HDFC Bank: The Behemoth of a Surging Nation

That the merger of HDFC Bank with its parent company, Housing Development Finance Corporation Limited, is setting records and catapulting India’s financial institutions into the global top hundred leagues is a cause for celebration for an economy of the size of India, the Poseidon sailing into the vast ocean of economic prosperity.

By Jennifer Paldano Goonewardane.

HDFC Bank, India’s leading private sector bank has announced the successful completion of merger of HDFC Ltd., India’s premier housing finance company with and into HDFC Bank.

As Indian media announced the closure of India’s homegrown gargantuan mortgage

lender HDFC Ltd at the end of June 2023 following a decision to merge with its banking arm, HDFC Bank, tipped as the largest transaction in India's corporate history, there was a sense of nostalgia tinged with bittersweet memories of its genesis and meteoric rise to become a corporate powerhouse.

HDFC Ltd revolutionized India's domestic retail housing mortgage ecosystem at a time when there were no non-banking financial institutions (NBFI) in India offering the facility to Indians who were dreaming of owning a home before retirement, growing exponentially over the years by making housing affordable to the middle class. The entity was also the face of a rising global economic dynamo, signaling to the world how its domestic market possessed enormous potential for growth and gains. The merger announced in 2022 was a strategic move to create one of the world's most valuable banks by amalgamating two asset-rich organizations—the reverse takeover of the parent company for $40 billion by HDFC Bank.

Following the merger, HDFC Bank became a fully publicly owned entity, with shareholders of HDFC Ltd receiving 41 percent ownership in the HDFC Bank. HDFC Bank owns all subsidiaries of HDFC Ltd following the tie-up. This inorganic growth gives the newly merged entity a competitive advantage in size and market capitalization, two sizable pools of resources to make it an entity with a combined value of $172 billion and customer bases of 120 million, making it the fourth largest Bank in the world by market capitalization next to JPMorgan Chase and Company, Industrial and Commercial Bank of China Ltd and Bank of America.

Significantly the merger was supposedly driven by a team of 18 advisors, a combination of global and domestic advisory banks and companies, including the Bank of America and Morgan Stanley, which received a combined fee of only one million dollars, a small price compared to the size of the transaction. Because the chairman, board members, and executives of HDFC Ltd guided the merger process and did the bulk of the work, they managed to keep costs down. Moreover, it demonstrates the challenges facing investment banks that try to leverage the enormous potential for sizeable fee-generating business in India as advisors. However, in this instance, India, described as a price-conscious market, has judiciously kept the costs of the merger under control by allowing an internal team to do most of the work.

Significantly the merger was supposedly driven by a team of 18 advisors, a combination of global and domestic advisory banks and companies, including the Bank of America and Morgan Stanley, which received a combined fee of only one million dollars, a small price compared to the size of the transaction.

Turning the Tables on a Debt-Averse Population

Financing people's housing needs was a radical shift in India when HDFC Ltd was set up in 1977 by H T Parekh, whose visionary project defined India's housing finance market, being the sole provider of mortgages for potential homeowners until the late 1980s. The company began with zero government assistance and pitched its proposal to a middle-class Indian population that was highly debt-averse. As a sole entity with no external support, the new company was entering unchartered and volatile territory. And there were challenges to the company's growth in a somewhat deserted landscape of a sole operator. However, seeing its growth potential and backed by the Indian Government, international agencies such as the World Bank, USAID, and the International Finance Corporation injected money into the entity, allowing it to grow and sustain its position in India's housing finance sector. Parekh's credentials as a veteran banker and his astute leadership as chairman of ICICI Bank from 1972 may have been to his advantage, as he continued to demonstrate his pioneering spirit with far-sighted sensibility in managing the operations of his visionary project while changing the domestic mortgage market in housing for good.

HDFC Ltd enlarged its business tentacles in the 1990s as the Indian government decided to issue licenses for private banking, and in 1994 led by Parekh, HDFC Bank began operations. Today, HDFC Bank enjoys being in the exclusive club of an elite list of Indian lenders deemed too big to fail by the Indian central bank.

The Combined Strength

The advantages of the merger have been spelt out extensively by analysts. It has created an enormous organization of value of global standards, attracting valuable investments in its stocks and augmenting the entity's existing high-profile investors, such as JPMorgan. The merger increases the scale and accrues a larger balance

sheet improving shareholder value and benefitting shareholders of both entities.

The amalgamation will strengthen the funding position as a registered bank compared to a NBFI. HDFC Ltd, like any NBFI, would have raised capital at higher costs but can henceforth access the Bank's low-cost capital derived from their deposits with a CASA ratio of 47 percent. The Bank, following the merger, will be able to expand its housing loan segment, which was hitherto 11 percent, but can grow to 33 percent in a post-merger landscape, while expanding product offerings and cross-selling its other services to existing HDFC Ltd customers, 70 percent of whom are not doing any banking with HDFC Bank. The tie-up also combines the two entities' strengths of skill and expertise, enabling synergy across revenue opportunities while collectively pursuing its expansionist agenda in housing loans through branch network enlargements in tandem with penetrating the lower and middle-income earner segments. Becoming a larger entity strengthens it to expand its loan portfolio to include large-scale infrastructure loans.

