Chapter - II

REVIEW OF LITERATURE AND METHODOLOGY
Before the establishment of housing finance institutions like HUDCO, HDFC etc, the studies made on housing were predominantly on the policies and programmes of the Government. It was only from 1980 onwards the studies have covered housing finance also

The first significant work on housing was the Report of the National Commission on Labour (1946)\(^1\) which reviewed the National Government's Housing Policy. It pointed out the difference in the emphasis envisaged and also the government wanted the housing programmes to be dependent on manpower and material resources and at the same time the Government seemed to be keen on making a start irrespective of possible difficulties

Renan Betrand in his paper entitled "Housing and Financial Institutions in Developing Countries (1983)\(^2\) pointed out that weak existence of borrowed capital in the developing countries was the main cause for the inadequate development of housing. He suggested that the problem of housing finance could be solved only through reconciling three conflicting objectives (a) improving competitions, (b) increasing efficiency, and (c) stimulating long term finance

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Vinay D. Lall (1986) in an important perspective paper on housing finance in 1986 lists the questions set out:

(i) Can the existing institutions, if necessary, with some strengthening of their capability, deliver the goods needed, or new institutions needed for the purpose?

(ii) Will the new system result in any additionality of resource mobilisation? Or will there be only a re-allocation of resources that would have been ordinarily mobilised without the new institutional development?

Rationale for New Institutions

(i) LIC, GIC, UTI and Banks are not suited for housing finance in their present form

(ii) HUDCO caters to Economically Weaker Sections and operates largely in a non-commercial capacity

(iii) HDFC is a major success story

(iv) HDFC- caters to HIGs, with a high loan - to - value margin

Lall also made a mention about additionality in resource mobilisation. The rationale of NHB is to mobilise resources that may have remained outside the stream of savings mobilised for productive purposes.

At the Workshop (1991) on Integration of Housing and National Finance Systems held at Goa in June 1991, the following conclusions and recommendations were made for improving and strengthening the housing finance system in developing countries.

It is felt that integration may not be feasible or even desirable at this time or in the short term, given the present level of domestic financial development in most developing countries. Success of financial integration depends very much on the degree of domestic financial development, which is still generally weak in these countries. Liberalisation of the financial markets could be destabilising, unless and until effective supportive legal, regulatory and supervisory frameworks and institutions are firmly put in place, which is not yet the case in most developing countries. For some of the developing countries that already have significant elements of those preconditions in place, however, the objective should be to strive towards a housing-finance system increasingly integrated into the larger financial system and progressively based on diversified savings mobilisation and allocation at market rates. These changes cannot of course, be expected to occur overnight or, in many cases, even in the short term.

Recommendations of the Workshop

1. Housing-Finance Institutions should, from the start, aggressively seek to diversify the sources of their domestic resources mobilisation as much as possible—household deposits, pension funds, mutual funds, insurance company funds— and should devise innovative schemes to


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mobilise domestic resources. A strong and stable resource base is an indispensable starting point for a viable housing finance institution or system. Efforts should also be directed towards varying product designs in both sourcing and use of funds in housing finance and building therefrom, including the introduction of mortgage-backed securities and bonds or similar instruments.

(ii) While the legal and regulatory framework is, in many ways, very necessary for the establishment, development, and operation of the housing finance system by setting the "rules of the game" (thus ensuring genuine institutions through appropriate chartering or licensing, specifying capital requirements, assets and liability powers of the institutions, disclosure and verification, stalling and overall "Watchdog" functions through diligent oversight and supervision as well as provision of statutory support measures), those regulations that explicitly impede the mobilisation of resources by the housing finance system should be minimised or removed completely. The housing finance system needs all the savings it can get in order to broaden its accessibility to all the socio-economic segments of the population. Policies or measures which place restrictions on savings mobilisation reduce the viability potential of the housing finance system. Current regulatory measures that restrict housing finance institutions in some countries to accepting "term deposits" only and deny them from accepting household deposits, or that limit the size of housing-finance institutions etc., ought to be reviewed. Unless this is done and access to short-term deposits made accessible to housing-finance institutions, it would be difficult for them to mobilise household savings which should, if fact form the bedrock of their operations.
(iii) The workshop recommends that similar fiscal concessions be extended to savers or investors as an added incentive, so as to increase resources mobilisation, particularly by housing finance institutions.

