Sound Financials is a key to Growth in Banking: A Case Study of HDFC Bank

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ABSTRACT

This case was prepared by the author for the sole purpose of aiding classroom discussion. Cases are not intended to serve as endorsements, or sources of data, or illustrations of effective or ineffective management. Certain names and information could have been disguised to maintain confidentiality.

INTRODUCTION

The Indian banking system consists of 12 public sector banks, 22 private sector banks, 44 foreign banks, 56 regional rural banks, 1,542 urban cooperative banks and 94,384 rural cooperative banks. In FY 17-18, total lending amplified at a CAGR of 10.94 per cent and total deposits amplified at a CAGR of 11.66 per cent. In April 2019,Vijaya Bank and Dena Bank were merged with Bank of Baroda. On 30 August 2019, Union Finance Minister Nirmala Sitaraman announced merger of six public sector banks (PSBs) to accelerate their operation and size, two banks were amalgamated to strengthen national presence and four were amalgamated to strengthen regional focuses.

New private sector banks began with full enthusiasm in the early 1990s with less than a handful turning successful. While some of them chose to merge, from the others, some are now facing governance issues .Older private banks are struggling under various types of stress. Urban cooperatives are primarily meant to be local, but management lapses are hurting their sustained growth. Day after market regulator .Due to tighter disclosure norms, Lakshmi Vilas Bank and Indian Bank have reported divergence in their bad loans for the last fiscal ended March 2019. Domestically, India faced issues related to financial health of the NBFC sector, high NPA levels in the banking space, slowing consumption demand and some concerns on the fiscal side.

Public sector banks reported 5,743 cases of fraud in the first half of the 2019-20 , involving Rs 95,760 crore,. State Bank of India reported 2,939 fraud cases, involving Rs 25,417 crore, between April 1 and September 30 – of these, 550 cases involving Rs 11 crore took place this year. Punjab National Bank reported 225 cases of fraud worth Rs 10,822 crore, while Bank of Baroda had 180 cases worth Rs 8,273 crore.(source: Business Standard). PMC Bank, a large commercial bank with 1.6 million depositors .

Long term Survival of Banks depend on its strong financial position since it deals with money which is very risky. Sound financials acts as a cushion to firms specially banks .The performance of banks can be indicated by study of following:

- Credit to deposit ratio
- Capital adequacy ratio
- Non-performing asset ratio
- Provision coverage ratio
- Return on assets ratio
- Asset Liability Management
- Risk Management.

This case has attempted to provide the example of HDFC Bank for sound financial performance which leads to its victory in present scenario.HDFC bank has emerged as a market leader. This can be taken as an example to mitigate the problems of public sector banks.

BODY

The Housing Development Finance Corporation Limited(HDFC) was established as part of the RBI's liberalization policy of the Indian Banking Industry in 1994, with its registered office in Mumbai, India. HDFC Bank started its operations as a Scheduled Commercial Bank in January 1995. HDFC has well positioned itself as a World-Class Indian Bank with its business philosophy based on four core values – Operational excellence, Customer Focus, Product Leadership and People.

As of June 30, 2019, the Bank's distribution network has reached at 5,130 branches across 2,764 cities. HDFC Bank provides an array of financial products and services including wholesale banking, retail banking, treasury, auto loans, two wheeler loans, personal loans, loans against property, consumer durable loan, lifestyle loan, digital products such as Payzapp and Smart BUY. HDFC Bank merged with Times Bank in February 2000 leading to the first merger of two private banks. In 2008, Centurion Bank was acquired by HDFC Bank. Equity shares of HDFC Bank are listed on both the Bombay Stock Exchange and the National Stock Exchange of India. Its American Depository Shares are listed on NYSE and the global depository receipt are listed on the Luxembourg Stock Exchange where two GDRs represent one equity share of HDFC Bank.

HDFC Bank's is the third largest CSR spender in Indiaas its Parivartan initiative has spent ₹443.8 crore towards CSR in 2018-19.

As on31 March 2019the authorized share capital of the Bank is Rs. 650 crore. The paid-up share capital is Rs 519,01,80,534which is comprising of 259,50,90,267 equity shares of the face value of Rs 2/- each. The HDFC Group holds 20.93 % of the Bank's equity and about 18.23 % of the equity is held by the ADS / GDR Depositories (inrespect of the bank's American Depository Shares (ADS) and Global Depository Receipts (GDR) Issues). 33.06% of the equity is held by Foreign Institutional Investors (FIIs) and the Bank has 5,32,368 shareholders. HDFC bank has emerged as a most promising brand in Indian banking industry.

