**CHAPTER – 2**

**REVIEW OF LITERATURE**

A

literature review is an evaluative report of information found in the literature related to selected area of study. In this chapter the reviews are described, summarized and classified the literature in order to give a theoretical base for the research. In this chapter the reviews are divided into three parts which will give complete base to invent the research gap to ignite and streamline the research process.

**2.1 INTRODUCTION**

Review of literature is the study of already established knowledge pertaining to the area that enables us to perceive clearly what is already lighted up in that area and what still remains enveloped in darkness. It has universally acknowledged that no work can be meaningfully conceived and soundly accomplished without critically studying – what already exists in relation to it, in form of general literature and in the shape of outcomes specific studies. Literature means writing and a body of literature refers to all published writings in a particular style on a particular subject. According to Cooper (1988) “A literature review uses as its data base reports of primary or original scholarship, and does not report new primary scholarship itself. The primary reports used in the literature may be verbal, but in the vast majority of cases reports are written documents. The types of scholarship may be empirical, theoretical, critical/analytical, or methodological in nature. Second a literature review seeks to describe, summarize, evaluate, clarify and/or integrate the content of primary reports.”

The purpose of a literature review is fourfold: The first is to summarize and access the state of existing knowledge on the topic. What knowledge exists and assess the state of existing knowledge on the topic. What knowledge exists and is generally accepted with regard to topic? Are there important differences or disagreements among scholars? Which research methods were employed in the various research studies, which were not, and with what consequences? What questions remain unanswered? What aspects or approaches seem relatively unexplored? Through the process of reviewing existing knowledge we can also develop a more nuanced understanding of the topic, the second reason for conducting a literature review. This new understanding leads to the third reason, to raise questions for further research. In other words, what has been left wondering? What questions or aspects of the issue find have been unanswered, unexplored or overlooked? How would our understanding be improved by pursuing those questions or angles? The final purpose of the literature review, based on the sources that have been assessed and the new questions that have been raised, is to identify one specific and significant research question that identifies the gap in the current state of knowledge or analysis about the topic.

Reviewing the literature is worth the effort: it will give you a fascinating, in-depth insight into the research topic and, even better, a great literature review will vastly improve the chances of getting a great mark. The review of the existing literature shows that only a limited number of research works are carried out by the industry and academicians for finding out the financial and other aspects of housing finance companies in India and abroad. So the researcher studied various financial reviews conducted by institutions including banks, Housing finance and other sectors and their profitability, credit risk and other aspects are analyzed. The following chapter summarizes the existing literature conducted in various financial institutions.

The Banking Commission (1972) chaired by R.G. Sarnia, recommended various management tools including the introduction of planning and budgetary control systems in order to increase the operational efficiency of the banking sector. The committee reviewed bank operating methods and procedures and made recommendations for improving and modernizing operating methods and procedures, particularly relating to customer service, credit procedures and internal control systems. It also studied the issue of profitability and suggested ways to improve it. Moreover, it also examined other important aspects of banking such as information systems, management development, training and employee appraisal, etc., which influence the productivity of banks and banking system. It suggested the use of certain ratios for measurement of operational efficiency of banks.

**2.2 REVIEW OF LITERATURE**

The relevant literature reviewed for the present study is described as under:

* Review related to Profitability growth analysis
* Reviews Related to Credit Risk
* Reviews Related to Liquidity Analysis

**2.2.1 Review related to Profitability Growth Analysis**

**Joagvin** (Joagvin, 1974)carried out an empirical study on ‘Profitability of Banks’ and reported that the rediscount rate is positively related to profitability and the relationship between profitability and rate of growth is not consistent. The study also showed that there is a positive relationship between return on owner’s equity and size for nationalized banks.

**Report of the committee on productivity, efficiency, and profitability in banking (1977**) set up by the Reserve Bank of India stressed the need for adopting planning and budgeting in banks. The report stated that the performance budget helps the management to proceed along the projected goals and the performance evaluation at monthly or quarterly intervals indicates the deviations and corrective actions that should be initiated. The committee analyzed the various issues related to the planning, budgeting and marketing in commercial banks, bank management information system, criteria for evaluation of bank performance, annual accounts of banks, trends in earnings and expenses of banks, and profitability as well as pricing of banking services. The major recommendations of the committee were: (i) the capital base of banks need to be improved. For this, banks should transfer at least 40 per cent of the disclosed profits to reserves, free of taxation, (ii) the interest on additional cash reserves in excess of the minimum 3 per cent should be related to cost of funds for banks, (iii) in the light of social obligations cast on the banks, tax laws need to be revised, (iv) to estimate the cost of various services and profitability of different activities, the Reserve Bank of India in collaboration with Commercial banks, should organize regular and systematic surveys, (v) to improve productivity, efficiency and profitability of banks, a systematic, prompt and regular flow of information and its analysis is essential for banks to contemplate timely corrective actions, (vi) there should be uniform system of audit for all categories of banks, on the lines of the one prevailing in the State Bank of India, (vii) simplification of systems and procedures in banks is necessary to bring economy in expenses and to provide better customer services.

**Mathur (1977)conducted** a case study of the State Bank of India and reported that the State Bank of India, in its two decades of service has accelerated the growth of Indian economy in two significant ways: (i) by pursuing the policy of vigorous branch expansion in general and its rural orientation in particular, and (ii) by playing a leading role in introducing bank credit facility to the new fields of the priority sectors of the Indian economy. The study also revealed that the bank had played a leading role in developing the backward regions of the country.

**Sapp (1978**) investigated the relationship between long-range planning and bank performance. The purpose of this study was to examine the extent of long-range planning by commercial banks and to study the relationship between such planning efforts and bank performance. Eight testable hypotheses were derived from the general hypothesis that banks, which engage in long-range planning, will perform better than banks that do not. The analysis of variance procedure (ANOVA) was used to determine the significance of the variance in the performance measure that could be “explained” by the levels of long range planning.

**Shah (1978)** in his article “Bank Profitability: The Real Issues”, concluded that profitability is not expected to be improved merely by increasing the margin between lending and borrowing rates. On the contrary, the findings suggested any increase in income may be observed by latent efficiencies in cost structure. Further, the spread between interest earned and interest paid is declining, not because interest margin has been squeezed but because: (i) staffing and working patterns are inefficient, (ii) funds and investment management is poor, (iii) credit is not supervised, and (iv) forms and procedures are complex and wasteful.

**Ganesh (1979**) reported in his paper on the system of profit monitoring in banks emphasized that the effectiveness of monitoring system would depend upon profit plan, identification of profit centers, setting up of standards for comparison and a proper management information system. The study highlighted that the working funds as a measure of comparing profitability at the branch level is inadequate instead the use of total business will be more suitable. Finally, the study suggested a monthly profitability monitoring report at branch level to central office that would enable the central office to monitor the branches effectively.

