at higher rates which is a major turn down for customers.

Manoj P K (2010) conducted a study on the competitiveness of housing finance companies in comparison to commercial banks and attempted to benchmark the housing finance companies of India. The author states that housing finance companies have been in a steep decline after commercial banks entered the housing finance sector. The survival of housing finance companies is at stake if the HFC’s fail to rethink their marketing strategies and improve their operational efficiency. The author argues that there is anutmost need for improving the performance if the housing finance companies hope to survive through the era of globalization. The paper discusses various government policies and statistics related to the housing finance market to benchmark the present condition of HFC’s.

A committee headed by**Dr. Rakesh Mohan (2009),**Deputy governor, Reserve bank of India submitted a six-volume report on financial sector assessment to the then president of India. The report states that for the growth of the stressed housing finance sector, it is imperative to create a National housing price index and a housing starts index.

Gupta and Kaur (2008)analyzed the private sector banks of the Indian housing finance sector and rated them based on their performance. The study focused on several major factors such as capital adequacy, lending rates and income generated to rate the banks. A sample of 10 banks were selected and examined among which HDFC bank held the highest position followed by karur Vysya and Tamilnadu mercantile bank

Bodla and Verma (2006)attempted to conduct a comparative study on the operational efficiency of the State bank of India and ICICI using the CAMEL model for a five-year term from 2000 to 2005. The study mainly focused on the factors of capital adequacy, management efficiency and asset quality. The state bank of India had an edge over ICICI in terms of Capital adequacy but ICICI bank fared better in all the other aspects such as better management, earnings, and asset quality.

Prasuna (2003)attempted to study the efficiency of 65 Indian banks in terms of factors that attract customers. The author has used the CAMEL model for rating the banks. The study concluded that even though several factors contribute to better performance, the service quality of the institution, more innovations in new financial products and better bargains were having a greater impact on the perspective of the customers. These factors will help financial institutions survive in the prevailing competitive market.

3. RESEARCH METHODOLOGY

The study depends mainly on the secondary data collected from 48 Housing finance companies in India. From the total, Top 9 Housing finance companies of MCLR, PLR and base rates of different financial institutions, Interest Expense and Net Profit, Net Interest Income (NII), Capital adequacy and Non-performing assetsfor the year 2020 have been collected and interpreted.

4. ANALYSIS AND INTERPRETATION

The housing finance companies in comparison to commercial banks have been reviewed based on a few factors that affect their performance and efficiency to a great extent. The lending rates, profitability, Net interest incomes, Capital adequacy and Non-performing assets are some factors that directly undermine a financial institution.

Effect of MCLR, PLR and Base rate of CB's and HFC's:

The lending rates of different financial institutions play a major role among the Indian population in the selection of the lending agency. The MCLR, PLR and base rates of different financial institutions is listed below.

Table 1: MCLR AND BASE RATE FOR INDIAN BANKS

Bank	**Current MCLR/ PLR Rate – 08th Nov 2020**	**Base Rate**	**Latest Update**
SBI	6.65% - 7.30%	7.40%	10th Oct 20
HDFC	16.20%	-	12th Jun 20
ICICI Bank	7.10% - 7.35%	8.85%	01st Nov 20
Axis Bank	7.30% - 7.65%	9.15%	18th Sep 20
PNB Housing Finance	14.35%	-	16th Apr 18
ICICI Home Finance	17.70%	-	03rd Apr 20
LIC Housing Finance	14.70%	-	01st Jan 20
Bank of Baroda	6.65% - 7.50%	8.15%	12th Oct 20
Citibank	6.15% - 6.50%	5.40%	07th Oct 20
Indiabulls	24.00%	-	01st Oct 18
HDFC Bank	6.95% - 7.50%	9.30%	07th Oct 20
IndusInd Bank	8.30% - 8.95%	10.30%	22nd Sep 20
Kotak Bank	7.05% - 7.85%	7.40%	16th Sep 20
Yes Bank	6.35% - 8.80%	9.25%	01st Oct 20
RBL Bank	8.40% - 8.95%	10.05%	22nd Sep 20
Piramal Housing Finance	16.05%	-	05th May 19
IDFC First Bank	8.40% - 9.50%	9.50%	08th Oct 20
DBS Bank	6.40% - 6.90%	7.00%	07th Oct 20
Bajaj FinServ	20.16%	-	01st May 14
United Bank of India	6.80% - 7.60%	9.55%	01st Oct 20
Union Bank of India	6.75% - 7.40%	8.35%	11th Oct 20
Jammu And Kashmir Bank	6.75% - 8.00%	9.50%	10th Oct 20
Bandhan Bank	8.94% - 11.09%	12.00%	30th Sep 20
UCO Bank	6.70% - 7.30%	9.60%	10th Oct 20
Punjab and Sind Bank	7.10% - 7.75%	9.70%	16th Sep 20
Central Bank of India	6.55% - 7.10%	9.10%	15th Oct 20

