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Role Of Leadership For Sustainability In Indian Banking: A Case Of HDFC Bank

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Abstract

A fragmented and inefficient banking has been a challenge for sustainable and inclusive growth in India. The largest democracy in the world needs robust, efficient and technology driven banking to reap the benefits of economies of scale, scope and inclusion. HDFC bank has announced merger with HDFC. The paper examines the impact of leadership on sustainability in Indian banking with reference to HDFC Bank. The approach of leadership towards sustainability is reviewed using published sources about the founding managing Director and HDFC Bank. The impact of merger announcement on stock price is evaluated using daily returns before and after merger announcement. It was found that sustainability has become a part of work culture of HDFC Bank led by the visionary Mr. Aditya Puri. There was a significant decline in the daily returns of stock price of both HDFC Bank and HDFC after merger announcement. The merger has potential to generate sustainable inclusive growth in the long term.

Keywords: Leadership, Sustainability, Indian Banking, HDFC Bank, HDFC, Merger, Synergy.

Introduction

HDFC Bank was one of the first banks to get approval to establish a private bank in 1994 at the time of liberalisation policy of 1990's. With a modest beginning from a rat infested space in a mill complex in central Mumbai, the bank has become the largest private sector banks by balance sheet size in the county with operations in 3188 towns serving more than 7.1 crore customers with 6342 branches 21683 banking correspondents (BC's) and 18130 ATM's (HDFC Bank, 2022a). At that time banking was dominated by public sector banks with distribution and money. Foreign banks were known for service and product. HDFC led by visionary Mr. Aditya Puri combined the best of both foreign banks and public sector banks offering technology driven quality service with the reach of public sector banks. Mr. Aditya Puri relied on common sense and simplicity to build the largest private sector bank from scratch. HDFC Bank is a domestic systemically important bank.

The journey of HDFC Bank started by offering loans to blue chip companies. Quickly the bank started catering to the emerging middle class, expanding its product portfolio by offering credit cards, personal loans and auto loans. Mr. Aditya Puri could identify the growth potential of rural India with more than 60% population, and started focussing on branch extension beyond big cities. Now 79% banking outlets of HDFC Bank are in rural and semi urban areas. HDFC Bank had net profits of INR 36961.3 crore, return on capital of 16.9% and capital adequacy of 18.9% (HDFC Bank 2022b).

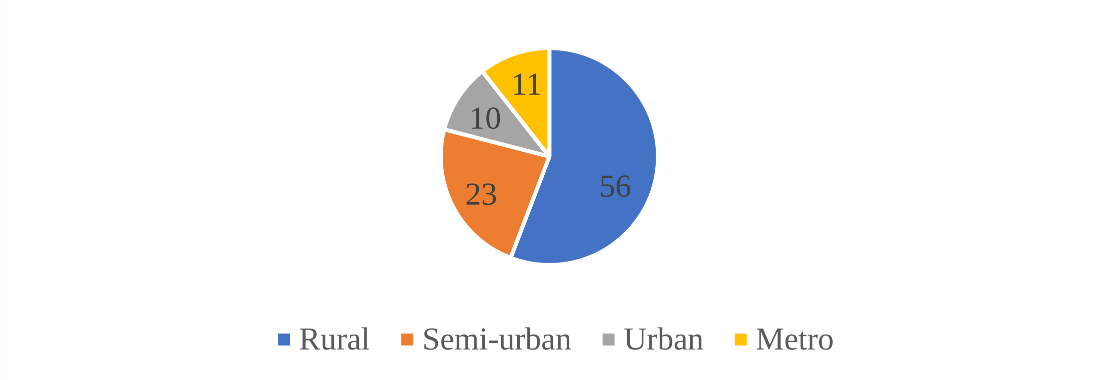

Figure 1: Geographical Distribution (%) of HDFC Banking Outlets
Source: HDFC Bank, 2022b

Leadership:

Mr. Aditya Puri led the bank since its inception till 2020. He has kept the strategy simple and sustainable. The bank never invested into businesses it does not understand. The credit standards were never diluted in the mad race to acquire business. HDFC Bank has watched and learned from other banks, while maintaining a conservative focus to ensure sustainable growth without compromise with ethics, meritocracy and compassion. All this in a very simple way. Mr. Aditya Puri has been a role model by following simplicity not only in professional but also in personal life. He leaves office at 5:30 pm everyday, goes for lunch at home, does not carry a mobile, doesn't carry a wallet and does not wear a watch. Mr. Aditya Puri has perfected the art of delegation. He has delegated the task of writing email to his secretary. The working style though looks relaxed but is still one hundred percent result oriented. While he leaves office a 5:30 pm, there is never any pending work or unanswered email. Transparency is inbuilt into the culture of HDFC Bank by the visionary Mr. Aditya Puri. All the communication from Mr. Aditya Puri was known to all staff even at the ground level within few hours. The simplicity is also reflected in closeness with nature. He loves ghazals, gourmet cooking, enjoys gardening has three pet dogs. The greatness of his leadership is reflected in his respect for his team. He considered himself, first among the equals and always gave credit of the HDFC Bank success to the team effort. He mentions that "HDFC Bank is not what it is because of me. I am who I am because of HDFC Bank and 120,000 colleagues". Visionary leader Mr. Aditya Puri has inbuilt sustainability into the DNA of HDFC Bank.

ESG Focus:

The bank has imbibed sustainability as part of its work culture by evaluating its decisions from environment, social and governance (ESG) lens. The bank has set the target to become carbon neutral by FY2032 (HDFC Bank, 2022). The bank has adopted ESG evaluation framework for corporate lending. The social initiatives under the Parivartan mission of the HDFC Bank span across 24 states, 3334 villages, 9.88 lakh households and more than 9.6 crore individuals being benefitted with an CSR expenditure of INR 736.01 crore in FY2022.

Merger:

HDFC Bank announced merger with HDFC on 4th April 2022. The opportunity of cross selling and complementing each other has led to merger of the two entities. 70% of customers of HDFC are not customers of HDFC Bank, and only 2% of HDFC Bank avail home loan from HDFC Bank. HDFC Bank has primarily focussed on consumer durables home loans. Though it has kept its Non-performing Assets at low level, it has missed the opportunity of home loans. The long tenure of home loans provide resiliency to balance sheet. The merger will enable HDFC Bank to provide complete bundle of products to its customers. It is also observed that home loan customers keep five to seven times more deposits as compared to other retail customers. Merger with home loan customers has potential to increse low-cost deposits to HDFC Bank.

The regulatory arbitrage has narrowed between a bank and a non-banking finance company (NBFC). The reserve requirements have come down. The bank has planned to open 2000 branches every year using phygital relationship centres. India being a low penetration market for financial services, bank has vision to capitalise on the opportunity with the merger and create a HDFC Bank every five years (HDFC Bank, 2022). Post-merger shareholders of HDFC holding 25 shares will get 42 shares of HDFC Bank. HDFC shareholders will acquire 41% shareholding of HDFC Bank post-merger and public shareholding will become 100% in HDFC Bank.

42 shares of HDFC Bank would be given for every 25 shares of HDFC (Chadha, 2022). INR 800 billion worth of non convertible bonds of HDFC would not require cash reserve ratio (CRR), statutory liquidity ratio (SLR) due to affordable housing status (Kumar, 2022). The merger will enhance underwriting capacity of HDFC Bank, as its balance sheet size will increase to INR 17.87 crore and market capitalisation will reach INR 12.8 lakh crore (Dey, 2022).

Objective:

Evaluate the role of Leadership on Sustainability in Indian Banking with reference to HDFC Bank.

Literature Review

Patel and Shah (2016) analysed the financial performance of six banks which were got merge during 2004-2010 and found that in most of the cases, post-merger performance has been increased. Soundarya et al. (2018) argued that mergers have been understood as a natural way of re-organisation of business. The drivers for mergers have been found out to be benefits of scale and scope economies, tax benefits, efficiency benefits, enhanced research capabilities, creating scale barriers for new entrants and enhancing product portfolio. Ishwarya (2019) examined the ensuing synergies and the merger's long-term repercussions by comparing the financials of banks before and after merger. It was found that mergers had a positive impact in Indian banking. Convertibility issues and necessity of investment banking are significant drivers of mergers in Indian banking.