**Bilgrami (1980)** studied the banking growth imbalances over a decade since nationalization and concluded that: (i) the rapid expansion of bank branches since 1969 have substantially increased the average number of bank branches per million populations in all regions, but such expansion could not actually prove helpful in eliminating the wide variations between backward and developed regions. (ii) the regions, which were above the national average population served by a bank in 1969, recorded more progress than the regions that were below the national average. Similar trends also emerged in case of deposits, credits and priority sector lending.

**Smith (1980)** conducted a study on Profitability and Liquidity and suggested that working capital management directly influence risk and profitability of a firm. Hence it can be inferred that effective working capital management can increase the financial strength of a business1.

**Seshadri (1981)** conducted a research study under the title “Banks since Nationalisation”. The study used fourteen public sector banks and thirteen private sector banks. Some peculiar features of this study are the assessment of temporal behavior of selected variables for growth analysis and the use of suitable techniques to evaluate the economies of scale in the banking industry. The study brings out that the profitability ratios have been higher for the selected group of private sector banks than for the nationalized banks and this was so in spite of the fact that the private banks had a higher proportion of establishment cost. The performance of the private banks has been noteworthy considering the odds they faced in securing growth of their business. The study also concluded that the private sector banks have taken banking service to a large number of centers and competed well with the public sector banks in spite of the inherent advantages the public sector banks have.

**Verghese (1983)** conducted a detailed study on profits and profitability of commercial banks during the decade 1970-79. The study discussed the following points: (i) had there actually been a declining trend in the profits and profitability of Indian Commercial Banks in the seventies? (ii) What were the main determinants of profits and profitability of the Indian banks during this period? and (iii) were the conventional profit accounting standards adequate to reject a true picture of the financial performance of the Indian banks? The study found that changes in the interest rate were the most important factor determining profitability of banks during the post-nationalisation but pre-deregulation period.

**Angadiand Devraj(1983)** in their paper revealed that difference in cost of working funds (deposits), interest earning, social banking, funds management, earning from sources other than the interest earnings, expansion of banking business, retail banking services, are main factors contributing to the difference in productivity and profitability ratios of the bank groups. They concluded that in the prevailing circumstances, changes in interest rates on deposits and credit, have a decisive impact on earnings and expenses and consequently on profitability of banks.

**Chakrabarthy(1986**) has made an empirical study of the relative performance of different groups of banks (public, private and foreign) based on three basic parameters such as: (i) profit, (ii) earnings, and (iii) expenses. The author has computed Herfindahl's index to measure the inequality in the sharing of profits, earnings and expenses by each group of banks. The study suggested that scheduled commercial banks should take up some exercise to evaluate the relative performance of each of their offices for more effective profit planning.

**Joshi (1986)**analyzed the trend of gross and net profits of all scheduled commercial banks. The study found out that there had been lowering yield rate and rising cost rate year by year which contributed a lot to the declining trend in profitability. He also suggested that declining demand from the corporate sector for bank funds had serious implications for bank profitability.

**Bourke (1989)** had reported that capital ratios are positively related to profitability. Bourke explained this by assuming that well capitalized banks may enjoy access to cheaper and less risky sources of funds and better quality asset markets. Alternatively the prudence implied by high capital ratios may also be maintained in their asset portfolio decisions with consequent improvement in loan loss provision and hence profitability.

**Duca and McAughlin (1990**) had indicated that variations in bank profitability are largely influenced by credit risk (Non Performing Loans) associated with the bank. They argued that loan loss provisions had a direct negative impact on profitability of commercial banks.

**Ramachandran (1992**) observed that profitability of banks was on the decline. The study reported the following reasons as main causes for the decline in profitability: (a) emphasis on social goal (b) increase in establishment cost (c) blocking fund in sick unit (d) compliance to statutory requirement (e) rural branch expansion (f) leakage in income, and (g) poor cash management.

**Amandeep (1993)**in a study on profitability of commercial banks has attempted to examine the trends in profits and profitability of twenty nationalized commercial banks, with the help of trend analysis, ratio analysis and concentration indices of the selected parameters. The study focused on identifying the various factors and empirical testing as to which of the identified factors have significantly contributed towards bank profitability in either direction. Using the multivariate analysis, the study concluded that it is the efficient management of the burden (as against the widely believed ‘spread’ element), which plays a major role in determining the profitability of commercial banks. In spite of lack of control of few determinants of burden, it is inferred that judicious management of the burden can significantly enhance bank profitability.

**Boyd and Runkle (1993**) by using market data (stock prices) instead of using accounting measures of profitability, found a significant inverse relationship between size and rate of return on assets in U.S. banks from 1971 to 1990, and a positive relationship between financial leverage and size. They do not provide, however, any theoretical model to rationalize this evidence.

**Raut and Das (1996)** have conducted a study titled “Commercial Banks in India – Profitability, Growth and Development”. The study attempted to examine, measure and analyse the profitability trends of the Indian banking sector over the period of 1980 to 1992. They have highlighted various factors responsible for the variations in banks’ profitability in either direction. They have also incorporated empirical analysis of profitability as well as of its determinants of the sample bank groups.

**Thamkirati (1996)** studied the relationships among the effects of banking deregulation, asset management ratios and profitability of the banking industry in Thailand. The purpose of this study was to examine the relationships among the regulatory variables, strategic alternatives, and performance variables of the commercial banks in Thailand, in terms of their composition of loans, sources of interest income, and asset management. A descriptive-correlation method was used to empirically investigate the expected differences of the pre and post-deregulation periods. The major findings of the study are: under deregulation, the average ratio of personal to commercial loans and the amount of total assets increased, as did the ratio of net interest income to total assets. However, deregulation did not influence the income performance of Thai commercial banks in the post-deregulation period (1990-1993).

A study conducted by **Ganesan (1998**) entitled “Priority Sector Advances vis-à-vis Profits and Profitability of Public Sector Banks in India (1969-1993)” analysed the following aspects: i) economies of priority and non-priority sector transactions with reference to spread, burden and surplus; ii) the use of efficiency, liquidity and profitability ratios to assess the operational efficiency; iii) determinants of profitability to derive a profit function model; and iv) the economies of scale regarding cost, production and profit functions. Finally, the study pinpoints certain ideas for the improvement of profitability and the technical change to be made to recover the problem loans of priority sector advances.