(iv) An enabling macroeconomic environment is a prerequisite to a viable housing finance system.

(v) Positive measures and strategies to encourage interaction between the informal sector and housing finance institutions should be considered and put in place. With well-thought-out initiatives, the informal sector is a financially rich field which the housing finance system could exploit with immense profit, if it could win the confidence of that sector. With the informal sector currently financing over 70 per cent of the housing in developing countries, its resources potential require no further proof or emphasis.

(vi) The development of a secondary mortgage market should not be priority at this stage.

(vii) Whatever system of housing finance is evolved, it must make specific provisions that cater the needs and requirements of the poor and low-income segment of the population.

(viii) Finally, competence of management of housing finance institutions is pivotal to the success of the system. No other consideration should therefore override that of technical qualification and professional competence in the selection of the chief executive and other managers of housing finance institutions.
Moorthy, D K (1991)\(^5\) in his unpublished thesis entitled "Role of Institutional Agencies in Housing Finance - An Evaluation Study", has conducted a study on HUDCO, HDFC and Karnataka Housing Board. The main findings of the study are as follows.

(i) In HUDCO the expenditure on interest on borrowed funds is increasing very rapidly relatively better when compared to HDFC, and the return on capital employed shows a declining trend. Based on the findings he recommend that it should try to get funds at lower cost from international agencies.

(ii) In HDFC the expenditure on interest on borrowed funds is increasing very rapidly, the return on capital employed shows a decreasing trend. Based on the findings, it was suggested that the corporation should try to diversify its activities. Through the assistance of its subsidiary company it may take up construction work of individual houses on contract basis

(iii) The financial performance of KHB can not be evaluated because it does not have proper accounting system.

NCAER (1996)\(^6\) conducted a study on various aspects of Housing, with a chapter on Housing Finance. The following are the highlights of the study.

(i) Housing finance is a critical bottleneck

(ii) Barring HDFC, none of the other housing finance companies have availed themselves of foreign currency loans.

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\(^6\) NCAER Study on Selected Aspects of Housing in India, May 1996, Chapter VII, pp 38-50

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(iii) Apart from equity, NHB refinance lines and fixed deposits constitute a major source of funds to housing finance companies.

(iv) Need for transition by housing finance companies to gravitate from short maturity funds to longer maturity funds and to manage interest spreads.

Robert M. Buckley (1996) an economist with the World Bank, made a study on housing finance in developing countries. This work covers the entire gamut of housing finance in developing countries and is most appropriate in Indian context. Most striking is his observation in the concluding portion of the report which observes that every economy must do what is best suitable to meet the local conditions and to gauge the mental preparedness of the players in the financial markets in their respective economies.

Buckley observed that financial intermediation is now on a global scale. It relies on a wide range of new financial products, such as securitisation and synthetic assets, to allocate the various risks and services provided by financial instruments. The public policy arena has also changed. It now gives much greater attention to the sustainability, transparency, and even the contingencies implied by the instruments of public policy. Housing finance system and traditional public housing delivery mechanisms have become obsolete.

7 Buckley Robert, M, Housing Finance in Developing Countries, (Great Britain: Hampshire, Macmillan Press, 1996), pp 1,2,7,175,178
Buckley then comments on how the World Bank's work in this area has changed to emphasize financial intermediation. Housing finance reforms are discussed in the light of the risks and rewards of innovations in these systems. Perhaps the overarching theme of the conclusion is that the institutions involved in housing finance systems are often complex, highly idiosyncratic, and developed almost through the accumulation of the accidents of history. Consequently, there is no single way to implement efficiency enhancing housing finance reforms. Nevertheless, even though the approaches to reform can vary a great deal, the basic principles of effective housing finance are straightforward and worth identifying. Indeed, it is only through clearing about these principles that the distortions and risks of the existing systems can be effectively addressed.