Mergers between strong and distressed banks should not be encouraged by the government or policymakers in order to protect the depositors of distressed banks, as this will harm the asset quality of the stronger banks. Intent and leadership are more important for sustainability than superficial reorganisation (Tiwari et al. 2020).

Prabha (2021) evaluated the concept of bank mergers in Indian Banking System. Author examined reasons for merger banking and did a comparative study of net worth of different banks, before and after merger. Merging is one of the principles that may be used to improve and support a long-term development plan. Bank merging is one of the RBI's objectives to boost India's economic growth. It has its own set of benefits and drawbacks, but it improves the bank's efficiency and strength, as well as its technical customer support service. It was found that after mergers of public sector banks in 2020, customers were not dissatisfied with the services (The Hindu Business Line, 2021).

Dhmeja et al. (2021) examined the trend of Indian bank mergers to make them capable for taking larger projects and become more globally competitive. Different internal and external issues with private sector banks are highlighted. Rai (2021) analysed the effect of merger announcement of six banks (targeted banks) into four banks (bidder banks) and found that bidder banks are negatively impacted whereas targeted bank are positively impacted on announcement date, but later it became negative too.

There is a research gap as there is lack of studies for examining the effect of announcement of merger on stock returns of HDFC Bank and HDFC. The impact of leadership on sustainability of banks have been ignored by researchers. This study attempts to bridge the gap.

Methodology

The secondary data is used for the study. Stock price of HDFC and HDFC Bank is collected from the website of National Stock Exchange (NSE) after the announcement date of merger. Stock price data of 10 days pre and post-merger announcement is considered. Merger announcement date is 4th April 2022. Paired t test is used to analyse daily returns pre and post-merger announcement. The role of leadership of HDFC bank for sustainability is reviewed using the published sources and annual repot of HDFC Bank.