**Demirguc-Kunt and Huizinga** (1999) in their article titled “Determinants of commercial bank interest margins and profitability: some international evidence” explained the determinants of profitability in detail. By using bank data for 80 countries for a period from 1988 to 1995, the authors showed that differences in interest margins and bank profitability are reflected by various determinants such as : bank characteristics, macroeconomic conditions, explicit and implicit bank taxes, regulation of deposit insurance, general financial structure, and several underlying legal and institutional indicators. Controlling for differences in bank activity, leverage, and the macroeconomic environment, the study found that: 1) Banks in countries with a more competitive banking sector--where banking assets constitute a larger share of GDP--have smaller margins and are less profitable. The bank concentration ratio also affects bank profitability; larger banks tend to have higher margins. 2) Well-capitalized banks have higher net interest margins and are more profitable. This is consistent with the fact that banks with higher capital ratios have a lower cost of funding because of lower prospective bankruptcy costs. 3) Differences in a bank's activity mix affect spread and profitability. Banks with relatively high non-interest-earning assets are less profitable. Also, banks that rely largely on deposits for their funding are less profitable, as deposits require more branching and other expenses. Similarly, variations in overhead and other operating costs are reflected in variations in bank interest margins, as banks pass their operating costs (including the corporate tax burden) onto their depositors and lenders. 4) In developing countries, foreign banks have greater margins and profits than domestic banks. In industrial countries, the opposite is true. 5) Macroeconomic factors also explain variation in interest margins. Inflation is associated with higher realized interest margins and greater profitability. Inflation brings higher costs--more transactions and generally more extensive branch networks--and also more income from bank float. Bank income increases more with inflation than bank costs do. 6) There is evidence that the corporate tax burden is fully passed on to bank customers in poor and rich countries alike. 7) Legal and institutional differences matter. Indicators of better contract enforcement, efficiency in the legal system, and lack of corruption are associated with lower realized interest margins and lower profitability.

**Chen (2002)** assessed the management performance of banks in Taiwan by incorporating operating efficiency, marketing efficiency and financial performance in the study. The study reported that the banks with public ownership exhibited superior profitability performance, whereas privately owned banks tend to perform better with regard to operational capabilities. Furthermore, the relatively large banks exhibited superior performance on profitability, whereas the smaller ones tend to perform better with regard to operational capabilities.

**Shri Partha Ray and Shri Indranil Sengupta** (2003) suggest that “Indian banking system was based on measures for improving the health of banking system and related regulatory and supervisory Initiatives, when the reform process started in the Indian economy after 1992, the recommendation of the committee of financial system. Issue of relating to the financial sector including reduction of directed credit allocation liberalization of interest rate and ensuring increased competition”

**Halkos and Salamouris** (2004) by applying the data envelopment methodology studied the efficiency of Greek banks for the period 1997-1999 and reported a strong positive correlation between size and efficiency. The empirical results showed that the Greek banking system operates at high overall efficiency levels, and that larger banks are more efficient than smaller banks.

**Goddard et al. (2004**)by using a dynamic panel and cross-sectional regressions estimated the growth and profit equations for a sample of commercial, savings, and co-operative banks from five major European Union countries during the mid-1990s. The growth regressions from that study revealed little or no evidence of mean-reversion in bank sizes. Profit is an important prerequisite for future growth and banks that maintain a high capital-assets ratio tend to grow slowly, and growth is linked to macroeconomic conditions. The persistence of profit appears higher for savings and co-operative banks than for commercial banks. Banks that maintain high capital-assets or liquidity ratios tend to record relatively low profitability. The study found some evidence of a positive association between concentration and profitability, but little evidence of a link between bank-level inefficiency and profitability.

**Athanasoglou et al. (2006)** examined the profitability behavior of bank-specific, industry-related and macroeconomic determinants, using an unbalanced panel dataset of South Eastern European (SEE) credit institutions over the period 1998-2002. The finding suggested that the increasing levels of financial reform and improvement in the structure of the credit institutions’ aggregated balance sheet are joint determinants of bank profitability. The study also found that with respect to the macroeconomic variables, inflation has a strong effect on profitability, while bank profits are not significantly affected by real GDP per capita fluctuations.

**Mittal & Dhade (2007**) assess the achievement and performance of PSBs vis-à-vis private sector banks and foreign banks using ratio analysis. Performance is evaluated on the basis of profitability and productivity from 1999 to 2004 for 27 PSBs, 30 Private sector banks and 33 foreign banks. The study reveals that PSBs are less profitable than private sector banks and foreign banks in terms of overall profitability (Spread-Burden ratio). The authors conclude that Indian PSBs and old private banks are less efficient both in terms of productivity and profitability with the exception of SBI and its associates.

**Bodla and Verma (2006)** studied the key determinants of profitability of public sector banks in India by using a stepwise multivariate analysis for the period from 1991-92 to 2003-04.The study reported that non-interest income, operating expenses, provisions and contingencies and spread have significant influence on the profitability of the public sector banks. The study also found a negative correlation between profitability and the non-performing assets as well as provisions and contingencies.

**Tarawneh (2006)**attempted to classify the commercial banks in Oman in to cohesive categories on the basis of their financial characteristics revealed by the financial ratios. The study selected five Omani commercial banks with more than two hundred and sixty branches by using a simple regression to estimate the impact of asset management, operational efficiency, and bank size on the financial performance of these banks. The study found that the bank with higher total capital, deposits, credits, or total assets does not always mean that has better profitability performance.

**Chen and Lin (2007)** while analyzing the efficiency of Australian banks for a period from 1996 to 2004, reported that return on assets (ROA) is an important financial factor affecting positively the performance of Australian banks. The study also noted that Australian banks showed better operational efficiency than their American counterparts for the period 2001 - 2004.

**Bennaceur and Goaied (2008)** studied the impact of bank specific and macroeconomic variables on the profitability in the Tunisian banking sector and revealed that banks with higher level of capital and higher overhead expenses tend to show higher profitability. The study found a negative relationship between the profitability and bank’s size and macroeconomic conditions have no significant effect on the profitability of the banks. The results also suggest that the private sector banks are relatively more profitable than their state public sector counterparts.

**Kosmidou (2008)** examined the determinants of performance of Greek commercial banks and revealed that better capitalized banks showed more profitability. The study also reported that Gross Domestic Product (GDP) had a positive influence on the profitability of Greek commercial banks while inflation rate had a negative influence on profitability.

**Ketkar and Ketkar (2008)**investigated the efficiency of Indian banks since systemic reforms began in the 1990s. By using data envelopment analysis on bank-specific data from 1997 to 2004, the study reported that the foreign banks to be the most efficient followed by new private banks. While the efficiency scores of all banks have increased over the reform period, the nationalized banks have registered the strongest gains due to infusion of new capital and the increase in competition. The study using the regression analysis showed that the mandates on priority sector lending have hurt the efficiency of state-owned and nationalized banks but bank branch expansion mandates have not hurt their efficiency.

