



## A study on the penetration of non-banking financial companies (NBFCs) in Indian financial markets

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### Abstract

Finance is the art of Managing money. The two major areas of finance are: Financial Management and financial Derives. Financial management is concerned with duties of the financial managers in the business who perform such varied tasks as budgeting, financial forecasting cash management, credit administration and investment analysis and funds management etc., Financial services is concerned with the design and delivery of advice and financial products to individuals and business with the areas of banking and related institutions personal financial planning, mutual funds, factoring, leasing and insurance etc., Non fund based and advisory are provided by the non-banking financial companies.

A modest attempt is made in this paper to study the growth and penetration of non banking financial companies in Indian financial markets.

**Keywords:** finance, financial management, financial derives

### Introduction

#### Non-Banking Financial Companies (NBFCs)

Non-banking Financial Companies (NBFCs) are financial institutions that provide certain types of banking services but do not hold a bank license. The NBFCs in India made a humble beginning way back in 1960s to serve the need of the savior and investor whose financial requirements were not sufficiently covered by the existing banking system. The NBFCs began to invite fixed deposits from the investors and work out leasing deal for big industrial firms. Initially they operated on a limited seal and could not make a significant impact on the financial systems. However between 1980s and 1990s, NBFCs have gained strong in Indian financial system. They are registered companies conducting business activities similar to regular banks. Their banking operations encompass making loans and advances available to consumers and business, acquisition of marketable securities leasing of hard assets such as automobiles hire purchase and insurance business. Through they are akin to banks, they differ in couple of ways. NBFCs cannot accept demand deposits and cannot issue clearances to customers and the deposits with them are not insured by the deposit insurance and credit guarantee corporation (DICGC).

#### Growth of NBFCs

The NBFC sector in India has witnessed a significance growth over the past 10 years and has come to be recognized as a systematically key element of the financial systems. The importance of NBFCs was not significant before 1980s and 1981, they were hardly 7063. At present the number of NBFCs has gone up to nearly over 40,000. Mainly NBFCs are of two types of financial and non financial. In these two categories of NBFCs there are public limited and private limited companies.

It is pertinent to note that nearly 85 to 90 percent of the

companies are of non financial in nature some of them accepting deposits. Some of the NBFCs are: Hire purchase finance companies, equipment leasing companies, loan companies, investment companies, housing finance companies, mutual benefit finance companies, insurance companies, stock broking companies. Other companies are Chits and Kuris and they organize the collecting of funds from subscribing members in installments with a definite time frame and each one of them is eligible for drawing the prize amount decided by the tender or lotto or in any sequential order as in the case of Nidhis.

By 2005, the member of NBFCs has been reported to have gone up to 38050 as against 25085 just before reforms started in 1991. During the last one and half tickets the number of NBFCs mobilizing, deposits have increased by 9 times and more. The rate of growth of deposits of NBFCs is however higher at 50% to 120%. The contribution of NBFCs to the economy has grown substantially from 8.4% in 2006 to more than 14% in March 2015. In terms of financial assets, NBFCs have registered robust growth, i.e., a compound annual growth (CAGR) 219 percent over the past few years, consisting of 13% of the total credit and estimated to reach nearly 18% by 2018-19. The success of NBFCs can be clearly attributed to their superior product lines, lower cost, broader and effective reach, robust risk management capabilities to check and control bad debts and proper comprehension of their consumer segments.

Not only they have shown success in their traditional bastions (passenger and commercial vehicle finance) but also managed to build substantial assets under management (AUM) in the personal loan and housing finance sector which have been the bread and butter for retail banks. Going forward, the latent credit demand of an emerging India will allow NBFCs to fill the gap, especially where traditional banks have been wary to serve. Additionally improving macroeconomic condition,

higher credit penetration, increased consumption and disruptive, digital banks will allow NBFCs credit to grow at a healthy rate of 7 to 10% was next five years.

