"AN IMPACT STUDY OF ROLE OF NBFC: NEW PATH OF DEVELOPMENT"

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ABSTRACT

Non-banking Monitory corporations are Monitory intermediaries engaged in the business of accepting deposits delivering credit. They play an important role in channelizing the scarce Monitory resources to capital formation. NBFCs supplement the role of banking sector in meeting the increasing Monitory needs of the corporate sector by delivering credit to the unorganized sector and to small local borrowers. Current study is based on the role of NBFCs in Indian economic environment and further more it deals with the future prospects under current Monitory scenario. Finally the paper concludes with analysis of key performance trends the results shows that NBFCs have to focus more on their core strengths and with determination make an effort to look forward for new dimensions of Monitory business in order to endure and grow up continuously.

Key Words: NBFCs, Indian Economy, Capital formation, Banking Sector etc.

INTRODUCTION

Although the Indian Monitory system is under the control of our banks, yet Non-Banking Monitory Corporations have rapidly emerged as an important part of the Indian Monitory system. Moreover, NBFCs having importance in the small business section as they first and foremost supplier to the credit requirements of the unorganized sector. NBFC is a varied group of Monitory institutions, providing a large series of services like hire-purchase finance, vehicle financing, equipment leasing, personal loans, working capital loans, consumer loans, housing loans, loans against shares, etc. NBFCs are incorporated under the Companies Act, 1956 and can be classified into two broad categories, viz.,

(i) NBFCs accepting public deposit (NBFCs-D) and

(ii) NBFCs not accepting/holding public deposit (NBFCs-ND)

The segment has noticed significant growth in the last decade and is now being known as harmonizing to the banking sector due to implementation of ground-breaking marketing strategies, by allocation of the increased Monitory services, the role they play in economy is surprising with having larger portfolio of products, & they also improves the return forecast. As per FICCI data NBFC's have accounted for 10.5% of population only from top metros (Delhi, Haryana, Mumbai, Chennai, Kolkata, & Bangalore), who consumed 61% of bank credit in 2006-2007 near about 70% of Indian population is using NBFC's as means to raise funds.

REVIEW OF LITERATURE

Literature Review is the study of the various papers, articles, and project that have been done on the same topic. "Study of role of NBFC in Indian Economy" in the past years. The data for this purpose has been collected from articles in the newspapers, papers, and the reports of monitory sectors and RBI on to the NBFC sector presented by Monitory advisors of such organizations & articles in the Indian banker journal.

Harsimran Kaur A. and Dr. Bhawdeep Singh Tanghi(2013) analyzed that NBFCs playing a crucial role in terms of macroeconomic prospective as well as strengthening the structure of the Indian Monitory

System. Consolidation in the sector and better regulatory framework for NBFCs has become more focused.

Dr. Amardeep (2013) analyzed that "The role of NBFCs in creation of productive national assets can hardly be undermined. This is more than evident from the fact that most of the developed conomies in the world have relied heavily on lease finance route in their developmental process".

P Vijaya Bhaskar, Executive Director of the Reserve Bank of India, explained NBFC companies are game-changers that are very important to the economy

Dr. Yogesh Maheshwari(2013) in his paper state that "Changing Monitory scenario have opened up opportunities for NBFCs to expand their global presence through self expansion strategic alliance etc. The Monitory reforms have brought Indian Monitory system closer to global standards".

Dubey.S (2007) analysed that Nbfc's in India had a great revolution after 1991 liberalization which led to simple regulatory mechanisms and allowance to greedy investors to park their money with NBFC's. With more customers base and unwise investments start rising to have large profitability. This in turn leads to weak not compatible with strong players and fading of golden era for NBFC's.

Krishnamurthy's (2003) analyzed that Kotak Mahindra getting of license to operate as a NBFC has led to an initiative in direction of NBFC's conversion in to banks. Now, other large profitable which are NBFCs such as Sundaram Finance, Ashok Leyland Finance and Cholamandalam Finance should try to avail this option in future for competition sake. Though the initial cost would be high as there higher capital requirements.