**Flaming et al. (2009)**carried out a detailed study on the “The Determinants of Commercial Bank Profitability in Sub-Saharan Africa” by using a sample of 389 banks in 41 Sub-Saharan African countries. The study found that the bank specific factors that influenced the profitability included credit risk, higher returns on assets, bank size, activity diversification, and ownership. Bank returns are also affected by macroeconomic variables such as inflation and GDP suggesting that macroeconomic policies that promote low inflation and stable output growth influenced credit expansion and profitability.

**Sufian (2009)** examined the determinants of bank profitability in Malaysian commercial banks and reported that Malaysian with higher credit risk and higher loan concentration exhibit lower profitability level. The study revealed that banks with higher level of capitalization and higher proportion of income from non interest sources and higher operating cost tend to exhibit higher profitability level. The findings suggested that there was an inverse relationship between economic growth and profitability in Malaysian banks and a positive relationship between inflation and profitability.

**Atikogullari (2009)** has analyzed the financial performance of banking sector in the Turkish Republic of Northern Cyprus from 2001 to 2007 and reported that the asset quality has deteriorated since 2001. Although the study found that in terms of profitability, trends of the banks have shown lots of fluctuations during the period investigated, in general, the profitability of the banks are noticeably higher in 2007 than in 2001.

**Ramlall (2009)** analysed the determinants of profitability for the Taiwanese banking system using bank-specific, industry-specific and macroeconomic factors, under a quarterly dataset, for the period 2002 to 2007.The results from that study showed that while credit risk triggers a negative impact on profitability, capital tends to consolidate profits. The results suggested that Taiwanese banking system is well-diversified. The main implication of the findings is that it may be difficult to mitigate the pro-cyclic nature of banks’ profitability in Taiwan subject to a non-concentrated banking system.

**Dr. Ashwani Kumar Bhalla(2010)** stated that the Housing Finance is a specialized form of finance and efficiency of housing finance system in a country is one of the basic indicators of the growth of its economy. Hence understanding the efficiency and effectiveness of housing finance system is very much essential and relevant. This paper critically examines the profitability of selected housing finance companies and analyzes the strong factors which affect the profitability of these companies. The evaluation of performance of housing finance companies is made using some widely used indicators of measuring finance companies performance, namely financial ratios. To compare the company wise profitability of selected housing finance companies they have used the set of ratios to compare the profitability of these companies and to analyse the strong factors which affect the profitability of these companies. These ratios are: Return on Capital Employed (ROCE) , interest Income as percentage of capital employed, non-interest income as percentage of capital employed, interest expenses as percentage of capital employed, operating and administrative expenses as percentage of capital employed employee expenses as percentage of capital employed. In the analysis bivariate correlation analysis has been used to study the correlation between various variables.

**Manoj (2010)** did an empirical study on the determinants of profitability and efficiency of Old Private Sector Banks in India with a focus on banks in Kerala State and reported that the banks in Kerala had shown enhanced profitability, operational efficiency and risk management capability, particularly credit risk management. The study also found that non-interest income was a significant determinant of the profitability of old private sector banks in Kerala.

**Eric Kofi Boadi (2013)** conducted a study is to find out the determinants of the profitability of insurance firms in Ghana. Secondary data on financial reports were collected from sixteen insurance firms in Ghana for the period 2005 to 2010.The study was quantitative in nature. It adopted the longitudinal time dimension, specifically, the panel method and ordinary least square regression. The study discovered that, apart from tangibility which has a negative relationship, there is a positive relationship between leverage, liquidity and profitability of insurance firms in Ghana. It was also concluded that, the profitability model adopted has been explained in respect to all the independent variables and that the degree of error is less than 20%. Finally, it is suggested that the explanatory variables used in this study should be regressed on Return on Equity to find their extent of relationship on profitability.

**Yuvaraj Sambasivam (2013)** examined the effects of firm specific factors (age of company, size of company, volume of capital, leverage ratio, liquidity ratio, growth and tangibility of assets) on profitability proxied by Return on Assets. Profitability is dependent variable while age of company, size of company, volume of capital, leverage liquidity ratio, growth and tangibility of assets are independent variables. The sample in this study includes nine of the listed insurance companies for nine years (2003- 2011). Secondary data obtained from the financial statements (Balance sheet and Profit/Loss account) of insurance companies, financial publications of National Bank of Ethiopia are analyzed. From the regression results; growth, leverage, volume of capital, size, and liquidity are identified as most important determinant factors of profitability hence growth, size, and volume of capita are positively related. In contrast, liquidity ratio and leverage ratio are negatively but significantly related with profitability. The age of companies and tangibility of assets are not significantly related with profitability.

**Pankaj Chadha (2013)**It has been recognized worldwide that good Corporate Governance is important for sound management of any organization. Non-Banking Financial Institutions (like Housing Finance Companies) are no exceptions and there has been increasing demand for transparency in functioning of these HFCs. This paper compare India’s ten major HFCs namely HDFC, HUDCO, LIC Housing, GIC Housing, CanFin Housing, Manipal Housing, Sundaram BNP Paribas, REPCO Housing, GRUH Housing and DEWAN Housing on the basis of corporate governance practices & disclosures in the annual report for the year 2011-2012. For this purpose, corporate governance score (CG score) is calculated for each HFC across the different parameters as per Clause 49 of the Companies Act. Regression analysis has been applied to determine whether there is any significant relationship between the corporate governance score of HFCs and independent variables like size of the HFCs, Profit margin and leverage. We observed that majority of HFCs are not able to score well in terms of corporate governance disclosures. Only two HFCs namely HUDCO & HDFC has corporate governance score over 90%. Regression analysis shows that there is no significant correlation exists between the HFCs corporate governance score and independent variables. The significance of this study is that it uses a new perspective and dimension for comparison of HFCs in India and contributes to the existing body of knowledge in the Corporate Governance.