It earns over 90% of net revenues from customer segments. It offers a well-balanced loan mix between wholesale and retail segments. It has a large retail deposits which is a source of stable funding. There is a healthy proportion of CASA (current & savings) deposit. HDFC bank is one among the lowest deposit costs in the industry. HDFC Bank operates in a highly automated environment in terms of information technology and communication systems. All the bank's branches have online connectivity, which enables the bank to offer speedy funds transfer facilities to its customers. Multi-branch access is also provided to users. It is the most valuable bank of India (LIVEMINT)

Achievements

- Ranked 1st in 2019 BrandZ Top 75 Most Valuable Indian Brands HDFC Bank for the 6th consecutive year.

- Among The Most Honored Company List,Institutional Investor All-Asia (ex-Japan) Executive Team 2019 survey
- India's Best Bank, Euromoney Awards for Excellence 2019
- Bank of the Year and Best Large Bank, Business Today – Money Today Financial Awards 2019.
- Best Bank in India 2019, by Global magazine FinanceAsia.
- Ranked 60th in 2019 BrandZ Top 100 Most Valuable Global Brands
- The Bank's brand value has increased from $20.87 billion in 2018 to $22.70 billion in 2019.
- Best Large Bank&Fastest Growing Large Bank in 2019, by Business World Magna Awards.

JOURNEY FROM ZERO TO HERO

- 1994 - The Bank was Incorporated on 30th August, Certificate of Commencement of Business was received on 10th October 1994 from RBI in both traditional commercial banking as well as investment banking.
- 1996 –HDFC entered the banking consortia of over 50 corporates, including some leading multinational companies, flagship companies of local business houses and strong public sector companies.
- 1997- It became one of the largest mobilisers of retail deposits through its network of 20 branches. Its credit deposits ratio was 53.8%. HDFC Bank entered into strategic alliances with 10 overseas banks to provide customers with a wide range of derivatives including interest rate and foreign currency swaps. HDFC Bank launched its debit card by April 1998.
- 2000- HDFC Bank signed a memorandum of understanding with Singapore Telecom's e-commerce arm Sesami.Com Pvt Ltd. to offer e-commerce solutions for the Indian market. HDFC Bank tied up with financial portals, e-brokerages and the National Stock Exchange to enable broker payments for e-broking ventures. HDFC Bank launched wireless application protocol-based mobile-banking in Coimbatore and Trichy in association with Aircel.
- 2001- HDFC Standard Life Insurance entered into a memorandum of understanding with the Chennai-based Indian Bank and launched the international Maestro debit card as well as credit card. HDFC Bank

applied to US regulators to list more than 11 million American Depositary Shares on the New York Stock Exchange.

- 2002 - Orange JV with HDFC Bank.
- 2003 -JV with HDFC Bank for its pension distribution. HDFC Bank launched India's first mobile payment solution. Mumbai
- 2004- HDFC Bank entered into an alliance with Clearing Corporation of India Ltd (CCIL- HDFC) and won Asiamoney award for Best Domestic Bank
- 2005- HDFC Bank inaugurated first ATM in Hotel and tied up with the International Bank of Qatar (IBQ) to launch banking services in Qatar
- 2007- HDFC Bank signed an agreement with Tata Pipes to offer credit facilities to farmers across the country.
- 2008 - HDFC Bank Tied Up With Postal Department, Extends Rural Reach , won Nasscom IT User Award The Year', opened its First Overseas Branch In Bahrain. HDFC Bank and Centurion Bank of Punjab merger at share swap ratio of 1:29 .HDFC Bank launched India's First Rural Banking BPO At Tirupathi
- 2009 - HDFC Bank got Asiamoney Award for the "Best Domestic Bank" .The Asian Banker declared HDFC Bank the Best Retail Bank.
- 2010- HDFC Bank replaced ICICI as Number 1 private retail bank in India. HDFC tied up with UAE bank for online remittances.
- 2011- The Asian Banker magazine declared that the strongest bank in Asia Pacific region is HDFC. Face value of Shares split from Rs10 to Rs2
- 2012- The third-largest US lender by assets, Citigroup Inc sold its complete 9.85 per cent stake in Housing Development Finance Corporation Ltd (HDFC) for USD 1.9 billion. HDFC Bank launched its mobile banking application in Hindi on targeting about 560-million Hindi-speaking population of India.
- 2013 -HDFC Bank named Organisation of the Year at Skoch Financial Inclusion Awards -Times Card launched in association with HDFC Bank -Jet Airways and HDFC Bank joined hands to launch 'Jet Privilege - HDFC Bank World Debit Card' -Analysts vote HDFC Bank as Best Bank in Asia, Mr Aditya Puri, Best CEO -HDFC Bank launched rural Financial Literacy Initiative in Goa .