SIGNIFICANCE OF NBFCS

India's Monitory services sector is touched enormous growth. It is not just includes the commercial banks, but also non-banking Monitory companies (NBFCs). These firms offer a wide array of Monitory services like loans, chit-funds, and are different from banks. Though NBFCs are small players of the industry but due to their performance and growth rate they are important to the economy, especially in a developing country like India where 65-70% of the population lives in rural areas. By following points we easy understand the significance of the NBFCs:

- Size of NBFC Sector: The NBFC sector has grown noticeably in the last decade despite the reduced speed in the economy. As of March 2013, it accounted for 12.5% of the country's GDP – a measure of the size of the economy. This is up from 8.4% in March 2006. However, this only counts NBFCs with assets more than Rs 100 crore. "If the assets of all the NBFCs below Rs 100 crore are reckoned, the share of NBFCs' assets to GDP would go further,".(P Vijaya Bhaskar)
- Growth: In terms of growth rate, the NBFC sector beat the banking sector in last decade. Its average growth rate is about 22% every year. Even when the country's GDP growth slowed to 6.3% in 2011-12 from 10.5% in 2010-11, the NBFC sector's growth rate is 25.7%. This makes evidence that NBFCs are contributing more to the economy year after year.
- Profitability: NBFCs are more profitable than the banking sector because of lower costs. This helps them offer cheaper loans to customers. As a result, NBFCs' credit growth – the increase in the amount of money being lent to customers – is higher than that of the banking sector. Credit grew an average 24.3% per year for NBFCs as against 21.4% for banks. This shows that more customers are opting for NBFCs.
- Infrastructure Lending: NBFCs contribute largely to the economy by lending to infrastructure projects, which are very important to a developing country like India. But they require large amount of funds, and earn profits only over a longer time-frame. As a result, these are riskier projects. This deters a lot of banks from lending to infrastructure projects. In the last few years, NBFCs have contributed more to infrastructure lending than banks. NBFCs lent over one third or

35.8% of their total assets to infrastructure sector as of March 2013. In contrast, banks lent only 7.6%.

- Promoting inclusive growth: NBFCs cater to a wide variety of customers – both in urban and rural areas. They finance projects of small-scale companies, which is important for the growth in rural areas. They also provide small-ticket loans for affordable housing projects. All these help promote inclusive growth in the country

ROLE OF NBFCS

Now it is well established, with the practice, that the vital growth and effective performance of a monitory sector for economic growth of any country. It is universally accepted that a well functioned Monitory system is indispensable for a successful modern economy (Kroszner, 2010). In all complex economies, for example, monitory systems efficiently deliver an extensive range of Monitory services and act as an important pillar in contributing to macroeconomic stability and sustained economic growth and prosperity (World Bank, 2003). Furthermore, the well developed Monitory markets relieve enlistment of investments, by offering the investors a wide range of investment instruments. In addition, investors get much more striking returns of there investment with NBFCs. This is the strongest reason of popularity of NBFCs in middles class income group of Indian economy. This expansion archetype is gradually more predictable, especially in the bank-dominated Monitory system with after effects of financial market crises.

According to a report from the World Bank (2003), developed Monitory Markets also have enhanced access to finance for more firms and individuals at reasonable cost, reduced shakiness and distortions, by working in an environment that is apparent, ready for action, and characterized by the occurrence of a varied array of financial products, including financial or monitory instruments for successful risk management. All these were achievable because of widening the Monitory system with valuable contribution of NBFCs. Without a doubt we can say that in India with the development of NBFCs and with its improved and competitive services which are defiantly favorable to consumers but also make a huge contribution for development of economy also, it challenged the other financial sectors, viz., banks to innovate, to improve quality and efficiency, and provide flexible timings and at competitive prices. In fact, there are numbers of financial products and services which are first provided by the NBFCs instead of banks and they make possible and competitive environment for banks, for instance, the loans against gold were also introduced by the NBFCs much earlier than nationalized banks. In the same way, the commercial vehicle financing, in particular segment, were also first initiated by the NBFCs. On the whole many specialized Monitory services, such as the factoring, lease finance, hire purchasing, venture capital finance, financing road transport, etc., were pioneered by the NBFCs.