**Pankaj Agarwal, Abhishek Vijayaraj and Abhishek Kothari -** Business-standard**(2015)**At a time when banks were grappling with the pressure of non-performing assets (NPAs) and slowing credit growth, the stock market shifted its preference to housing finance companies (HFCs). However, with recent developments, analysts believe this shift could reduce in size and pace. The stock prices of [India bulls](http://www.business-standard.com/search?type=news&q=Indiabulls)Housing Finance, LIC Housing Finance and Dewan Housing Finance have more than doubled in the past two years. Even in the shorter timeframes of one, three, six and 12 months, these have outperformed the benchmark S & P BSE Sensex. The ability to shop for funds at a lower cost, maintain NPAs at levels visibly lower than at banks, thereby ensuring relatively subdued loan book delinquency, plus some regulatory advantages, made HFCs a better bet. However, the Reserve Bank of India (RBI) recently introduced a slew of changes which could plug the gap between HFCs and banks. Among others, RBI has allowed banks to raise bonds of seven years or more maturity for lending to the infrastructure and affordable housing sectors, with an exemption on key metrics such as the statutory liquidity and cash reserve ratios. Narrowing the gap with HFCs, this could also improve the competitive advantage of banks and strengthen their net interest margin (NIM).RBI has also rationalized a bank’s risk weight and loan to value for individual housing loans, which would make lending to the housing segment less stringent and improve the return on equity. Recently, RBI also revised its norms for fixing the lending rate, adding to the competition. Analysts believe these regulatory changes, coupled with benign demand in the realty sector, have taken away investor optimism towards HFCs.  
“Growth and margins will come under pressure as competition increases and real estate prices remain soft,” says **Pankaj Agarwal of Ambit Capital**. Concurring, **Abhinesh Vijayraj** of Spark Capital suggests that as the valuation of HFCs appear expensive, the room for multiple (valuation) upside for stocks of HFCs might get limited. On the other hand, India’s mortgage loan market remains under-penetrated. **Abhishek Kothari** of Anand Rathi opined this ensure growth for HFCs. Experts believe HFCs focused more on the retail mortgage business might score better than those with a higher proportion of commercial or builder book loans. Hence, they remain positive on LIC Housing Finance, a stock which has returned 11 per cent in the year-to-date. Nomura analysts say LIC HF, with a high share of the government employee business, should remain the most resistant to the current slowdown. The research firm expects the former to report 15 per cent revenue increase each in FY16 and FY17, with high growth in its loan against property segment and an improving builder book from a weak base (now around five per cent compared to peers at over 25 per cent). As many as 39 of 47 analysts polled on Bloomberg have a ‘Buy’ recommendation on the stock. Likewise, analysts believe the government’s focus on affordable housing could improve the prospects for HFCs with a smaller loan sizes such as Dewan Housing Finance, Gruh Finance, CanFin Homes and Repco Home Finance. Among these, Dewan Housing, despite its relatively low NIM (2.9 per cent versus peer's three to four per cent) emerges the most preferred stock, due to superior asset quality.

**2.2.2 Reviews related to Credit Risk**

**The Basel Committee on Banking supervision (1988**) through its Capital Accord (Basel I) outlined the guiding principles to improve the safety of the financial system that required the banks to have an adequate ‘capital cushion’ to cover unexpected losses. In this regard the committee recommended banks to have eight percent of its capital against their Risk Weighed Assets (RWA). As a simple and standard ratio, Basel I has been broadly accepted by the industry and by the authorities in both developed and developing countries. The introduction of the 1988 Basel I Accord on bank capital reignited research interest on the effects of bank capital regulations.

A study carried out by **Sinkey and Greenwalt (1991**) on the loan-loss experience and risk taking behavior of commercial banks in the United States of America, showed that credit risk mainly arise from poor lending policies and bad macroeconomic conditions. The study used a simple linear regression model and data from large commercial banks in the United States for the period from 1984 to 1987 and found a significant positive relationship between the loan-loss rate and internal factors such as high interest rates, excessive lending, and volatile funds. The study also reported that depressed regional economic conditions were responsible for the loss-rate of the commercial banks.

**Shrieves and Dahl (1992)**while studying the effectiveness of capital adequacy regulations and the relationship between increased banking capital and risk found out that the new capital regulation (Basel I) has been effective in increasing capital ratios without substantially shifting their portfolio and exposure towards riskier assets.

**Caprio and Klingebiel (1996)** argued that regulation-oriented reforms cannot deliver the desired outcome unless banks are restructured simultaneously; this includes introduction of measures that empower banks to work the new incentives into a viable and efficient business model and encourage prudent risk taking. The study presented data on bank insolvency episodes since the late 1970s. This database can be used in conjunction with readily available data. The study revealed information and insights that are presented in seven areas namely: a) major bank insolvencies episodes and systemic banking crises; b) main characteristics of banking crises; c) trade terms in crisis countries; d) trade concentration prior to crises; e) restructuring characteristics; f) financial analysis of crisis countries; and g) restructuring outcome in crisis countries. In a companion paper the authors discuss possible preventatives and the tradeoff between safety and soundness versus efficiency. Meanwhile, this initial database suggests further avenues for research. There is a dearth of widely available indicators on bank performance. More attention should be focused on developing indicators that might predict bank insolvency for individual banks and systems as a whole. The authors devised criteria for assessing how governments can deal with insolvency.

**Berger and DeYoung (1997)** using data on US banks for the period   
1985-1994, found that decreases in cost efficiency are related to increases in   
non-performing loans, suggesting that high levels of problem loans (Non Performing Loans/Assets) cause banks to increase spending on monitoring. Studies have shown that reduction in the NPA level contributed to reduction in risk concentration.

**Sarkar et al, (1998)** while studying the impact of reforms and liberalization on the Indian banking sector highlighted how the banking sector had undergone significant effective operational autonomy. The study reported how the Indian banks have taken advantage of the reforms to compete with each other, and learn from each other to be able to invade each other’s market niches.

**Caprio and Honagan (1999)**in their article, “Restoring Banking Stability: Beyond Supervised Capital Requirements” explained how the emerging economies have been prone to financial sector crises, reflecting marked information asymmetries and political interference, as well as the substantial volatility in underlying economic conditions, and the vulnerability of banking sector when structural economic changes create a new and uncharted operating environment. The study highlighted how the standard regulatory paradigm relies mainly on supervised capital adequacy and suggested that this may not be enough. They concluded that there is need for other measures to improve the incentive structure for bankers, regulators, and other market participants which could effectively increase the number of concerned, skilled and watchful eyes.

**Gray (1998)**studied the credit risks in the Australian banking sector and noted that the credit risk measurement was at the rudimentary level up to the early 1990s and also noted the development of better assessment models for credit risk measurement. The study highlighted that the credit risk plays a critical role in the banking sector role because the loans are by far the largest asset item of a bank, which generally account for half to three-quarters of the total value of all bank assets. The study also warned that during a financial crisis, there is a probability that some of a bank’s assets, especially its loans, will decline in value and perhaps become worthless.

**Kent and D’Arcy (2000)** examined the cyclical lending behaviour of banks in Australia and found that, the potential for banks to experience substantial losses on their loan portfolios increases towards the peak of the expansionary phase of the cycle. However, towards the top of the cycle, banks appear to be relatively healthy - that is, non-performing loans are low and profits are high, reflecting the fact that even the riskiest of borrowers tend to benefit from buoyant economic conditions. While the risk inherent in banks’ lending portfolios peaks at the top of the cycle, this risk tends to be realized during the contractionary phase of the business cycle. At this time, banks’ non-performing loans increase, profits decline and substantial losses to capital may become apparent.