- 2014 -HDFC Bank set GUINNESS WORLD RECORD -HDFC Bank achieves 200th branch milestone in Tamil Nadu .HDFC Bank launched 'Bank Aapki Muththi Mein'
- 2015 - -HDFC Bank launched 'Har Zaroorat Poori Ho Chutki Mein, Bank Aapki Mutthi Mein' -HDFC Bank reached out to 42000 dairy farmers in Rajasthan under 'Milk-to-Money' programme HDFC Bank wins Best Private Banking Services for Super affluent clients for 5 years in a row at Euromoney Awards -HDFC Bank voted India's Best Managed Company - HDFC Bank launched Medical Benefits Prepaid Card -HDFC Bank launches PayZapp, Indiaâ€s first 1-click mobile-pay solution –
- 2016 -HDFC Bank launched a digital bank for its small and medium enterprises (SME) customers. HDFC Bank topped in Institutional Investor magazine ranking.
- 2017 -HDFC Bank alloted 1793900 equity shares Bank, launched Smart Up zone to cater startups, allotted 3909200 equity share and replaced TCS to become 2nd most valued company .
- 2018- Net profit up by 21.0% to 55.68 Bn, Net NPA / net advances at 0.4% Capital Adequacy Ratio (CAR)* - Total 16.9% of which Tier I at 15.6%, Gross NPA / gross advances at 1.40%

PUBLIC SECTOR VS PRIVATE SECTOR BANKS

Financial performance of private sector banks in India is improving in the last few years due to better asset quality, better risk management techniques, improved customer services even in times of economic slowdown. This can be visible by the following tables:

Bank Name	Revenues	Total Assets
Axis Bank	₹414.093 billion (US$6.0 billion)	₹10,600 billion (US$150 billion)
Bandhan Bank	₹43.20 billion (US$620 million)	₹302.36 billion (US$4.4 billion)
Bank of Baroda	₹422 billion (US$6.1 billion)	₹16,130 billion (US$230 billion)
Bank of India	₹418 billion (US$6.0 billion)	₹9,030 billion (US$130 billion)
Bank of Maharashtra	₹130.53 billion (US$1.9 billion)	₹2,340 billion (US$34 billion)
Canara Bank	₹558.30 billion (US$8.1 billion)	₹15,203 billion (US$220 billion)
Catholic Syrian Bank	₹16.17 billion (US$230 million)	₹162.2324 billion (US$2.3 billion)
Central Bank of India	₹259 billion (US$3.7 billion)	₹4,680 billion (US$68 billion)
City Union Bank	₹29.4421 billion (US$430 million)	₹352.71 billion (US$5.1 billion)
DCB Bank	₹20.76 billion (US$300 million)	₹240.46 billion (US$3.5 billion)
Dhanlaxmi Bank	₹11.16 billion (US$160 million)	₹122.86 billion (US$1.8 billion)
Federal Bank	₹97.5920 billion (US$1.4 billion)	₹1,149.8 billion (US$17 billion)
HDFC Bank	₹816.02 billion (US$12 billion)	₹8,638 billion (US$120 billion)

ICICI Bank	₹736.60 billion (US$11 billion)	₹12,720 billion (US$180 billion)
IDFC First Bank	₹85.327 billion (US$1.2 billion)	₹1,121.6 billion (US$16 billion)
Indian Bank	₹405.74 billion (US$5.9 billion)	₹8,080 billion (US$120 billion)
Indian Overseas Bank	₹235.2 billion (US$3.4 billion)	₹3,750 billion (US$54 billion)
IndusInd Bank	₹185.77 billion (US$2.7 billion)	₹1,786 billion (US$26 billion)
Jammu & Kashmir Bank	₹71.66 billion (US$1.0 billion)	₹820.18 billion (US$12 billion)
Karnataka Bank	₹51.85 billion (US$750 million)	₹641.26 billion (US$9.3 billion)
Karur Vysya Bank	₹54.43 billion (US$790 million)	₹576.63 billion (US$8.3 billion)
Kotak Mahindra Bank	₹211.76 billion (US$3.1 billion)	₹2,146 billion (US$31 billion)
Lakshmi Vilas Bank	₹25.68 billion (US$370 million)	₹287.32 billion (US$4.2 billion)
Nainital Bank	₹6.12 billion (US$89 million)	₹7.7 billion (US$110 million)
Punjab and Sind Bank	₹87.44 billion (US$1.3 billion)	₹1,710 billion (US$25 billion)
Punjab National Bank	₹774.22 billion (US$11 billion)	₹17,940 billion (US$260 billion)
RBL Bank	₹44.68 billion (US$650 million)	₹486.74 billion (US$7.0 billion)
South Indian Bank	₹65.62 billion (US$950 million)	₹743.12 billion (US$11 billion)
State Bank of India	₹2,110.00 billion (US$31 billion)	₹52,050 billion (US$750 billion)
Tamilnad Mercantile Bank Limited	₹38.11 billion (US$550 million)	₹322.4 billion (US$4.7 billion)
UCO Bank	₹185.61 billion (US$2.7 billion)	₹3,170 billion (US$46 billion)
Union Bank of India	₹696.39 billion (US$10 billion)	₹14,594 billion (US$210 billion)
Yes Bank	₹205.81 billion (US$3.0 billion)	₹2,150 billion (US$31 billion)