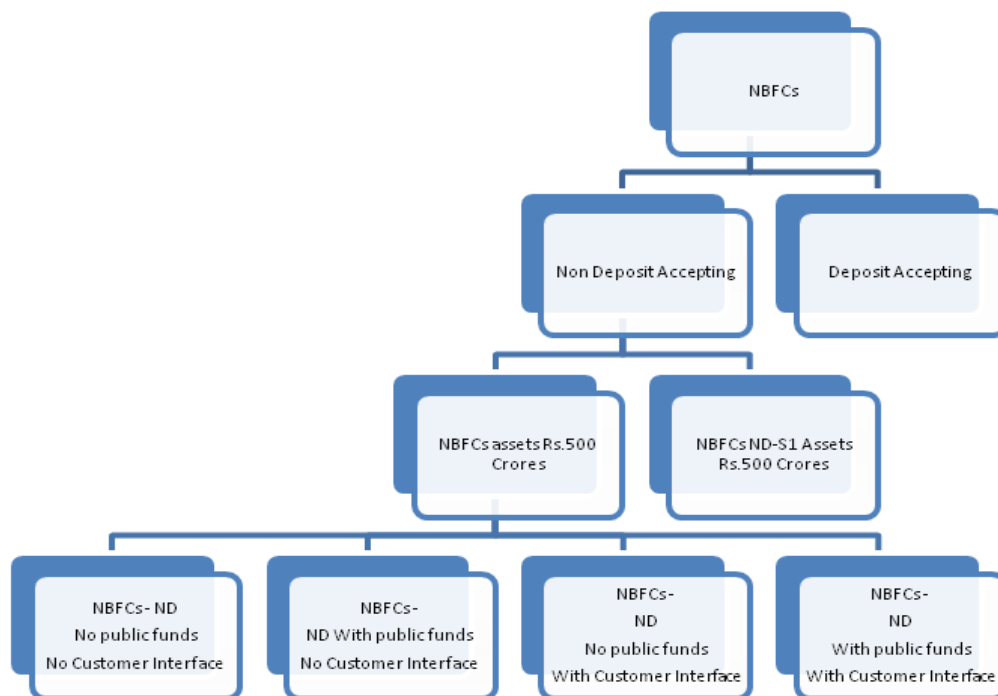
**Evaluation of NBFCs**

Over the past several decades, NBFCs have emerged as important financial intermediaries particularly for the small and retail sectors in underserved areas and unbanked sectors. NBFCs have turned out to be the growth engines in an era where increased importance is aligned to financial inclusion. The growing importance of the NBFC segment in the Indian financial systems has led to a changing landscape of the NBFC framework with NBFCs emerging as an important segment deeply connected with entities in the financial sector, coupled with failures of large NBFCs a more comprehensive and enhanced framework was put into place by the RBI in the years 1996 and 1997. In 1999 the capital requirement for the fresh registration was enhanced from Rs.25 lakhs to Rs.200 lakhs. Further more in 2006 in order to bridge the gap between bank and NBFCs, non deposit accepting NBFCs and non systematically important NBFCs based on their asset size. Certain prudential norms were imposed on such NBFCs. The

forms of RBI has shifted from deposit accepting NBFCs to non deposit accepting NBFCs.

**Regulatory Framework for NBFCs**

In the Indian context NBFCs are considered similar to shadow banks although they are still subject to regulatory imprecision. The light touch regulations on shadow banks gave rise to high leverage and the credit assets. The resultant liquidity crunch got further transformed to the banking systems due to its interlinkages with the shadow banking sector. The financial statistics Board (FSB) has been instantly working towards strengthening the oversight and regulation of the shadow banking systems to mitigate the risk, arising therefore. At the same time, the RBI has not failed to recognize the important role played by NBFCs in bringing about financial inclusion in the country. NBFCs fill the important gaps in financial inclusions by catering to geographies and sectors where the banking sector is unable to foray into. In the light of the above the RBI took various steps to revamp the NBFC framework. The details of the revised NBFC classification figure. Revised NBFC classification details



Source: Collected through internet has been presented in the above figure.

Fig 1

A comprehensive review of NBFC regulations was conducted by the RBI in 2014. The revised regulations are meant to focus.

**Large Penetration of NBFCs**

For a huge and diverse country like India, ensuring financial access to fuel growth and entrepreneurship is essential. There is a strong urban demand and an increase in credit penetration to should continue to drive the growth consumer finance segment. However there may be a period of muted growth from the rural sector. Driven by higher disposable incomes

through increased effectiveness of government schemes and seventh pay commission, it can be said that healthy growth in the consumer segment would become the reality. On the small and medium enterprises (SMEs) front, business and professional loans seem to be on a growth trajectory, but mortgage backed loans (Loan against property), which form a large proportion of the SME loans will remain muted due to the increased competition from the new entrants in the financial market and traditional banks, which have been successful in capturing and retaining the upper end of the ticket sized band. With the commencement of Government

backed schemes such as Pradhana Mantri Jan Dhan Yojana (PMJDY), there has been a significant jump number of bank accounts, however only 15% of the adults have reported using an account to make or receive payments. The government and regulatory bodies have initiated vital measures to enhance this number and subsequently financial access by granting in principal and above focused approach of the other industries bodies like the National Payments Corporation of India (NPCI). To further solidify and augment the payments by launching the unified payment interface (UPI) and Bharat Bill Payment System (BBPS).