Finally, Buckley concludes that the process of moving towards market-based, competitive housing finance systems is in full train. As the processes of greater financial integration and more market-based public policy come into play, the methods of financing shatter will undoubtedly continue to undergo substantial change. This process of change will take many forms and will rarely come quickly. Nevertheless, it is worth remembering that first and starts of this process, as reflected in the stresses on existing institutions, are usually a response to underlying market forces. It is also worth noting that establishment of a market-based system ultimately holds out more than the prospect of being able to use resources much more effectively.
Sundar Ram, G (2000) made a study on "Business Strategies of Housing Finance Companies for Raising Funds - A Look into the Existing and Emerging Sources of Funds". The main findings of the study are as follows:

(i) Some of the areas in housing finance have been overlooked, such as broad-basing of financing avenues, better accessing of capital market and a better system for the transformation of savings and channelling them into the national housing effort.

(ii) There were many choices available to housing finance companies even within the constraint boundaries, but were not exercised either due to lack of awareness, confidence or innovative spirit.

(iii) Though a rank correlation measure performed between the awareness and preferences, in respect of various financing instruments by managers in HFCs from the FY 2000 to FY 1997, in reverse chronological order, themselves exhibited a rank correlation of -0.22, confirming the awareness-preference gap and concluded as the HFC managers tendency to be rooted to the past and repeat a successful formula, thereby disregarding the subtly changing macro-environment.

Based on these findings, he made the following recommendations:

(i) NHB needs to accord special treatment to HFCs and, as a regular, shed the NBFC mindset.

Sundar Ram, G, *Business Strategies of Housing Finance Companies for Raising Funds - A Look into the Existing and Emerging Sources of Funds* (Un-published Doctoral dissertation), (Mumbai University of Mumbai, 2000), pp 211-221
(ii) NHB will have a great role to play as a refinancing agency to facilitate the flow of more and more innovative instruments as funds flow through the financial system,

(iii) Housing finance companies and banks are advised to enter into a strategic alliance, rather than fight each other whereby banks could lend "through" housing finance companies, and share spreads on volumes,

(iv) Foreign equity is welcome since it represents a long-term source,

(v) The government must give up its short-sighted policy on high stamp duties and legal costs on securitisation,

(vi) There should be a grand co-existence of mortgage-backed securities and gold-backed securities, to fuel the growth of housing and infrastructure in India

Sudhakar Chetty, S (2000) made a study on "Housing Finance in India". The main findings of the study are as follows

(i) Majority of the borrowers of housing finance institutions are facing problems with regard to rigidity of rules and regulations, offering surity/security, inadequate sanction of loan, delay in sanction, preparation of documents to be submitted along with the loan applications and incidental expenses

(ii) Housing finance institutions confront the problem of lack of sufficient demand for housing loans. Recovery of loan instalment is also a problem for HFIs to a certain extent

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6 Sudhakar Chetty, S., Housing Finance in India, A Study with Reference to Tirupati; Andhra Pradesh (Un-Published Doctoral dissertation), (Tirupati S V University, 2000), pp 235-237
Based on the findings, the following recommendations were made

(i) The government and NHB can evolve a sort of credit guarantee scheme to safeguard the interest of the housing finance institutions

(ii) People have to be encouraged to take up house construction in their early age

(iii) Housing finance institutions can introduce mortgage insurance to improve the rate of recovery of loans

Statement of the Problem

Although non-banking financial companies have been operating for quite a long time in India, an attempt to regulate them started only in the recent past. Regulation of these institutions was found to be necessary for three reasons Viz., ensuring efficacy of credit and monetary policy, safeguarding depositors' interest and ensuring healthy growth of Non-Banking Financial Companies.

Several attempts were made in the past, from time to time, to ensure healthy growth of the non-banking financial companies on the recommendations of several committees and working groups such as those under the Chairmanship of Bhabatosh Datta (1971), James Raj (1974-75), Vaghul Working Group on Money Market (1985), Chakravarthy Committee on monetary system (1987), Narasimham Committee (1991), A C Shah (1992), Mindra JPC Committee on the security scam (1992), Vasudev Committee and Khanna Committee (1996) etc. These attempts have yielded some results for the healthy growth of the Non-Banking Financial Companies in India
There are different categories of non-banking financial companies operating in the country as stated below:

1. Loan Companies (LCs)
2. Investment Companies (ICs)
3. Hire Purchase Finance Companies (HPFCs)
4. Equipment Leasing Companies (ELCs)
5. Mutual Benefit Finance Companies (MBFCs)
6. Miscellaneous Finance Companies (MFCs)
7. Miscellaneous Non-Banking Companies (MNBCs)
8. Residuary Non-Banking Companies (RNBCs)
9. Housing Finance Companies (HFCs)

The working and operations of these companies, except housing finance companies, are regulated and supervised by the Reserve Bank of India, whereas that of housing finance companies are regulated and supervised by the National Housing Bank.