NBFCs have also played an important role in the business of securities- based lending such as Loan against Shares (LAS), Margin Funding, Initial Public Offering (IPO) Financing, Promoter Funding, etc. These made to control credit services and products have added liquidity and often reinforce the retail inputs in public issues in equity markets, resulting in better price detection according to a report by the Task Force appointed by FICCI. Even housing finance was taken to newer heights by the NBFCs. In the recent years, NBFCs also played important role in extensive reach of microfinance. Moreover, development of such alternative financing vehicles adds to the liquidity and diversity of the Monitory system, thereby mounting its effectiveness as an engine for economic growth and enhancing the Monitory system's capacity to absorb shocks (Carmichael et al, 2002). Both banks and non-banking financial intermediaries are key fundamentals of sound and stable Monitory system and growth of both sectors offer important synergies. It is interesting to note that the growth in the non−bank Monitory services industry in many countries has been more rapid than the deposit / lending activities of commercial banks.

As a result, banking and non-banking financial institutions have sought after to diversify away from the conventional commercial financial business i.e., accepting deposits and providing loans to non-conventional financial activities, viz., investment banking, IPO financing and other capital market related activities besides the lease finance etc. NBFIs thus, in general tend to offer enhanced equity and risk-based products...' (RBI, 2005). With the augment of middle earning class in India which has reached a firm stage of perceptible economic development, growing demand for owning property, small investment, and retirement saving plans and also rising demand for housing loans, contractual savings, insurance services, and asset management. The banking system alone is not able to handle the wide-ranging requirements as banking financial system in India is not functioning as a full-fledged 'universal banking'. To meet this demand of finance almost all major banks in India open non-banking financial subsidiaries. These subsidiaries are works as merchant banks, mutual funds, insurance companies, primary dealers and other NBFCs. Thus, NBFCs play a fundamental role in expansion access to Monitory services, enhancing competition and diversification of the Monitory sector (RBI, 2005). It is therefore, necessary to view NBFCs fragment of Monitory system as a mechanism for economic growth and to provide proactive regulatory.

According to the Economic Survey 2010-11, it has been reported that NBFCs as a whole account for 11.2 per cent of assets of the total Monitory system. With the growing importance assigned to Monitory inclusion, NBFCs have come to be regarded as imperative Monitory intermediaries mainly for the unorganized sectors such as small-scale business units and retail sectors. As we know the Indian financial system is Multi-tier, the significance of NBFCs is on the main focus of various committees appointed by RBI time to time, and RBI also has been modifying its regulatory framework and supervising norms from time to time to keep velocity with the changes in the system. NBFCs have turned out to be engines of growth and are integral part of the Indian Monitory system, enhancing competition and diversification in the Monitory sector, scattering risks specifically at times of Monitory distress and have been more and more known as complementary of banking system at competitive prices. The Banking sector has always been highly keeping pace, however easy approval procedures, flexibility in working style and timeliness in meeting the credit needs and low operation cost resulted in the NBFCs in receipt of an edge over banks in providing funding. In financial crisis era the market has seen explosive growth, as per a Fitch Report the compounded annual growth rate of NBFCs was 40% in comparison to the CAGR of banks being 22% only. NBFCs have been ground-breaking at retail asset backed lending, lending against securities, microfinance etc and have been extending credit to retail customers in under-served areas and to unbanked customers.

KEY PERFORMANCE TRENDS

As per the studied material it is clearly analyzed that 40 large sized NBFCs comprising of deposit accepting NBFC as well as non-deposit accepting NBFCs with being there across a variety of asset classes. These 40 large size NBFCs account for or around 40% - 45% of the total NBFC sector assets.

1. Capital Adequacy remains comfortable

At present the CAR for the NBFC sector is contented both on Total CAR as well as Tier - I CAR basis. The overall CAR for the sector was around 20% with Tier I CAR of around 15.5% as on March 31, 2014 which was contentedly higher than the minimum mandate regulatory requirement of 15% for Total CAR and 7.5% for Tier - I CAR except for gold loan NBFCs which is required higher minimum Tier I CAR of 12%.