### Performance of Selected NBFCs

Among many NBFCs, three NBFCs have been selected to access their performance; they are L & T finance Mahindra & Mahindra Financial Services Ltd and Shriram Transport Finance Corporation. In order to ascertain as to whether the three mentioned NBFCs are on equal footing or not two variables or factors that have been considered are net income or net sales / Net Revenue from operations, profit before tax and profit after tax/ profit or loss for the period.

**Table 1:** The Mean Values of three financial parameters from March 2012 to March 2016

Years	L & T Finance			Mahindra & Mahindra Finance Services Ltd			Shriram Transport Finance Corporation		
	Net Income (NI)	Profit Before Tax (PBT)	Profit After Tax (PAT)	Net Income (NI)	Profit Before Tax (PBT)	Profit After Tax (PAT)	Net Income (NI)	Profit Before Tax (PBT)	Profit After Tax (PAT)
March 2012	2980.90	684.25	454.80	2884.90	961.30	644.52	6178.74	1957.51	1308.75
March 2013	3956.76	988.61	729.19	4094.99	1352.66	928.91	7014.43	2162.66	1463.89
March 2014	5055.94	824.88	594.84	5275.23	1456.53	964.77	8476.02	1970.46	1357.94
March 2015	6196.23	1174.82	850.71	6021.14	1399.87	924.87	9177.00	1649.56	1028.44
March 2016	7288.79	1252.67	853.69	6553.87	1224.12	787.40	10,310.29	1789.28	1183.62
Mean Value	5095.72	985.46	696.64	4966.03	1279.89	850.94	8231.30	1905.89	1268.53

The mean value of three financial parameters for the above three companies are presented for the period from March 2012 to March 2016 in Table 1. The hypothesis would be the three

NBFCs do not differ with reference to mean performance. The alternative hypothesis is that the three NBFCs do differ with reference to mean performance.

**Table 2:** Details of Financial Parameters

Financial Parameters	NBFCs			
	L & T Finance	Mahindra & Mahindra Finance Services Ltd	Shriram Transport Finance Corporation	Total
Mean Net Income or Net Revenue from Operations	5095.72	4966.03	8231.30	18,293.05
Mean Profit Before Tax	985.06	1279.89	1905.89	4170.83
Mean Profit After Tax	696.64	850.09	1268.53	2815.27
Total	6777.41	7096.02	11405.72	
Mean (x)	2259.14	2365.34	3801.91	T=25279.15

**Source:** Collected from company records

Table 2 explains the details of Financial Parameters of the said three companies and how they have performed on the area of their financial matters.

The development of NBFCs and their financial operations would certainly play a crucial role in the metamorphosis of the banking value chain in its entirety. This offers a strategic opportunity for NBFCs to ensure sustainable growth area long term. Partnerships with payment banks, bill payment providers and other financial institutions, like insurance and asset management companies will assist NBFCs offer the complete proposition, i.e., from deposits to lending investments and transactions. The reach of NBFCs along with their robust understanding of the market, can assist them position themselves as a better option to the conventional ways of banking.

The growth of leasing and purchase companies and their deposits was faster during the last two decades. They also borrow from commercial banks larger amounts than any other category of NBFCs. Their larger reliance on banks instead of mobilizing resources of their own has been a cause of concern to the RBI.

### Reforms of NBFCs

Since the financial reforms were market in July 1991, the importance of NBFCs has from enormously and they are also subject to financial sector reforms. Narasimham Committee (1991) on financial reforms recommended that these companies should also be brought under the board of regulations of the RBI and be subject to the prudential norms as in the case of commercial banks. Committees were appointed by the RBI on various aspects of working 2 NBFCs. In May 1992, AC Shah Committee was appointed to study the working of NBFCs was the country. The committee recommendations for the better functioning of NBFCs. It suggested that only there NBFC with a make owned funds (NOF) of Rs.50 lakhs and above should be regulated by the RBI and the interest rates on their deposits accepted should be 2 or 3 percentage points above those of banks. Deposits for periods ranging from 12 months to 84 months only are allowed to be accepted by them. A board for financial supervision (BFS) has set up with an advisory council to supervision NBFCs. In January 1997, Khanna Committee was set up to examine the feasibility and desirability of resulting

NBFCs. Khanna Committee recommended greater comfort owner NBFCs by the RBI through compulsory registration, investment norms receipt of deposits and creation of reserve fund etc., Capital adequacy norms of 8 percent to be made applicable to NBFCs and it was also suggested to create an in house market intelligence out fit for collection of information on the activities of NBFCs in the Country.