Findings

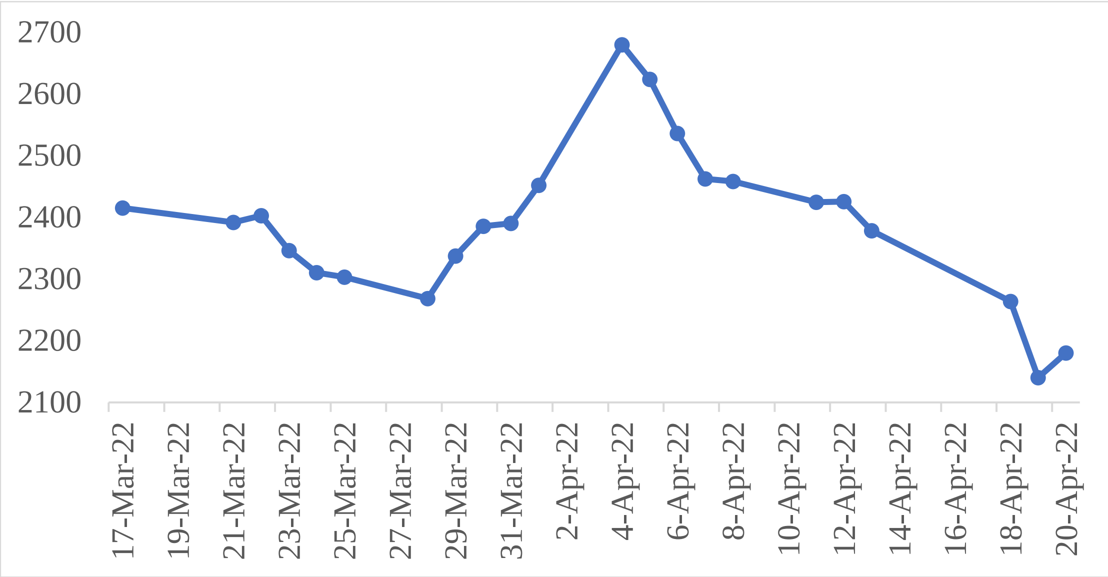

Figure 2: Stock Price Trend of HDFC 10 Days pre and post-Merger Announcement

Source: Compiled by Authors from National Stock Exchange, 2022

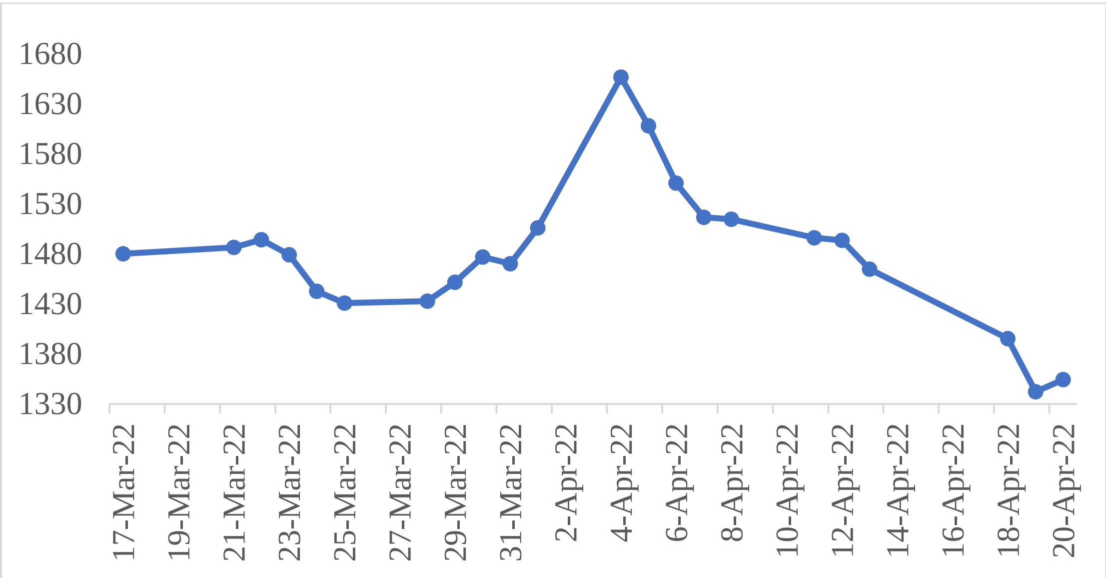

Figure 3: Stock Price Trend of HDFC Bank 10 Days pre and post-Merger Announcement