**Bratanovic and Greuning (2000)** explained the usefulness of certain ratios to evaluate the credit risk associated with the banking sector. They also highlighted the usefulness of such ratios that can be derived from banks specific variables which are readily available and how banks can use such ratios internally to avert any catastrophic failures.

**Santos (2000)** reviewed the existing literature on the capital adequacy in light the Basel I Accord and suggested that raising minimum capital standard may improve the banks stability but would increase the operating cost of the banks. The study highlighted the reasons for the market failures that justify banking regulation and gave an analysis of the mechanisms to deal with these failures. The study concluded that the new capital regulation may lead to inefficiency in the banking sector due to increased operating cost.

**The Bank for International Settlements (2001)** has developed new tools to manage market risk and credit risk which are being implemented through the Basel II Accord. According to this new frame work, bank regulation and bank monitoring is mostly implemented at the level of the individual bank, usually based on the assumption that the banking system is safe as long as each individual bank is safe. It proposed a three pillar approach and emphasized on efficient credit risk management at bank level.

**Bhide et al., (2001)** in their article, “Emerging Challenges in Indian Banking” have examined the process of banking sector reforms in India and the beneficial impact of the reforms on the financial system. The study also highlighted the current weaknesses in the banking system. By using a stress test of credit risk the analysis revealed that, depending on the percentage of loans that graduate into non-performance and the provisioning made, the loss of interest income was between Rs. 21-55 billion at that time. However the study suggested that the level of provisions for this amount of loss can be supported by the level of capital adequacy ratio at that time.

**Rose** (2002) in his book “Commercial Bank Management”, has explained the critical role of credit risk in the banking sector since the largest asset item is loans.  
The book defines that the goal of credit risk management is to maximise a bank’s   
risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The book emphasized that the effective management of credit risk is a critical component of a comprehensive approach to risk management of the banking sector and essential to the long-term success of any banking organization.

**Ward** (2002) while studying the implications of Basel II on developing counties concluded that the Basel II is likely to be costly to implement, complex to understand, and prescriptive in its numerous recommendations. The study revealed that the Basel II favours active risk management and in preparation for its adoption many banks are improving their internal models. He also suggested that the positive side of Basel II could be an improved risk management, enhanced information flows, and related disclosures in the banking industry. These measures could drive parallel improvements in the stability of global financial markets. The study argued that the new disclosure provides regulators with early warnings that banks or rating agencies could then pass on to the public and to investors, potentially enhancing trust in financial markets. In addition the Basel II Accord can be pro-cyclical, since banks will require more capital when companies are downgraded, but the Basel Committee has taken some steps to reduce pro-cyclicality. It requires banks to carry out ‘stress tests’ under Pillar 2 by calculating how much capital would be needed in a crisis.

**Muniappan (2002)** while studying the Non Performing Assets in the Indian banking sector, suggested that resolving the large stock of NPAs has been a policy priority since the start of economic reforms in the early 1990s. He reported that NPAs which stood at 25 percent of gross credit of Public Sector Banks during 1994 were significantly reduced to 12 percent by 2001. The net NPAs have also continually declined from 14.46 percent in 1993-94 to 6.74 percent in 2000-01. This is mainly on account of a rapid growth in the volume of credits rather than a decrease in the level of NPAs.

**Nag and Das (2002)** by using a simple decomposition analysis of growth in assets portfolio as well as a model based analysis of credit growth for the Indian public sector banks corroborated that in the post reform period, public sector banks shifted their portfolio in a way that reduced their capital requirements. The banks have also adopted stricter risk management practices with respect to lending in the post reform period. The study also found that the minimum capital requirements due to regulatory pressure have had a dampening effect on the overall credit supply in the public sector banks between the periods of 1992 – 2000.

**According to Mukhergee (2003**), the presence of large NPAs in the SCBs can affect a bank’s profit in a number of ways namely through reduced interest income, and through the creation of reserves and provisions at the expense of profits. This decline in profit has a bearing on variables like the capital adequacy ratio (CAR). When profit decline, it becomes difficult for the banks to raise Tier-I capital and hence the capital base is affected. In the face of declining profit, in order to maintain the stipulated CAR, the bank may have to raise Tier-II capital through bond-issues. The interest cost then will be higher, pushing the cost ratio of the bank up and thereby resulting in a further shrinkage of profit. Thus the presence of large NPAs may lead to a vicious circle, making the financial health of a bank deteriorate over time.

**Ranjan and Dhal (2003)**carried out an empirical analysis of commercial banks' nonperforming loans (NPLs) in the Indian context. The study showed how banks’ non-performing loans are influenced by three major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macroeconomic shocks. The empirical results from panel regression models suggest that terms of credit variables have significant effect on the banks' non-performing loans in the presence of bank size induced risk preferences and macroeconomic shocks.

**De (2003)** evaluates the ownership impact on bank’s performance in a deregulated regime with the main objective to identify whether there is any significant difference in the performance of public sector, old private sector and new private sector banks. He measures performance in terms of profitability, operating efficiency and efficiency in portfolio management by using the Panel Regression Technique over 58 banks of which 27 representing public sector banks (including SBI), 23 representing private banks and 8 new private banks over a period of 5 years from 1997 to 2001. In order to capture the bank specific and time specific factors influencing performance he employs panel data regression technique making use of Fixed Effects and Random Effects which accounts for such variables. He uses ROA and NIM as the measures of profitability and OCR for operating efficiency. The results reveal that with respect to ROA, there is no significant ownership effect, but if the SBI and its seven associates are dropped from the group of public sector banks the new private sector banks exhibit a positive significant impact on ROA. The public sector banks show a higher level of NIM at the same time higher OCR as compared to other groups. He also undertakes a pair wise comparison and finds that both with respect to NIM and OCR public sector banks show a satisfactory performance followed by old private banks further followed by new private banks.

**Misra (2003)** opines banks as mobiliser of savings and emphasizes its role in efficient allocation of savings amongst competing projects. He makes an attempt to analyze the impact of reform on Allocative Efficiency (AE) of banks. For this purpose a productive project is defined by him as the one which increases the Economic Rate of Return (ERR). A bank is said to have attained AE if the projects financed by banks increases the ERR. On the contrary a bank is considered inefficient if it generates a lower ERR from the projects financed. However, the concept of AE is generalized as the ability of the banks to generate the maximum output from the resources deployed in its operation. The author delineates AE as the elasticity of the banks’ output with respect to credit. The study is conducted across 23 states for period covering both pre and post reform in order to facilitate comparative analysis. Further sector wise comparison of credit (as output) is made to get hold of a deeper insight. The Fully Modified Ordinary Least Square (FMOLS) estimation technique is used to measure elasticity. The results indicate improvement of overall Allocative Efficiency in the banking system of almost all the States reflecting the success of reforms in improving AE of banks. With respect to sectoral comparison it is observed that while AE of deployment of bank’s funds in the service sector improves, it deteriorates in agriculture and industry in the post reform period for almost all the states.