### **Regulation of NBFCs**

Presently there are nearly more than 40,000 NBFCs big and small and reporting and non reporting of these, there were about 918 companies reporting to RBI and they have deposits of nearly Rs. 1,24,370 crores consisting about 8 percent of aggregate deposits of commercial banks. Next to banks, they have the largest network for deposit mobilization and collection of savings of the public. It was also observed that weighing for the banks and NBFCs it was formed that the growth rate of deposits of NBFCs faster than 2 banks particularly during the last few years (upto 1997) when the financial reforms and liberalization have attracted both foreign and domestic companies to expand their activities and NBFCs have been brought under the of RBI since 1997. Since then, RBI has brought out same measures to protect the interests 2 depositors and public from any unhealthy practices by NBFCs. These measures apply to those NBFCs accepting deposits from public while the others will be supervised by the RBI in a limited manner. The RBI also imposed guidelines on NBFCs disclosures, prudential norms on income recognition accounting standards provisions for bad and doubtful debts credit concentration on family concerns etc., The RBI removed the ceiling on bank credit laid down for all registered NBFCs engaged in principal business on equipment leasing, hire – purchase, loan and investments Since May 1999. The possibility of failures of banks and NBFCs is there and more so in the present environment of deregulation and free market economy. Many NBFCs like CRP Caps, Habbland, Aneja, Lloyd finance, GVK etc., have formed themselves in a financial crisis and could not repay the deposits at all or at the proper time. The RBI has asked such companies to stop accepting deposits the public.

The Nachiket Mor Committee appointed by the RBI has observed that the larger number of NBFCs categories give birth to regulatory arbitrage and hampers the evolution of NBFCs which have the capability to provide the wide range of credit products. The committee suggested a shift from entirely based regulation of NBFCs to activity based regulation 2 NBFCs. The revised regulatory structure issued recently by RBI was the first step in this direction. It is expected that RBI will bring about further amendment in the NBFC regulations aimed at consolidation of various forms of NBFCs.

### **Prospects of NBFCs**

The Indian consumer is increasingly adopting digital as a way of daily life. India is currently the second biggest smart phone market, with a user base of 220 million and is expected to cross 300 million users by December 2017. To stay relevant in such as environment, NBFCs need to re think their strategies to enhance their product portfolio (positioning to pricing), processes (internal and customer facing) and end to end

customer experience. Additionally they need to leverage the vast digital customer data available to be able to serve customer better. The absence of income proofs or IT returns due to temporary self employment are name 2 the primary reasons for the less credit penetration in India digital and social data can often act as a surrogate to such documents to help NBFCs make better credit decisions with the launch by of digital India programme, a flagship programme of the government of India to digitally empower society, NBFCs will have to find ways to serve the millennial customers through digital means.

### **Governance Requirement**

Act NBFCs were required to comply with governance requirement such as the fair practices code (FPC) and anti money laundering resulting compliance burden. Under the new framework only those NBFCs that have a customer interface are required to comply with such governance requirements. NBFCs – ND (Non – Deposit) with no public funds and no customer interface are not subject to any prudential norms and thus have complete regulatory freedom to conduct their business activities. This chance would give as great filling to NBFCs engaged in investment activity through their own funds given the spur of ups in the country their single change could make NBFCs a very attractive reliable for Private Equity (PE) investments.

### **Conclusion**

Non-banking Finance companies (NBFCs) are playing a significant role in providing million of rupees to the domestic small cottage and reliable sectors of the economy and they are helping them to meet their financial requirements for their diversification and development. NBFCs are working actively on par with scheduled commercial banks in meeting the requirements of trade and industry in the country. The credit appraisal systems of NBFCs have been reasonably well for the mutual benefit of the lenders and borrowers. With their inherent ability to move fast and to tap into specific customer segments, it seems that NBFCs would be able to transfer these benefits in meeting the non-corporate needs of the economy including those of small and medium enterprises and retail customers with an estimate suggesting that more than 50 percent of micro, small and medium enterprises (MSMEs) do not have reach to formalized credit the needs of the industry cannot be overstated other than the opportunity in SME financing enhance penetration for housing will surely drive double digit growth over the next decade. India's housing finance regiment continues to display huge potential for growth, and housing finance companies with 40 percent of the share are clearly leading the way in the country. Moreover as newer customer needs emerge from a digitally savvy customers segment, NBFCs could potentially open up new avenues for growth. It can be noticed that there was a proliferating many number of NBFCs of varying types in the Indian economy and are playing a key role in meeting the credit demands and requirements which are not liberally provided by traditional banks. NBFCs have a significant presence is a notes of the economy and its part in the development of the economy in various ways.

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