Fig. Comparison of cost of deposits, cost of funds and return on investments

Bank Group / Year		Cost of Deposits	Cost of Borrowings	Cost of Funds	Return on Advances	Return on Investments	Return on Funds	Spread
1	2	3	4	5	6	7	8	9 = 8-5
PSBs	2016-17	5.7	4.8	5.6	8.4	7.5	8.2	2.5
	2017-18	5.1	4.7	5.1	7.8	7.1	7.5	2.5
PVBs	2016-17	5.6	6.6	5.8	10.0	7.5	9.3	3.5
	2017-18	4.9	6.2	5.2	9.5	6.9	8.8	3.6
FBs	2016-17	4.2	4.3	4.2	8.8	6.8	7.9	3.7
	2017-18	3.8	3.0	3.7	8.1	6.6	7.4	3.7
All SCBs	2016-17	5.6	5.4	5.6	8.9	7.4	8.4	2.8
	2017-18	5.0	5.3	5.1	8.3	7.0	7.9	2.8

Notes: 1. Cost of deposits = Interest paid on deposits/Average of current and previous year's deposits.
2. Cost of borrowings = (Interest expended - Interest on deposits)/Average of current and previous year's borrowings.
3. Cost of funds = Interest expended / (Average of current and previous year's deposits plus borrowings).
4. Return on advances = Interest earned on advances /Average of current and previous year's advances.
5. Return on investments = Interest earned on investments /Average of current and previous year's investments.
6. Return on funds = (Interest earned on advances + Interest earned on investments) / (Average of current and previous year's advances plus investments).
7. Data for both 2016-17 and 2017-18 include SFBs.

Source: Annual accounts of banks.

Cost of deposits and spread of private sector banks is higher than that of public sector banks.

Fig (Credit risk adjusted ratio)

(At end-March)

(Amount in ₹ billion)

	PSBs		PVBs		FBs		SCBs	
	2017	2018	2017	2018	2017	2018	2017	2018
1. Capital Funds	**7,047**	**6,578**	**4,239**	**5,157**	**1,373**	**1,487**	**12,659**	**13,221**
i) Tier I Capital	5,480	5,270	3,643	4,470	1,292	1,407	10,414	11,147
ii) Tier II Capital	1,567	1,308	596	687	81	80	2,245	2,074
2. Risk Weighted Assets	**58,053**	**56,414**	**27,289**	**31,383**	**7,335**	**7,799**	**92,677**	**95,596**
3. CRAR (1 as % of 2)	**12.1**	**11.7**	**15.5**	**16.4**	**18.7**	**19.1**	**13.7**	**13.8**
Of which: Tier I	9.4	9.3	13.3	14.2	17.6	18.0	11.2	11.7
Tier II	2.7	2.3	2.2	2.2	1.1	1.0	2.4	2.2

Source: Off-site returns (domestic operations), RBI.

Private sector banks have lesser volume of risky assets and better provision for risky assets .

Fig Comparison of return on assets and return on equity

(Per cent)

Bank group	Return on Assets		Return on Equity	
	2016-17	2017-18	2016-17	2017-18
Public Sector Banks	-0.1	-0.8	-2.0	-14.6
Private Sector Banks	1.3	1.1	11.9	10.1
Foreign Banks	1.6	1.3	9.1	7.2
All SCBs	0.4	-0.2	4.2	-2.8

Notes: 1. Return on assets = Return on assets for the bank groups are obtained as weighted average of return on assets of individual banks in the group, weights being the proportion of total assets of the bank as percentage to total assets of all banks in the corresponding bank group.
2. Return on equity = Net profit/Average total equity.

Source: Annual accounts of banks.