**Rahman et al. (2004)**studied the reasons for the banking and financial crisis that took place in South Asian countries in the late 1990 during which time many banks had to be bailed out by their governments. The countries in the study included Indonesia, South Korea and Thailand. Models were developed for each country that identified banks experiencing financial distress as a function of financial ratios. The study reported that the banks enjoyed profitability during the pre-crisis period were the ones most severely affected by the financial crisis in 1997. The study used Logistic regression to analyze the data sample from 1995 to 1997 and found that capital adequacy, loan management and operating efficiency are three common performance dimensions found to be able to identify problem banks in all three countries. The study hoped that the financial ratios and results of the models will be useful to bankers and regulators in identifying problem banks in Asia in the future.

**Hu, et al. (2004)** studied the effect of ownership on the credit risk associated with Taiwan’s banks and found that there is an inverse relationship between bank size and nonperforming loans. Their argument is that large banks have better risk management strategies that usually translate into more superior loan portfolios than their smaller counterparts. They also found that the banks with higher government ownership recorded lower non-performing loans than the privately owned banks.

**Ghosh and Das (2005)** studied the capital adequacy ratios in the Indian public sector banks and reported that apart from regulatory pressure, market discipline due to the competitive environment motivated the banks to have higher capital adequacy. The study suggested that the competitive environment in the Indian banking sector was mainly created by the private sector banks. The study also reported that the capital adequacy ratio influenced the cost of deposits.

**Eichberger and Summer (2005)**analyzed the impact of capital adequacy regulation on bank insolvency by using a model. The study attempted to examine the impact of capital adequacy regulation on systemic risk, in particular to analyze the impact of regulation on contagious defaults arising from mutual credit relations. The study found that the impact of capital adequacy on systemic stability is ambiguous and that systemic risk might actually increase as a consequence of imposing capital constraints on banks.

**Jimenez and Saurina (2006)**in an extensive study on Spanish banks by using an econometric model found that macroeconomic conditions such as GDP has a negative correlation with the accumulation of problem loans. They also reported that during credit boom period, the loan growth expands and as a result the lagged loan growth had a positive influence on the nonperforming loans. They also noted that the loan loss provisions are proxy measure of credit risk in the banking system. They also developed a regulatory prudential tool, based on a countercyclical, or forward-looking, loan loss provision that takes into account the credit risk profile of banks.

**Anbar (2006)** while studying the credit risk management in the Turkish banking sector stated that the Turkish banks paid more attention to credit risk but management practice was not at a desired level. Only 35 percent of the banks surveyed used quantitative methods for risk measurement. The study also noted that many Turkish banks are not ready for the Basel II accord implementation in 2008.

**Safakli (2007)** did an extensive study of credit risk associated with the banking sector and Northern Cypress and found that certain credit risk ratios such as total loans to total assets, total loans to total equity, non performing loans to total loans and so on were indicative of the credit risks associated with the banking sector. The study also found certain correlation between the credit risk ratios and key macro-economic indicators and reported an inverse relationship between non performing loans and Gross Domestic Products (GDP).

**Altunbas et al (2007)** analyzed the relationship between capital, risk and efficiency for a large sample of European banks between 1992 and 2000. In contrary to the established evidence they did not find a positive relationship between inefficiency and bank risk-taking. Inefficient European banks appear to hold more capital and take on less risk. Their empirical data showed the positive relationship between risk on the level of capital (and liquidity), possibly indicating regulators’ preference for capital as a mean of restricting risk-taking activities. They also found that the financial strength of the corporate sector has a positive influence in reducing bank risk-taking and capital levels. There were no major differences in the relationships between capital, risk and efficiency for commercial and savings banks.

**Das and Ghosh (2007)**by using advanced panel data techniques examined the factors affecting problem loans of Indian state-owned banks for the period 1994-2005, taking into account both macroeconomic factors as well as microeconomic variables. The findings from the study revealed that at the macro level, GDP growth and at the bank level, real loan growth, operating expenses and bank size play an important role in influencing the credit risk. They suggested that the high incidence of nonperforming loans has been attributed to many factors such as poor credit analysis skills and lending decisions, external shocks and shortcomings in the legal and judicial system that prevent the timely exercise of creditor rights.

**Cai and Wheale (2007)** while studying the implications of the Basel II Accord on the Chinese banking sector highlighted that there is a growing pressure on all countries that wish to participate in global markets to meet global standards of regulation in banking, securities, and insurance. In principle, this pressure has always existed, but in the past many countries have only nominally complied with global standards. Some of the internationally active banks have not held anything approaching 8 per cent capital as required by the Basel I and Basel II and this was partly because regulators themselves were not sufficiently stringent. In addition, the accounting standards adopted in some countries left a lot to be desired and this makes the true position hard to assess. However the study stressed that Basel II will improve risk management and will improve capital allocation efficiency. They also observed that compliance with advanced risk management system as proposed in Basel II is biased in favour of the large banks.

**Karunakar et al. (2008)** reported that the efficiency of a bank is not reflected only by the size of its balance sheet but also the level of return on its assets. The study emphasized that the NPAs do not generate interest income for banks but at the same time banks are required to provide provisions for NPAs from their current profits. The study revealed that NPAs have deleterious impact on the return on assets and contributes significantly to credit risk concentration in the Indian banking sector.

**Al-Zubi et al. (2008)** examined empirically the Jordanian banks capital and risk behavior as a reaction to pressure during the period 1990-2003. The study used various econometric models such as the Generalized Least Square (GLS), the Fixed Effect Model (FEM), and the Random Effect Model (REM). The study reported that there was a strong positive correlation between the regulatory pressure and banks’ capital and their risk levels. The study concluded that the Jordanian banks are close to the minimum regulatory capital requirements and the banks tend to increase both their ratio of capital-to-risk weighted assets and levels of risk.

**Ho and Yusoff (2009)** studied the credit risk management practices in Malaysian commercial banks and reported that the financial institutions believed in risk mitigation and managed their credit risk through better quality assets and human resources. The research also noted that the financial institutions utilize a variety of mitigations techniques to avoid credit risk. The study concluded that no single strategy is superior in covering all exposures, but combinations of a variety of techniques were effective in the mitigation of credit risk in the Malaysian commercial banks.

**Aman and Zaman (2012)** studied the credit risk performance of private and state owned banks in Pakistan and found that the private sector banks were performing better with regards to the credit risk compared to the state owned banks. The study by analyzing data for a fifteen year period from 1990 to 2005 reported that the private sector banks were efficient in managing their credit risk and suggested that the public sector banks need to improve their efficiency of credit risk management.