Canara Bank	6.95% - 7.40%	9.40%	07th Oct 20
Bank of Maharashtra	6.80% - 7.30%	9.40%	07th Oct 20
LT Housing Finance	17.50%	-	26th Apr 18
Bank of India	6.70% - 7.80%	8.80%	01st Nov 20
Andhra Bank	6.75% - 7.40%	9.45%	11th Oct 20
Indian Overseas Bank	7.05% - 7.50%	9.45%	10th Oct 20
HSBC Bank	7.10% - 7.40%	8.30%	02nd Nov 20
Standard Chartered Bank	7.15% - 9.35%	8.85%	07th Oct 20
Corporation Bank	6.75% - 7.40%	9.65%	11th Oct 20
IDBI Bank	7.10% - 8.60%	9.65%	12th Oct 20
Indian Bank	7.05% - 7.30%	8.30%	03rd Nov 20
Allahabad Bank	7.05% - 7.30%	8.30%	03rd Nov 20
OBC	6.80% - 7.60%	9.50%	01st Oct 20
PNB	6.80% - 7.60%	8.80%	01st Oct 20
Karur Vysya Bank	7.90% - 8.65%	10.10%	07th Sep 20
Syndicate Bank	6.95% - 7.40%	9.50%	07th Oct 20
DCB Bank	8.35% - 9.95%	10.64%	05th Sep 20
Dhan Laxmi Bank	8.00% - 8.90%	10.70%	01st Nov 20
Karnataka Bank	8.20% - 8.95%	9.25%	01st Sep 20
South Indian Bank	7.80% - 8.20%	9.75%	20th Sep 20
Federal Bank	7.85% - 8.10%	9.63%	16th Sep 20
Lakshmi Vilas Bank	9.05% - 9.60%	10.15%	01st Oct 20

Source: www.myloancare.in

The MCLR is a internal benchmark that helps bank in fixing the rate of interest on floating rate loans while PLR is the prime lending rate followed by non-banking financial companies (NBFC) and housing finance companies (HFC’s) for fixing the rate of interest. From April 2018, the RBI has instructed all banks to link their base rates to MCLR rates which will lower the interest rates on bank housing loans. It can also be noted that the PLR followed by housing finance companies is much higher compared to the MCLR of banks which will increase the interest on housing loans lend by HFC’s. This greatly affects the popularity of HFC’s as the interest rates in banks are much lower and affordable by the middle-income class of Indians.

Interest Expense and Net Profit:

The sales and net profit data reveals that size of the housing finance company plays a major role in its performance and survival in the market. The data reveals that the larger housing finance companies such as Aavas financiers, PNB, HDFC etc., have better sales and profit turnover compared to smaller HFC's that suffer from lesser profits inspite of good sales growth. This is mainly due to the burden of interest expenses as smaller financing companies depend on loans from other financial institutions. Indiabulls housing finance is one good example where inspite of a 12.6% growth, the net profit is a meagre 1.8% due to other expenses.

Table 2: Sales and net profit

Housing Finance Companies	**Sales growth**	**Net Profit Growth**
HDFC Ltd	16.5%	24.3%
LIC Housing Finance	12.9%	11.6%
Aavas Financiers	54.1%	67.1%
Indiabulls Housing Finance	12.6%	1.8%
HUDCO	13.4%	10.2%
PNB Housing Finance	36.6%	28.6%
Can Fin Homes	20.0%	34.3%
REPCO Home Finance	14.2%	17.9%
GIC Housing Finance	14.5%	12.0%

Source: https://blog.investyadnya.in/

Net Interest Income (NII)

The net interest income is a direct index for the performance of a financing institution as more income and lesser expenses increase the probability for a better net profit. It can be observed from the below table that HFC's with better NII have better net profits compared to the other companies with a lower net interest Income. Financing companies rely on the interest as their primary source of income and hence it is a major factor influencing its performance.