The main objective of contemporary Governments is to eradicate poverty by meeting the basic needs of the people and one of the basic needs of man is housing. All governments irrespective of their political persuasions and ideologies, have a similar objective for the citizens to ensure that all families have a decent house in a suitable living environment.

Housing finance is a term which covers financing at all stages of the development of housing. Finance is required at three stages viz., purchase of land, construction of house and repayment of loan amount. Making provision of adequate funds at cheaper cost and at right time is one of the most difficult
tasks faced by all those concerned with housing - the individuals, organisations, and governments at local, regional and national level.

The Government of India on the recommendations of the High Level Group set up in June 1986 under the Chairmanship of Dr. C. Rangarajan, the then Deputy Governor of Reserve Bank of India, established a National Housing Bank as an apex finance institution with its share capital being fully contributed by Reserve Bank of India. Accordingly, National Housing Bank (NHB) as a statutory corporation came into being on 23rd December 1987 to "operate as a principal agency to promote housing finance institutions both at local and regional level and to provide financial and other support to such institutions."

A housing finance company means a company incorporated under the Companies Act 1956 which primarily transacts or has one of the principle objects of transacting business of providing finance for housing sector directly or indirectly. The National Housing Bank is responsible for supervision and regulations of housing finance companies. It is also responsible for registration or canceling of registration of housing finance companies. As a part of its supervisory duties the National Housing Bank collects information with the help of prescribe statutory returns and other information from time to time from housing finance companies.

National Housing Bank has also powers to regulate funds raising activity, by public deposits, of housing finance companies. National Housing Bank issued the housing finance companies (NHB) directives in 1989 which deals with the conditions for accepting deposits. The National Housing Bank issued an advertisement on 19-10-2000 indicating that certification of
registration will be compulsory for housing finance companies, without which they will not be able to carry the business of housing finance. This condition is applicable to those housing finance companies which have net worth of Rs 25 lakhs or more and those which will be incorporated after 12th June 2002. If the given housing finance company is already in existence on 12th June 2000 and has net worth less than Rs 25 lakhs, then the same Housing Finance Company will have to attain the level of Rs 25 lakhs before 12th June 2003. The new companies, incorporated after 12th June 2000, will have to take the certification of registration from National Housing Bank without which they can not commence business. These are some of the efforts of National Housing Bank to regulate the functioning of housing finance companies.

**Need for the study:**

Housing is important for the development of the society both in economic and welfare terms. It is observed that 'a man's house is his castle' and plays a significant role in the overall development of the individual. The effect of bad housing is the demoralisation and consequent lowering in the productive power of a great proportion of the individuals. Further, housing generates employment in all service industries.

Basing on this backdrop, the Government has been allocating large funds to this sector. But the efforts of the Government in providing shelter to the people are far from satisfactory. The Government could make financial provision for providing low-cost housing to a small segment of the vast masses of the society. Therefore, the burden of providing housing to the
people is largely on the shoulders of the corporate sector. It is in this context, a good number of corporates have come into existence, providing finance at different terms to the people, particularly those in the lower-middle income groups and above.

The housing finance companies may be grouped as those private sector housing finance companies, public sector housing finance companies, banks and co-operative sector.

The main sources of funds to the housing finance companies are owned funds, borrowed funds and deposits from the public. Since the main business of these companies is financing housing activity, the major part of the applications of funds is providing different kinds of housing loans to the needy. Incidentally, the housing finance companies also make other investments by participating in the capital market.