Source: Compiled by Authors from National Stock Exchange, 2022

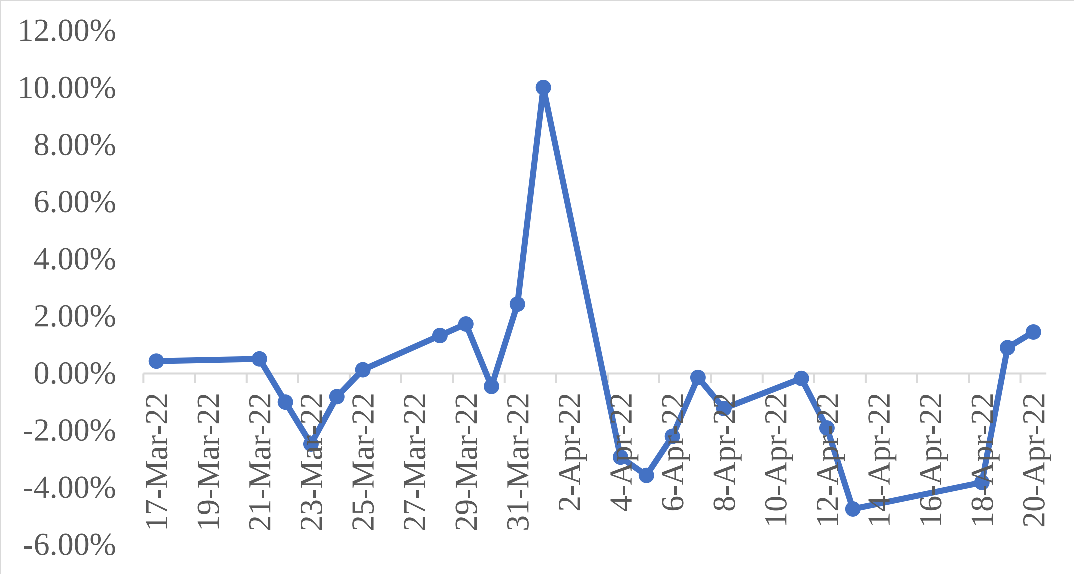

Figure 4: Daily Returns of HDFC Bank 10 Days Pre and Post Merger Announcement
Source: Compiled by Authors from National Stock Exchange, 2022

The stock price of both HDFC and HDFC bank has shown significant rise on the day of announcement. Subsequently a sharp decline in observed post-merger announcement indicating concerns of shareholders.

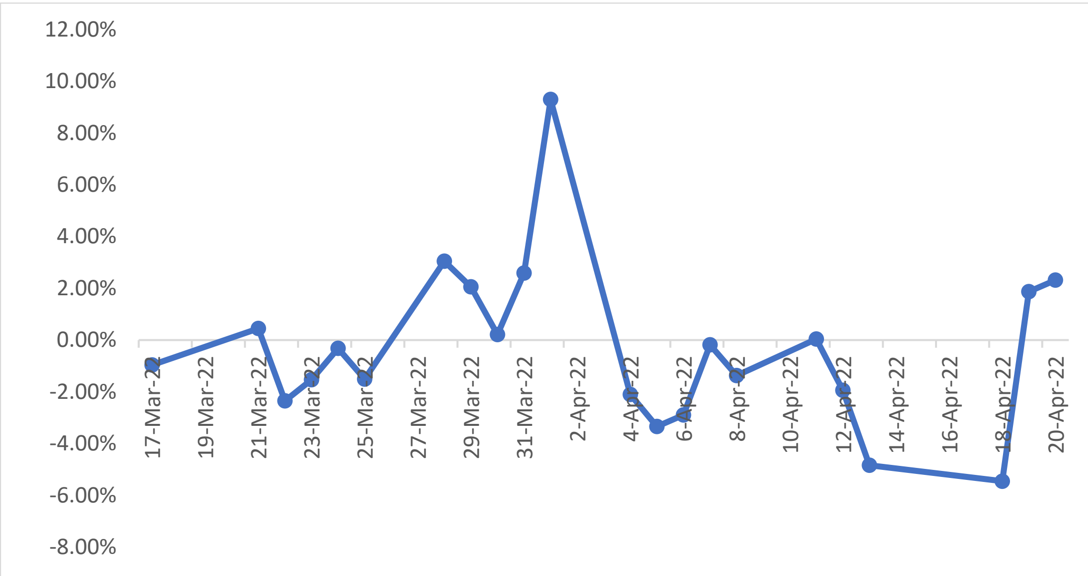

Figure 4: Daily Returns of HDFC 10 Days Pre and Post Merger Announcement
Source: Compiled by Authors from National Stock Exchange, 2022

Table 1: Paired t Test of HDFC Daily Returns

	Mean	N	Std. Deviation	T	df	Sig
HDFC Pre-Announcement Return	1.194	10	3.379586			
HDFC Post Announcement Return	-1.578	10	2.627998	2.672	9	0.026

Source: Compiled by Authors from National Stock Exchange, 2022

Table 2: Paired t Test of HDFC Bank Daily Returns

	Mean	N	Std. Deviation	t	df	Sig.
HDFC Bank Pre-Announcement Return	1.14	10	3.432828			
HDFC Bank Post Announcement Return	-1.543	10	2.079995	2.667	9	0.026

Source: Compiled by Authors from National Stock Exchange, 2022

It is found that there is a significant difference between pre and post-merger daily returns of HDFC (p=0.026) and HDFC Bank (p=0.026). The daily returns are significantly lower than pre-merger announcement returns for both the firms.

