Banking Case Study

About the Case:

Business Overview:

Kaira Commercial Bank (KCB) has just got banking license to operate as a commercial bank in India. KCB shall start with an initial equity capital of Rs.450 million. The company shall service clients by providing:

- Housing Loans
- Personal Loans
- Corporate Loans
- Other Loans

While the interest rate to be charged by KCB for housing loan shall be on lower side at an average 9.5% per annum, the corporate loans and personal loans shall give it an income push with higher interest income expectations at 12.5% and 14.0% p.a. respectively.

The main business of KCB is expected to be driven by interest income from corporate loans; however, it is also expected to generate considerable non-interest income from:

- Fees from Investment banking division
- Other fees and commissions (like FX sale/purchase)

Capital Expenditure:

The company shall spend heavily on capital expenditure towards initial set up, including:

- Office furniture and fixtures
- IT and other infrastructure

To maintain a robust infrastructure, KCB shall continue to invest in core capex, which shall be depreciated over useful economic lives of 7 years for Office furniture and fixtures and 5 years for IT and other infrastructure. The model should have flexibility to automatically adjust the depreciation based on changes in useful economic life assumption.

Bank Staff:

The company shall start operations with 57 employees with a properly structured resource pyramid. In order to align with future expansion, KCB shall aggressively hire resources and keep improving its overall staff pyramid index.

Leased Area:

The bank shall start with a leased space of 4,000 sq.m. and shall expand its number of branches in line with its future expansion plans and gradually reaching to 7,000 sq.m. space in 5 years timeframe.

Other Operational Expenses:

- The bank shall start with 30 ATMs and plans to gradually increase the number of ATMs to 75 over the next 5 years. The bank shall take space on rent for this which is expected to cost approx. Rs.30,000 per ATM per month including all incidental expenses. The monthly cost may be modelling appropriately with annual inflation of ~8%
- The other operational costs are projected to Rs.5 million in the initial year of operation and is expected to witness an yearly increase of ~8%

Capital Adequacy:

• Capital adequacy ratio (CAR) may be computed as per prevalent banking regulations

• Any shortfall to meet required CAR may be met with additional equity infusion into the bank

Requirement:

• Set the key assumptions in place along with a broad structure of Income Statement, Balance Sheet and Cash Flow Statement

• Prepare detailed schedules for interest income drivers, interest expense drivers, fixed assets and financing along with the completed projected financial statements for the next 5 years

• Using the final integrated financial model, compute key ratios and metrics to better analyze the bank’s 5 years long-range plan

Tax Rate: The average corporate tax rate may be taken as 25%