Fig Comparison of Assets

(At end-March)

(Amount in ₹ billion)

Bank Group	Year	Standard Assets		Sub-standard Assets		Doubtful Assets		Loss Assets	
		Amount	Per cent*	Amount	Per cent*	Amount	Per cent*	Amount	Per cent*
PSBs#	2017	45,012	87.5	1,641	3.2	4,603	9.0	167	0.3
	2018	46,021	84.5	2,053	3.8	5,936	10.9	465	0.9
PVBs	2017	20,310	96.5	244	1.2	429	2.0	65	0.3
	2018	24,506	96.0	272	1.1	700	2.7	52	0.2
FBs	2017	3,302	96.0	40	1.2	82	2.4	14	0.4
	2018	3,495	96.2	38	1.1	84	2.3	16	0.4
All SCBs**	2017	68,624	90.4	1,925	2.5	5,114	6.7	247	0.3
	2018	74,022	88.5	2,364	2.8	6,720	8.0	534	0.6

Notes: 1. Constituent items may not add up to the total due to rounding off.
2. *: As per cent to gross advances.
3. #: Includes IDBI Bank Ltd.
4. **: Data exclude SFBs.

Source: Off-site returns (domestic operations), RBI.

Fig. Comparison of NPA

(Amount in ₹ billion)

Item	PSBs*	PVBs	FBs	All SCBs#
Gross NPAs				
Closing Balance for 2016-17	6,847^	932	136	7,918
Opening Balance for 2017-18	6,192^	932	136	7,265
Addition during the year 2017-18	4,882^	1,077	70	6,043
Recovered during the year 2017-18	823	408	47	1,283
Written-off during the year 2017-18	1,295	308	21	1,627
Closing Balance for 2017-18	8,956	1,293	138	10,397
Gross NPAs as per cent of Gross Advances**				
2016-17	11.7	4.1	4.0	9.3
2017-18	14.6	4.7	3.8	11.2
Net NPAs				
Closing Balance for 2016-17	3,831	478	21	4,331
Closing Balance for 2017-18	4,545	642	15	5,207
Net NPAs as per cent of Net Advances				
2016-17	6.9	2.2	0.6	5.3
2017-18	8.0	2.4	0.4	6.0

Notes: 1. *: Includes IDBI Bank Ltd.

2. #: Data includes scheduled SFBs. As at end-March 2017 and end-March 2018, two and six scheduled SFBs, respectively, were operating.

3. **: Calculated taking gross NPAs from annual accounts of respective banks and gross advances from off-site returns (global operations).

4. ^: The opening balance of PSBs for 2017-18 does not match with that of closing balance of 2016-17 as the acquisition of associate banks and Bharatiya Mahila Bank by the State Bank of India is reflected under the head 'Addition during the year 2017-18'.

Source: Annual accounts of banks and off-site returns (global operations), RBI.

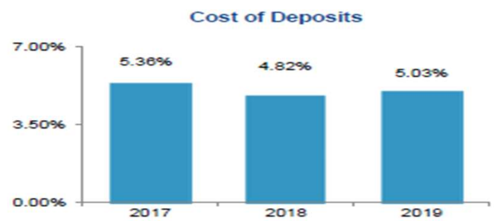
The top players from private sector banks are compared for 2018-19 to know the comparative financial position of HDFC bank. HDFC bank has strong financial position as compared to its competetors as shown from the table given below:

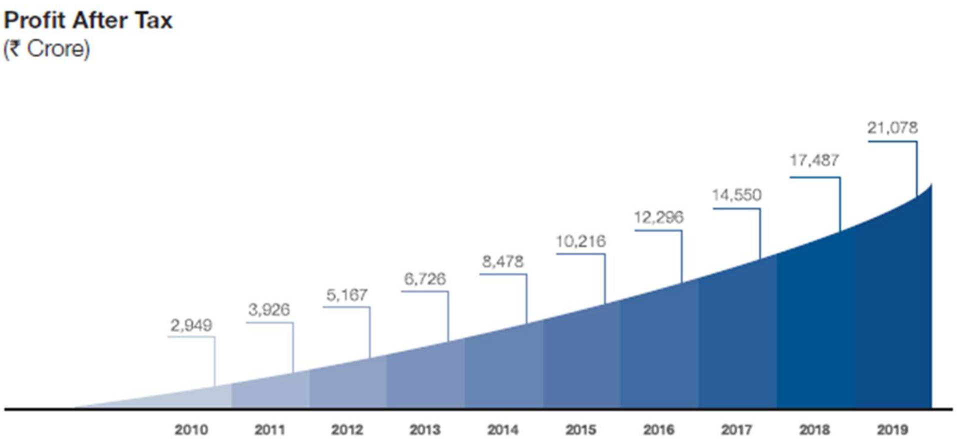
COMPARATIVE FINANCIAL ANALYSIS OF PRIVATE SECTOR BANKS DURING 2018-19

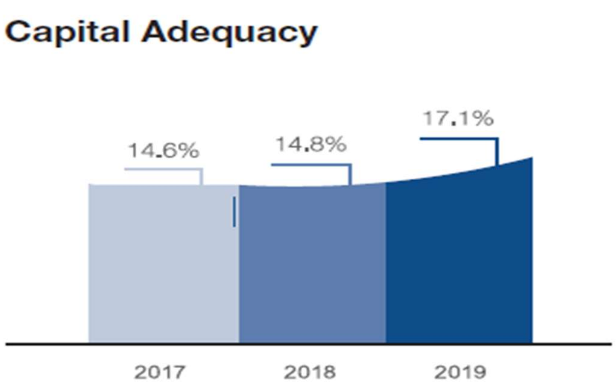
FINANCIAL RATIOS	HDFC BANK	ICICI BANK	AXIS BANK	KOTAK MAHINDRA BANK
FACE VALUE	2	2	2	**5**
Dividend Per Share	**15**	1	1	0.8
Operating Profit Per Share (Rs)	**85.43**	15.05	25.6	21.54
Net Operating Profit Per Share (Rs)	**363.43**	98.35	213.82	125.44

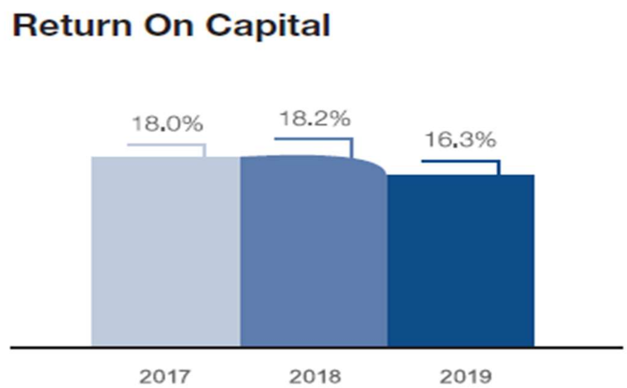
Interest Spread	**7.2**	6.36	6.37	6.73
Adjusted Cash Margin(%)	**19.05**	5.31	7.9	18.32
Net Profit Margin	**21.29**	5.3	8.5	20.32
Return on Net Worth(%)	**14.12**	3.19	7.01	11.47
Adjusted Return on Net Worth(%)	**14.12**	3.19	7.01	11.47
Interest Income / Total Funds	**8.57**	6.9	7.37	8.3
Net Interest Income / Total Funds	**4.18**	2.94	2.91	3.9
Profit Before Provisions / Total Funds	**3.44**	2.55	2.55	2.89
Loans Turnover	**0.13**	0.12	0.12	**0.13**
Total Income / Capital Employed(%)	**10.1**	8.48	9.13	9.89
Asset Turnover Ratio	**0.09**	0.07	0.08	**0.09**
Capital Adequacy Ratio	17.11	16.89	15.84	**17.45**
Advances / Loans Funds(%)	83.95	75.11	75.95	**86.44**
Credit Deposit Ratio	86.32	90.54	**93.25**	89.7
Investment Deposit Ratio	31.12	**33.84**	32.82	32.44
Cash Deposit Ratio	**8.85**	5.85	7.04	4.73
Total Debt to Owners Fund	6.97	7.77	**10.52**	6.09
Financial Charges Coverage Ratio	**1.81**	1.67	1.59	1.69
Financial Charges Coverage Ratio Post Tax	**1.44**	1.11	1.16	1.41
Earning Retention Ratio	80.78	71.31	**100**	96.71
Cash Earning Retention Ratio	81.77	76.69	**100**	96.94

Fig Trends of Cost of Deposits, Net Interest margin, Net Profit, CAR, Return of HDFC Bank









RISK MANAGEMENT PROCESS AT HDFC BANK

The Bank has a process for identifying its overall capital adequacy in relation to the Bank's risk profile and then for maintaining its capital levels. The process assures that the Bank has adequate capital to support all risks integral to its business and a proper capital buffer based on its business risk. The Bank identifies, assesses and manages broadly all risks through sound governanceand control practices, robust risk management framework. HDFC Bank has a comprehensive Internal Capital Adequacy Assessment Process (ICAAP) to cover the capital management policy of the Banks for assessment of the adequacy of capital to support current and future activities for risks and prepare a report on the capital projections for a period of 3 years.

The Bank considers all material risks in the course of its **business such as** Credit Risk, Credit Concentration Risk,Market Risk Business RiskOperational Risk, Strategic Risk**,** Interest Rate Risk in the Banking Book, Compliance Risk**,** Liquidity Risk, Credit Risk.