The present study on the "Financial Performance of Non-Banking Financial Companies" is apt and there is a greater need for such studies as the studies conducted earlier did not make much focus on the effective utilisation of the resources by the finance companies whose business is primarily housing finance. It is also utmost important to have this systematic introspection of the financial performance of these companies, especially in the present juncture of cut-throat competition thrown up by many private sector organisations having entered into this industry.
OBJECTIVES:

(i) To study the origin and development of non-banking financial companies, particularly housing finance companies in India

(ii) To study the trends in housing finance in India

(iii) To analyse the various sources and applications of funds of housing finance companies

(iv) To study the relative financial performance of the housing finance companies

(v) To suggest measures to strengthen the housing finance system in India

METHODOLOGY

Sampling:

There are 29 housing finance companies in public as well as in private sectors which are approved for refinance assistance from National Housing Bank. They undertake housing finance as their primary business with a professional approach and outlook.

A sample of four housing finance companies was selected at random for a detailed study. The four companies which constituted the sample were Housing Development Finance Corporation Ltd, LIC Housing Finance Ltd, Can Fin Homes Ltd, and Vysya Bank Housing Finance Ltd.

Scope of the study:

The study was confined to the financial performance of the select housing finance companies in India.
Hypotheses:

Against the backdrop of objectives stated above, the following hypotheses were formulated and tested

1. There is no significant difference between the companies in regard to amounts of loans sanctioned

2. There is no significant difference between the companies in regard to amounts of loans disbursed

3. There is no significant difference between the companies in regard to loan disbursements to sanctions

4. There is no significant difference between the companies in regard to amounts of shareholders' funds

5. There is no significant difference between the companies in regard to amounts of borrowed funds

6. There is no significant difference between the companies in regard to amounts of long term funds

7. There is no significant difference between the companies in regard to debt equity ratio

8. There is no significant difference between the companies in regard to amounts of total share capital,

9. There is no significant difference between the companies in regard to proportion of shareholders' funds in total resources

10. There is no significant difference between the companies in regard to proportion of share capital in total resources

11. There is no significant difference between the companies in regard to proportion of borrowed funds in total resources.
There is no significant difference between the companies in regard to proportion of deposits in borrowed funds.

There is no significant difference between the companies in regard to proportion of deposits in total resources.

There is no significant difference between the companies in regard to amounts of deposits.

There is no significant difference between the companies in regard to amounts of retained earnings.

There is no significant difference between the companies in regard to proportion of retained earnings in total resources.

There is no significant difference between the companies in regard to amounts of gross income and operating income.

There is no significant difference between the companies in regard to amounts of profit after tax.

There is no significant difference between the companies in regard to profit after tax to gross income.

There is no significant difference between the companies in regard to profit after tax to shareholders' funds.

There is no significant difference between the companies in regard to amounts of working capital.

There is no significant difference between the companies in regard to current ratio.

There is no significant difference between the companies in regard to proportion of fixed assets in application of funds.

There is no significant difference between the companies in regard to proportion of investments in application of funds.
There is no significant difference between the companies in regard to amounts of total expenditure and changes

There is no significant difference between the companies in regard to interest expenditure to interest income

There is no significant difference between the companies in regard to growth of branches

There is no significant difference between the companies in regard to amounts of total assets

There is no significant difference between the companies in regard to amounts of loans outstanding

Database:

The database for the study consists of both primary data and secondary data. The primary source of data includes the internal records of the sample companies. The annual reports of the Non-Banking Financial Companies, Reserve Bank of India, National Housing Bank, etc. on the secondary sources of data for the study.

Data Analysis:

The data was analysed by compound growth rates, ratios, percentages, charts, ANOVA, etc.

Limitations of the study:

1. The study period was limited to 10 years from 1991-92 to 2000-2001
2. The conclusions of the study may not be possible for generalisations as each company has got its own approach and style of management and operations quite distinct from others.
Chapter Scheme:

The thesis is constituted into six chapters

Chapter-1 Presents the introduction of the study covering the origin, and development of non-banking financial companies in India with a focus on housing finance companies

Chapter-2 Comprises the review of literature and methodology of the study

Chapter-3 Covers the institutional housing finance in India. An overview

Chapter-4 Discusses the profiles of select housing finance companies

Chapter-5 Deals with a comparative analysis of financial performance of select housing finance companies

Chapter-6 Comprises summary and conclusions