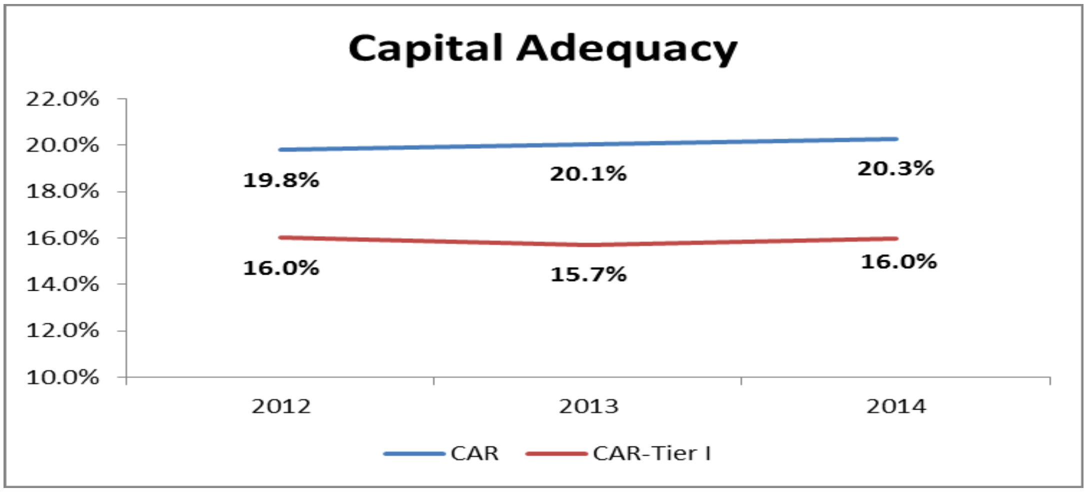

Chart 1: Trend in Capital Adequacy of NBFCs Source: CARE Study

In recent years the overall CAR has remained stable with admission of new large players with well-built capital back-up. However, over a period of time it is observed that due to higher issuance of Tier - II capital is first and foremost in the form of subordinated debt followed by preference capital and perpetual debt, the share of Tier - II capital has increased. However, at the current level of Tier - I CAR, the segment seems relaxed with respect to revised guiding principle of 10% of Tier - I CAR by March, 2018.

2. DUE TO ECONOMIC STRESS THE ASSET QUALITY IS UNDER PRESSURE

NBFCs sector have witnessed a stress in asset quality during the last few years due to feeble operating environment and fiscal depression. Sectors which are straightforwardly linked to monetary activities like commercial vehicle, construction equipment and infrastructure financing have witnessed sharp decline in asset quality. Gold loan NBFCs have also witnessed asset quality concerns on account of regulatory qualms, correction in gold prices and funding constraints.