**Ali and Daly** **(2014 )**investigated the interaction between the cyclical implications of loan defaults (credit risk) in an economy and the capital stock of a bank. The approach used a macroeconomic credit model that through a comparative analysis of two countries, namely Australia (a relatively immune economy from the recent crisis) and the United States of America (the worst affected economy from the recent crisis). The results indicated that the same set of macroeconomic variables display different default rates for the two counties. Additionally the study finds that compared to Australia, the US economy is much more susceptible to adverse macroeconomic shocks.

**B. Di Renzo, M. Hillairet, M. Picard, A. Rifaut (2010)** in their study entitled operational risk management in financial institutions: process assessment in concordance with Basel II stated that the improvement of banks’ operational risk management frameworks concerns new requirements addressed in the Basel II Framework, a new capital adequacy regulation proposed by the Basel Committee on Banking Supervision (BCBS). Basel II will apply to internationally active banks and to all banks and investment firms in the EU via transposition of a new Directive into national regulations. By doing so, the national financial supervisory authority (CSSF) in Luxembourg, and a public research center (CRPHT) have engaged in a joint research project that investigates solutions conformant to ISO/IEC 15504 for assessing operational risk management frameworks implemented in banks. The ISO/IEC 15504 requirements can meet the CSSF’s expectation on consistent, transparent and sound risk assessments, as well as the expectation on promoting enhancements in institutions’ risk management practices without dictating the form or operational detail of their policies and practices. Moreover, although the domain is largely outside the scope of software and systems engineering, the ISO/IEC 15504 process assessment standard provides for an adequate solution to the so-called supervisory review process. This adequacy is validated through the structure of Basel II and financial domain requirements. Last but not least, we will show that ISO/IEC 15504 provides an adequate approach to assessing institutions in two sub-domains, namely the domain of credit operational risk management and the domain of IT risk management (including IT security risks management).

**Agnes Koomsonthe** (2011) conducted a study on the title “Operational Risk Management and competitive advantage in the Ghanaian banking industry” stated that Banking industry today is characterized by intense competition coupled with rapid changes in customer expectations, increasing regulatory requirements, technological innovation and mounting competition. Failures in processing activities as a result of human errors, fraud and system failures brings significant losses to banks and these losses are key sources of operational risk. Stringent corporate governance, regulatory standards and investor expectations are increasingly making operational risk management a focus for the banking industry. In view of the rising competition within the industry in respect of customer satisfaction and retention, corporate reputation and reward maximization, there is the need for banks to critically align business objectives with risk and control information to enhance operational performance, reduce cost in order to achieve the competitive advantage. The study focuses on operational risk management and competitive advantage in the Ghanaian banking industry with an objective of identifying the relevance of operational risk management practices in the industry and whether it can be a source of competitive advantage. Closed-ended questionnaires were administered to two hundred and fifty (250) respondents from seven selected banks. The findings of the study indicated that even though operational risk is quite new in the Ghanaian Banking industry, its effects are being realized. It also reveals that Ghanaian banks are realizing the significance and importance of operational risk management as a tool for gaining competitive advantage and are allocating the requisite resources for it. Some recommendations were made and prominent amongst them were that Banks must link their operational risk management activities to their business objectives and identify the potential hurdles that hinder their competiveness. Operational risk management is the responsibility of all staff including the Board of Directors and management and as such awareness must be created on the need to identify, evaluate, monitor, control and report operational risk issues in accordance with the strategies and policies of banks in ensuring the adequacy of capital against operational risk

**Economic times** (2017) opined that the Reduction in home loan rates by banks is likely to affect the profitability of housing finance companies (HFCs), as customers with large home loans of above Rs 50 lakh might shift to banks, according to India Ratings and Research (Ind-Ra). This could act as a double blow for housing finance companies (HFCs) already reeling from the slowdown in core or small-ticket housing loan, portfolio growth. The fall in lending rates by banks is likely to incentivise borrowers to shift their portfolio from high-cost HFC loans to bank loans the agency said. Housing loans from banks do not involve prepayment charges, if borrowing is undertaken on a floating rate. About 20% of the housing portfolio of large HFCs could be higher than Rs 50 lakh in ticket size. "The competition between HFCs would have implications for profitability, especially in view of limited maneuverability of such companies with regard to the expansion of leverage or high-yield non-core portfolio, Ind-Ra said. The rating agency also said that playing on the yield curve, and taking the short-term borrowing to save on tenor premium, while lending largely remains long-term, would expose HFCs to liquidity and refining risks. The impact of the fall in lending rates on small-ticket loan providers is unlikely to be significant, as borrowers are generally less price-sensitive. Furthermore, HFCs in this segment have a superior pricing power due to limited competition from banks, it said. IndRa also believes that any correction in material prices of the underlying loan collaterals would bring the housing loan segment under some pressure. Loans where underlying property is under construction would especially be vulnerable," they opined.

* + 1. **Review related to Liquidity Analysis**

**Smith (1980)** conducted a study on Profitability and Liquidity and suggested that working capital management directly influence risk and profitability of a firm. Hence it can be inferred that effective working capital management can increase the financial strength of a business.

Liquidity management is a concept that is receiving serious attention all over the world especially with the current financial situations and the state of the world economy. Some of the striking corporate goals include the need to maximize profit, maintain high level of liquidity in order to guarantee safety, attain the highest level of owner’s net worth coupled with the attainment of other corporate objectives. The importance of liquidity management as it affects corporate profitability in today’s business cannot be over emphasized. The crucial part in managing working capital is required maintenance of its liquidity in day-to-day operation to ensure its smooth running and meets its obligation **(Eljelly, 2004).** Liquidity plays a significant role in the successful functioning of a business firm.

**Lazaridis and Tryfonidis (2006)** investigated the relationship of corporate profitability and working capital management for firms listed at Athens Stock Exchange. They reported that there is statistically significant relationship between profitability measured by gross operating profit and the Cash Conversion Cycle. Furthermore, Managers can create profit by correctly handling the individual components of working capital to an optimal level.

Dilemma in liquidity management is to achieve desired trade-off between liquidity and profitability (**Nahum et al, 2007**).This study seeks among other things, to investigate the problems of bank liquidity management in order to determine its effect on bank profitability.

A firm should ensure that it does not suffer from lack-of or excess liquidity to meet its short-term compulsions. A study of liquidity is of major importance to both the internal and the external analysts because of its close relationship with day-to-day operations of a business **(Bhunia, 2012**).

**2.3 RESEARCH GAP**

There are studies carried out for measuring the profitability, credit risk and other aspects of financial and non financial organizations which includes banks, insurance companies and housing loan providers but only a very few studies conducted for analyzing the financial performance of housing finance companies in India. *The current study will concentrate to analyze the growth and financial performance of selected housing finance companies which are listed in BSE.*

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