Table 3: Net Interest Income

Housing Finance Companies	**NII% Share**
HDFC Ltd	92.1%
LIC Housing Finance	98.1%
Aavas Financiers	85.7%
Indiabulls Housing Finance	59.0%
HUDCO	98.2%
PNB Housing Finance	69.7%
Can Fin Homes	98.3%
REPCO Home Finance	94.6%
GIC Housing Finance	99.0%

Source: https://blog.investyadnya.in/

Capital adequacy ratio:

The capital adequacy ratio is an indicator of capital available in comparison to the companies risk weighted assets. A better capital adequacy ratio is an indicator of better financial health. Aavas financiers has a capital adequacy ratio of 55.9% while its nonperforming asset percentage is only 0.46%. In comparison to Aavas, GIC housing has a higher NPA of 5.37% and its capital adequacy ratio is only 16.6%.This also reveals that the percentage of Non-performing assets influences the capital of a company affecting its overall performance. An increase in NPA's greatly undermines the credibility of a financial institution affecting its operational efficiency and income.

Table 4: Capital adequacy and Non-performing assets

Housing Finance Companies	**Capital adequacy ratio**	**Gross NPA**
HDFC Ltd	17.3%	1.87%
LIC Housing Finance	13.9%	2.86%
Aavas Financiers	55.9%	0.46%
Indiabulls Housing Finance	27.9%	2.20%
HUDCO	57.0%	3.82%
PNB Housing Finance	18.1%	2.76%
Can Fin Homes	22.3%	0.75%
REPCO Home Finance	26.2%	4.00%
GIC Housing Finance	16.6%	5.37%

Source: https://blog.investyadnya.in/

Outstanding loans:

The amount of outstanding loans affects the performance and profitability of financing businesses to a great extent. Unlike commercial banks, most of the small housing finance companies depend on financing from external sources for lending purposes. This leads to higher interest expenses for the HFC’s. The companies can profit only if the loans are performing well. In case of huge amounts of outstanding loans, the expenses for the company in terms of interest expense keeps rising leading to a loss in net profits. Small housing finance companies that depend on external financing for their lending needs must maintain a check on the amount of outstanding loans and take diligent measures for the recovery of the same.

Centralized Services:

Most of the commercial banks of India offer several centralized services apart from financing aided with technology such as internet banking, UPI facilities, mobile banking and many more. There are 12 nationalized banks in India that are also participants in the housing finance sector. On the other hand, there are nearly 84 recognized housing finance companies which mainly depend on housing finance alone as its primary business model. This kind of heavy fragmentation among housing finance companies leads to decentralized services which hinders the customer satisfaction. This is one major reason why housing finance companies started losing popularity while competing against commercial banks that offer better services and better customer satisfaction.

Marketing:

The housing finance market in India is growing at a rapid rate.In the past decade, commercial banks have taken over the market pushing aside the Housing finance companies using their aggressive promotional marketing. Kumaraswamy (2014) suggested that housing finance companies will find it hard to survive in the competitive market if they fail to rethink their marketing strategies. This might be because commercial banks have several financial products to offer to the customers while housing finance companies have been majorly concentrating on real estate and housing finance only. Better financial products will help financial institutions attract better customers and retain them.

5. SUGGESTIONS:

The following suggestions for improving the performance of housing finance companies have been derived based on the findings

1. Housing finance companies must concentrate on effective recovery of non-performing assets such as outstanding loans.
2. Diligence in ensuring high quality of assets will reduce non-performing assets.
3. Housing finance companies are concentrating only on financing for housing requirements which has greatly limited their income. Concentrating on financing for other needs may raise additional income leading to better performance annually.
4. Calculated investments and deposits will reduce expenses due to interest.
5. Use of better technology will reduce operating costs and staff income expenses considerably.
6. Commercial banks have better centralized services which makes operating across the country easier compared to the highly fragmented HFC’s. Use of ICT to provide better centralized services will attract more valuable customers.
7. Residential mortgage-based securitization will control the increase in non-performing assets.

6. CONCLUSION:

The available literature and the corresponding finding of the paper reveal that the housing finance companies of India face numerous challenges that threaten their survival in the fast expanding market. The non-performing assets of HFC's have been on the rise and the market share has been declining steadily. Housing finance companies must concentrate on several crucial factors such as loan recovery, income generation, cost cutting and better services to improve their performance. Smaller housing finance companies are the worst affected and must find ways of tapping cheaper financing sources and cut interest costs. Meaningful changes to the operations can still revive the housing finance market failing which surviving against the better equipped commercial banks will be impossible in this era of globalization.

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