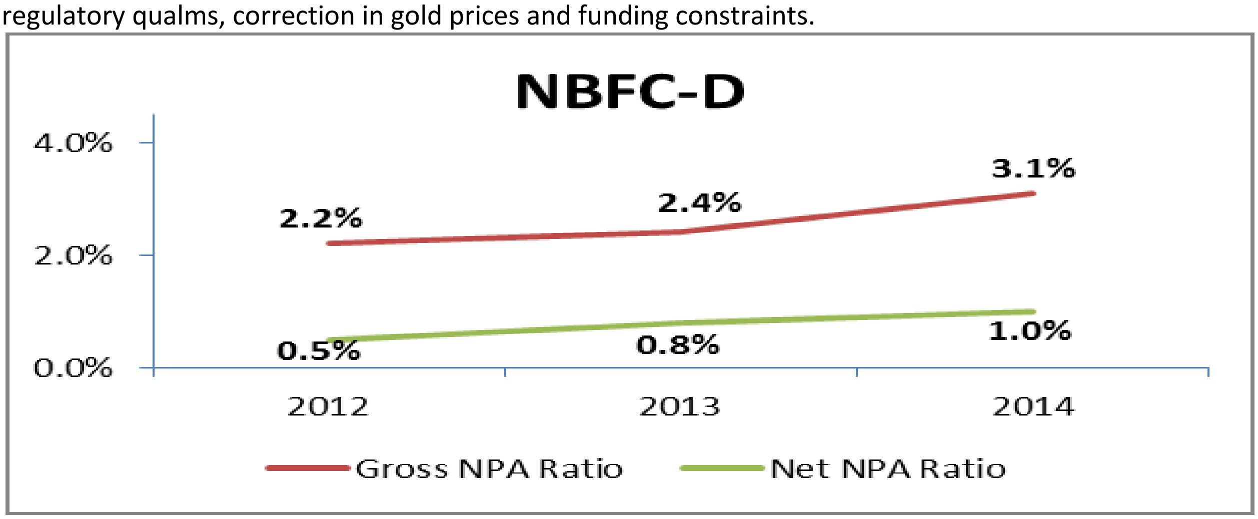

Chart 2: Trend in Asset Quality of NBFC-DsSource: RBI

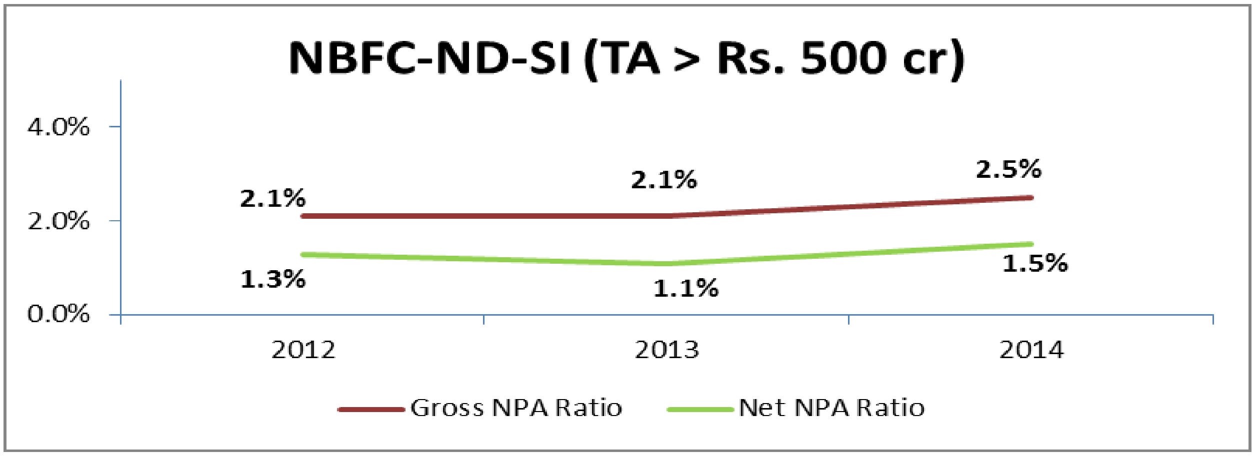

Chart 3: Trend in Asset Quality of NBFC-ND Source: RBI

NBFCs-D have seen high weakening in asset quality as compared to NBFCs-ND-SI. As key deposit accepting NBFCs are contribute in commercial vehicle financing. Though, NBFCs-D have better provision coverage of approximately 60%.

During current financial year i.e. FY15 (refers to period April 01, 2014 to March 31, 2015), delinquencies for NBFCs remained at elevated levels due to no pick-up in industrial activity**(CARE REPORT).** However, the industrial activity is expected to see recovery during later part of the year.

3. Profitability impacted on account of slowdown in growth and asset quality pressure

During FY13, overall profitability remained stable as compared to FY12 levels. The Return on Total Assets (ROTA) for FY13 was at 2.57% as compared to 2.58% for FY12.