The tie-up has occurred at an opportune moment for the Indian economy, which has been experiencing a robust uptick in credit growth. Therefore, the private banking sector in India, analysts contend, requires scaling as the demand for credit in the Indian economy will grow in the coming years as projected. Consolidating their positions in the banking sphere to meet such needs may lead to more mergers between banks and NBFIs with corresponding credit profiles. Analysts consider the tie-up a wake-up call to competitors, especially the larger banks that will have to be on their feet to improve their internal efficiencies to compete sufficiently with a high-value bank such as HDFC Bank. Multiple scenarios are playing to the advantage of such healthy mergers. With the consolidation strengthening the Bank's capital, its competitiveness globally increases while ensuring economic stability at home. As the merger strengthens HDFC Bank's capitalization through improved asset quality, the lower cost of financing debt leading to higher credit growth will see it playing an active role in bolstering economic activity by increasing the delivery of more credit to the public.

Atanu Chakraborty, Chairman, HDFC Bank.

Making a Case for a Stable Financial Market

There is a case for the merger from the recent past. Suppose history can teach lessons for the future and caution decision-makers to be proactive to face future economic scenarios. In that case, the Indian deal seems to be one of the most far-thinking power-consolidating marriages. Despite their status as registered entities, the operational volatility surrounding NBFIs resembles a recurring wound for central banks. Central banks carry the risk of insolvency and a follow-up hoopla of dramas that fall onto their lap, and that of governments trying to contain depositor and investor drama and its spillover effect on the financial sector, the stock markets, and the economy. In our countries, NBFIs operate in a disincentivized economic environment accompanied by intermittent tightening of rules by central banks to police their operations. In India, the Indian Reserve Bank has been imposing regulatory strictures to push NBFIs to transition towards embracing the more regulated and safer risk management practices of banks accompanied by more

rigorous supervision and new regulatory frameworks. That has been making the operating environment more challenging for many NBFIs in India, where NBFIs with over ten years of operational presence and a stipulated asset base can shift to a licensed fully-fledged commercial bank under the guidelines of the RBI.

The RBI harmonizing banking and non-banking financial institutions regulations in a bid to promote smoother merger transitions must be looking to avoid the NBFI crisis that swept India in 2018-2019, which was a wake-up call for action lest its shenanigans continue to threaten to shake the very foundations of the Indian economy. The crisis that erupted with a NBFI-led loan default impacted the broader NBFI ecosystem. Even stronger operators like HDFC Ltd witnessed their market capitalization deteriorate significantly, affecting stock and debt markets. The crisis was enormous in its spillover effect, as rating agencies began giving their verdict on struggling NBFIs, pushing investors into a cautionary approach, making them wary of pumping money into the beleaguered NBFIs. With sell-offs, vulnerable NBFIs were struggling to borrow as the cost of borrowing rose, further threatening their survival. By 2019, the RBI stepped in vigorously to prevent any more significant collapses of major NBFIs. However, cautious investment in such institutions led to further borrowing costs for NBFIs.

Meanwhile, NBFIs saw a slowing down in loan growth influenced by the high cost of borrowing and increased risk aversion. Just as the central bank tried to contain the crisis, the world witnessed the rise of the COVID-19 pandemic, which again swept the Indian financial sector into stress with the threat of increasing NPLs. NBFIs survived the pandemic period with moratoria from large State-owned banks, with the central bank extending moratoria periods for the repayment of loans. This recent fallout exposes the dangers of a weak financial sector impacting economic growth. The potential impact of financial sector weakness on economic growth, among other factors, has been studied extensively to avert future scenarios. First, credit shocks impact economic activity significantly. Second, financial crisis-induced recessions have grave and sustained impacts on economies. However, in promoting well-capitalized financial institutions, such as in India, their debt financing costs become lower, leading to higher annual credit growth, pushing for faster economic activity and GDP growth. The newly merged HDFC Bank has a very high market capitalization of $172 billion, which can spur credit growth. As HDFC Bank becomes an inclusive banker, extending its reach across India through the combined strength of branch networks while embracing the possibility of spreading its wings globally, it seems poised to support the country’s economic roadmap by extending more credit to drive GDP growth.

Harmonizing with the Big Indian Picture

As the old mortgage colossus ceased operations at the end of June 2023, merging with HDFC Bank on July 1, 2023 the latter was quick to allay the fears of depositors

belonging to both institutions, assuring the depositors of HDFC Ltd of continuity of deposits and services under the new regime. To their employees, the outgoing chairman Deepak Parekh of HDFC Ltd, assured continuity in employment, being absorbed into the Bank's workforce. He called on them to embrace change, the new era of possibilities, and to continue working as a team. Teamwork was the cornerstone of the company's founder in 1977, rooted in integrity, transparency, and professionalism. The founder's nephew, who was hanging his boots after a well-run race after taking the baton from his uncle, in his parting message, underscored the importance of considering the new management as an extension of the old team, complementing each other because he opined that it is an era of new possibilities, of building on each institution's strength to increase profitability in a contemporary Indian roadmap focused on raising India as an economic behemoth. This era demands decisions harmonizing with the country's onward journey. The employees had to grasp the momentum in this new journey that centers on the Indian Age of new possibilities. His words resonate as a lesson for the future, where the financial system and the corporates must navigate the new Indian economic trajectory of becoming a global economic powerhouse with stealth and precision for strategic benefits.

A HDFC Bank branch.