The variations in the levels of credit risk, Market risk, Liquidity Risk and Interest Rate Risk in the Banking Book (IRRBB) and the changes in the on and off balance sheet positions of the Bank are assessed under assumed "stress" scenarios and sensitivity factors. Typically,these relate, inter alia, to the impact on the Bank's profitability and capital adequacy. Stress tests are conducted on a quarterly basis at consolidated level including subsidiaries (HDB Financial Services Limited and HDFC Securities Limited) in order to assess the impact on capital adequacy of the Group.

CREDIT RISK MANAGEMENT

The Bank has an elaborate credit risk management process. The Board of Directors of the Bank endorses the credit risk strategy and approves the credit risk policies of the Bank by considering the Bank's risk appetite, derived from perceived risks in the business, balanced by the targeted profitability level for the risks assumed. The Board analyses the credit risk management functions of the Bank. The Risk Policy & Monitoring Committee (RPMC), which is a committee of the Board, guides the development of policies, procedures and systems for managing credit risk, towards implementing the credit risk strategy of the Bank.

There are two different credit management models within which the credit process operates - the Retail Credit Model and the Wholesale Credit Model. It uses the Standardised Approach under the RBI"s Basel III capital regulations for its credit portfolio.

For computation of capital requirement for Credit Risk, the Bank recognises only those collaterals that are considered as eligible for risk mitigation in the RBI Basel III guidelines on standardised approach ie. Cash deposit with the Bank, Gold, including bullion and jewelry, Securities issued by Central and State Government, Kisan Vikas Patra and National Savings , Life insurance policies with a declared surrender value of an insurance company which is regulated by the insurance sector regulator, Debt securities rated at least BBB (-)/PR3/P3/F3/A3, Units of Mutual Funds, where the investment is in instruments mentioned above. The Bank undertakes both purchase and sale transactions through both securitisation and loan assignment routes and has Board approved policies for both.

ASSET LIABILITY MANAGEMENT

The ALM risk management process of the Bank operates in the following hierarchical manner:

1. **Board of Directors**

The Board has the overall responsibility for management of liquidity and interest rate risks. The Board decides the strategy, policies and procedures of the Bank to manage liquidity and interest rate risk including setting of risk tolerance/limits.

2. **Risk Policy & Monitoring Committee ('RPMC') of the Board**

RPMC is a Board level committee, which supports the Board by supervising the implementation of the risk strategy. It guides the development of policies, procedures and systems for managing risk. It ensures that these are adequate and appropriate to changing business conditions, the structure and needs of the Bank and the risk

appetite of the Bank. It ensures that frameworks are established for assessing and managing liquidity and interest rate risks faced by the Bank.

3. **Asset Liability Committee ('ALCO')**

ALCO is a decision-making unit responsible for ensuring adherence to the risk tolerance/limits set by the Board as well as implementing the liquidity and interest rate risk management strategy of the Bank in line with the Bank‟s risk management objectives and risk tolerance. The ALCO is also responsible for balance sheet planning

from risk-return perspective including strategic management of liquidity and interest rate risks. The role of the ALCO includes the following:

i. Product pricing for deposits and advances

ii. Deciding the desired maturity profile and mix of incremental assets and liabilities

iii. Articulating interest rate view of the Bank and deciding on the future business strategy

iv. Reviewing funding strategy

v. Ensuring the adherence to the liquidity and interest rate risk limits set by the Board of Directors

vi. Determining the structure, responsibilities and controls for managing liquidity and interest rate risk

vii. Ensuring operational independence of risk management function

viii. Reviewing stress test results

ix. Deciding on the transfer pricing policy of the Bank

4. **ALM Support Groups**

ALM support group is responsible for analysing, monitoring, and reporting the relevant risk profiles to senior management and relevant committees.

CAPITAL ADEQUACY

The Bank's capital to risk-weighted assets ratio ('Capital Adequacy Ratio') as at March 31, 2019 is calculated in accordance with the RBI guidelines on Basel III capital regulations ('Basel III'). The phasing-in of the minimum capital ratio requirement under Basel III is as follows:

(% of RWAs)

	2018	**2019**	**2020**
Common equity tier 1 (CET1)	7.375	7.525	8.200
Tier I capital	8.875	9.025	9.700
Total capital	10.875	11.025	11.700

The above minimum CET1, tier I and total capital ratio requirements include capital conservation buffer (CCB) and additional capital applicable to us as Domestic-Systemically Important Bank (D-SIB).The Bank's capital adequacy ratio computed under Basel III is given below:

(Rs. Crore)

Particulars	**March 31, 2019**	**March 31, 2018**
Tier I capital	147,022.76	106,004.9
Of which CET1 capital	139,172.76	98,004.90
Tier II capital	12,434.88	12,535.47
Total capital	159,457.64	118,540.37
Total risk weighted assets	931,929.87	800,125.98
Capital adequacy ratios under Basel III		
Tier I	15.78%	13.25%
Of which CET1	14.93%	12.25%
Tier II	1.33%	1.57%
Total	**17.11%**	**14.82%**