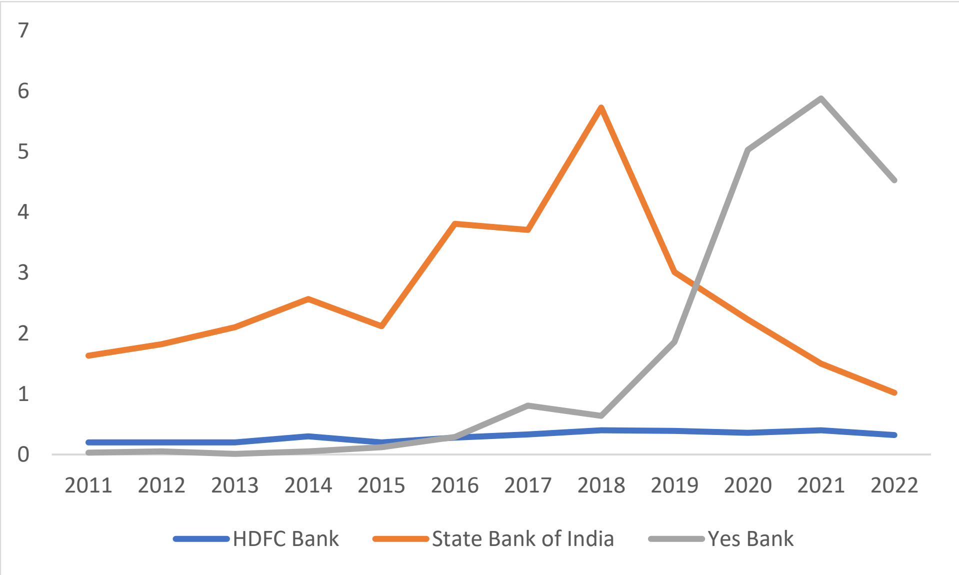

Figure 5: Net Non-Performing Assets (%) of HDFC Bank, SBI and Yes Bank

Source: Compiled from MoneyControl.com (2022)

The net non-performing assets (NPA) impacts the sustainability of banks. The sustainable credit appraisal and financing facilitates a bank to keep its net NPA at low level. HDFC bank as the largest private sector bank in India has one of the lowest net NPA ratio despite achieving 20% year on year quarterly growth. On the other hand, SBI, the largest public sector bank has significantly higher net NPA. The impact of leadership on sustainability of a bank can be understood with the case of Yes Bank. The net NPA of Yes Bank has increased significantly since 2018. The founder of Yes Bank, Mr. Rana Kapoor was put behind bars in 2020 and A case of alleged kickback of Rs 4300 crore received by him and the family members is being investigated by Enforcement Directorate. An independent director Mr. Uttam Prakash Agarwal resigned from the board of Yes Bank citing serious corporate governance failure (Business Today, 2020). The leadership of the bank has a crucial role to play in establishing the values and culture of sustainable banking driven by good governance.

Merger of many badly managed banks will not make the merged bank sustainable. In 2019, ten public sector banks were merged into four banks on the premise of better operational efficiency and economies of scale. Satisfaction from services is a significant determinant of continuous usage of financial services (Chand et al. 2022). The merged public sector banks have become more riskier according to financial stability report of RBI (Nayak, 2021). It is the quality of leadership which will influence sustainability rather than sheer size of balance sheet.

Conclusion:

Quality of leadership of an institution determines its sustainability. HDFC bank right from its inception had a leader who built good corporate governance, meritocracy, ethics led sustainability become the DNA of the bank. The aggressive growth of HDFC Bank from a small space in a mill compound in central Mumbai to the largest private sector bank with lowest net non-performing asset shows that ethical leaders positively influence sustainability of bank in India. Corporate governance issues led to sustainability issues in Yes Bank, which was bailed out by RBI by handing over to SBI. Mr. Aditya Puri has demonstrated that simplicity and ethics are needed for sustainable profitable growth of a bank in India. The daily returns of HDFC bank and HDFC have significantly declined after merger announcement. The merger holds a long-term potential for delivering sustainable growth led by good corporate governance, technology leverage, rural outreach and sustainable management practices.

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