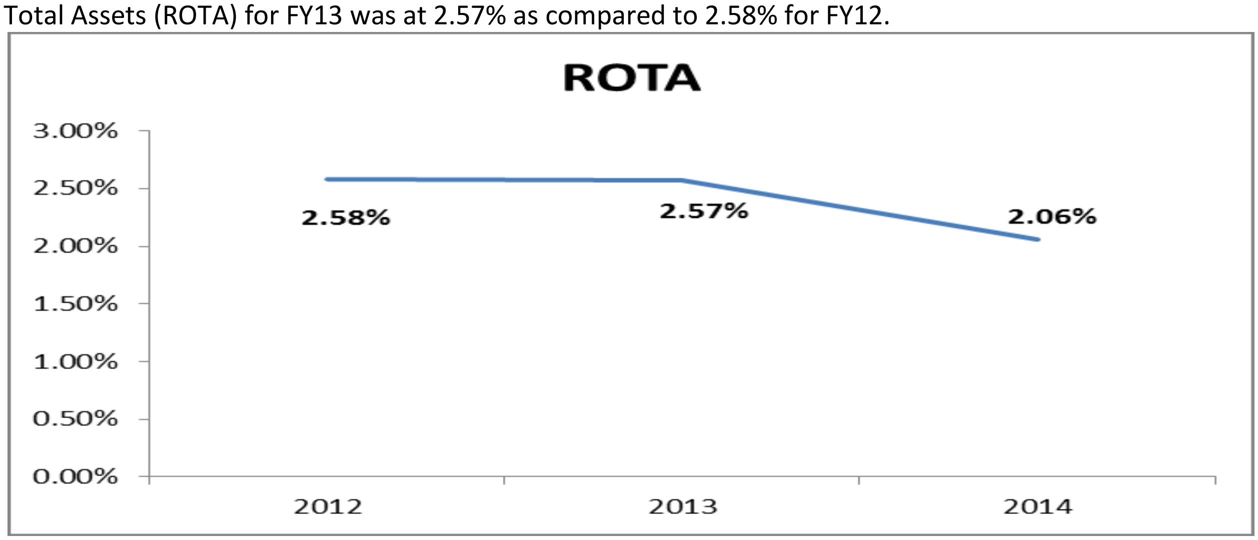

Chart 4: Trend in Return on Total Assets of NBFCs Source: RBI

During FY14, due to hardening of interest rates and increasing delinquencies, the NBFC sector has seen stress on net interest margins and boost in credit cost. Increase in NPAs has dual effect firstly not earning of interest and secondly setback of interest income which was booked in earlier period. Due to which the productivity has taken a strike which is visible from ROTA that declined from 2.57% for FY13 to 2.06% for FY14.

4. Resource profile continues to be stable

Borrowings through capital market together with NCDs, subordinated debt, preference shares, perpetual debt sustained to be the major resource of funding for NBFCs as it accounted for 34% of total borrowings in FY14 followed by banks funding which accounted for 31% of their overall borrowings. Overall borrowing mix in FY14 has remained in order with FY13. Dependency on short term borrowings like commercial paper is less at around 7% which helps them to manage their asset liability incongruity.

Future of NBFCs in India

The passage of the Banking Laws Amendment Bill 2011 has put NBFC stocks in the focus. This is true particularly for those organizations that are vigorously looking for a license. One more factor that has added to the enthusiasm is the current recommendations by the RBI for the NBFC sector. A panel headed by the former deputy governor of RBI, Usha Thorat has made certain recommendations which will tighten the ropes on the NBFC sector as a whole but ensure a better and safer functional environment. Here are some recommendations which will help in strengthening the NBFC sector going forward:

- Tier -1, or core capital of NBFCs, has been pegged at 12% from 7.5% now.
- The new provisioning rules will be 90 days instead of 180 days.
- The risk weights for NBFCs not sponsored by banks could be raised to 150% for capital market exposures and 125% for commercial real estate (CRE) exposures.
- A minimum asset size of over Rs 50 crore is required for registering a new NBFC.
- The panel has stipulated the maintenance of a statutory liquidity ratio of 15% of aggregate deposits for deposit accepting NBFCs, besides, making applicable ALM guidelines to those holding deposit of Rs 20 crore and above.
- Existing NBFCs will be given a period of 2 years with milestones for achieving the minimum threshold of Rs 25 crore of Monitory assets.
- All registered NBFCs, both deposit taking and non-deposit taking, should maintain high quality liquid assets in cash, bank deposits available within 30 days, money market instruments maturing within 30 days, investment in actively traded debt.

CONCLUSION

NBFCs have been playing a crucial role in terms of the macroeconomic perspective as well as strengthening the structure of the Indian Monitory system. Consolidation in the sector and better regulatory framework for NBFCs has helped them become more focused. However, in the real world of competition, NBFCs have to focus more on their core strengths and must constantly endeavor to search for new products and services in order to survive and grow constantly.

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