POVISIONS TAKEN :

- Provision for standard assets is made @ 0.25% for direct advances to agriculture and Small and Micro Enterprises (SMEs)sectors, @ 1% for advances to commercial real estate sector, @ 0.75% for advances to commercial real estate – residential housing sector, @ 5% on restructured standard advances, @ 2% until after one year from the date on which the rates are reset at higher rates for housing loans offered at a comparatively lower rate of interest in the first few years and @ 2% on all exposures to the wholly owned step down subsidiaries of the overseas subsidiaries of Indian companies, sanctioned / renewed after December 31, 2015.
- Provision is maintained at rates higher than the regulatory minimum, on standard advances based on evaluation of the risk and stress in various sectors as per the policy approved by the Board of the Bank.
- In accordance with regulatory guidelines and based on the information made available by its customers to the HDFC Bank, for exposures to customers who have not hedged their foreign currency exposures, provision for standard assets is made at levels ranging up to 0.80% depending on the likely loss the entities could incur on account of exchange rate movements.
- Provision for standard assets of overseas branches is made at higher of rates prescribed by the overseas regulator or RBI.

- Pursuant to a recent RBI guideline issued in January 2019, additional 5% provision is maintained in respect of Micro, Small and Medium Enterprises (MSME) sector standards accounts which have got restructured.
- For all other loans and advances including credit exposures computed as per the current marked to market values of interest rate and foreign exchange derivative contracts, provision for standard assets is made @ 0.40%.
- In accordance with RBI guidelines, an additional provision is made @ 3% on the incremental exposure to the "Specified Borrowers" (except NBFCs / HFCs) beyond normally permitted lending limit ('NPLL') as defined by RBI.

EXCHANGE RISK MANAGEMENT

HDFC bank maintains a policy and process for managing currency induced credit risk. The credit appraisal memorandum is prepared inbeginning and review of a credit facility is required to discuss the exchange risk that the customer is exposed to from all sources, including trade related, foreign currency borrowings and external commercial borrowings. It could cover the natural hedge available to the customer as well as other hedging methods adopted by the customer to mitigate exchange risk.

QUESTIONS:

1. Analyse the factors affecting Indian Banking Industry and compare the position of Public vs private banks.
2. What is Asset Liabilty Management? Discuss the Policies related to ALM for banking industry.
3. Explain the Basel Norms for CAR. How Performance of banks is correlated to its CAR?
4. Suggest the measures to improve the competitive position of Indian public sector banks.
5. Do you HDFC would be able to sustain its position and will be able to surpass SBI in long term? Explain measures as well.

TEACHING NOTES

Overview

This case is a very good example of how the understanding of the financial soundness of banks can lead to survival in times of recession. The case also articulates how proper risk management lead to growth of HDFC bank. The case reiterates the principles and provides an opportunity to analyse various concepts e.g. Basel Framework, ratio analysis, Asset management, risk management to evaluate HDFC and its current situation in the banking industry.

Application

This case is appropriate for a class of students studying in a graduate management program

(i.e. PGDBM or MBA) as part of their Management of Financial institutions and Services/Banking course. The pre-requisite on the part of students, before they attempt this case are:

• A good understanding of the Financial services will greatly help the reader to understand role of banks.

They should have nearly completed their syllabus on banking course

• They should have a good understanding of the Financial analysis of banks.

• They should have studied the topics like asset laibilty management, NPA, Capital adequacy ratios

OBJECTIVES OF THE CASE

Type of Case: Complex

The objective of this case is to enable students to appreciate the concept of risk management to understand its correlation with survival of financial institutions. The students are advised tobe familiar with the concepts of types of risk, structure of banks, assets and liabilities of banks, Basel accord, financial ratios of banks, risk adjusted assets and liabilities etc. They should know the current scenario of Indian banking sector to forecast the future of banks.

Post this case discussion; students should be able to answer the following key questions:

1. How well HDFC is prepared to move from “ZERO” business to “HERO”?

2. Moving from Investment company to banking would need significant changes in financial policies. How has HDFC been able to align into the shoes of a banking organization?

3. Has globalization and corporate governance issues deteriorated the asset quality of HDFC?

4. What is your recommendation for public sector banks to strengthen their position as a strong banking organization?

Teaching Suggestions

The class should be given a good backgrounder of the Banking industry landscape and the how is has reshaped over the last decade or so. The case needs to be studied in the class as a single group. The student after going through the case can reflect upon their understanding of Risk Management process and tools of financial institutions.

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