A STUDY ON THE GROWTH AND DEVELOPMENT OF NON BANKING FINANCIAL INSTITUTIONS IN INDIA

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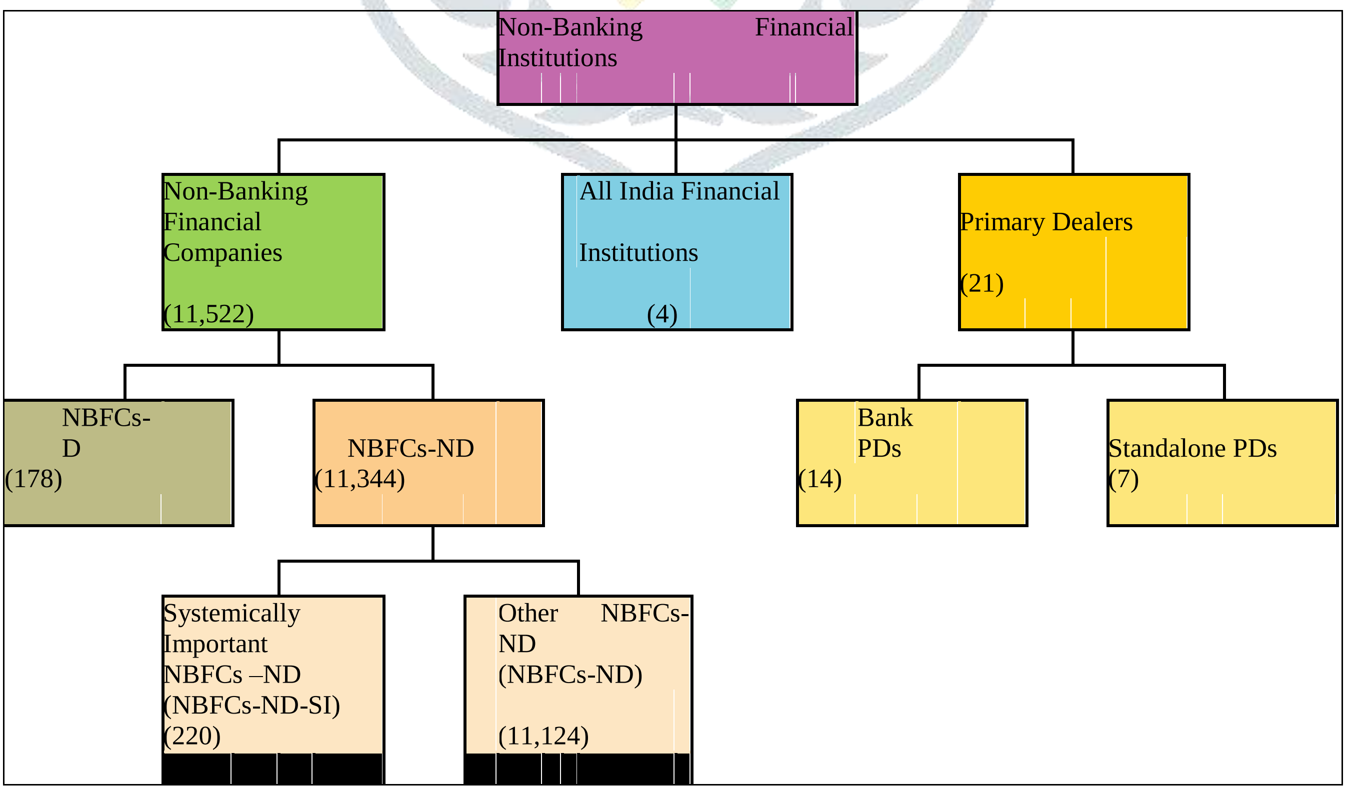
Abstract: ***The financial sector in India consists of several intermediaries. It includes banking entities, investment intermediaries, insurance companies, information and analysis providers, investment banks, portfolio managers etc. All the entities that offer financial services other than banking may be called as non banking financial institutions. Non banking financial companies have been playing an important role in channelizing the scarce financial resources in capital formation. Non banking financial institutions are an important alternative channel of finance for the commercial sector in India's bank dominated financial sector. They are emerging as an integral part of Indian Financial System and have tremendous contributions towards financial inclusion. Their role in promoting financial inclusion and catering to the needs of small businesses is significant. The objective of the present study is to highlight the growth and development of Non banking financial institutions in India. The study is both analytical and descriptive in nature and is based on secondary data. The research paper concludes that there is tremendous growth in this sector and it contributes significantly towards the economic development of the country.***

Index Terms: Non Banking Financial Institutions, Financial Resources, Commercial Sector, Financial Inclusion, Economic Development

INTRODUCTION

The financial sector in India consists of several intermediaries. It includes banking entities, investment intermediaries, insurance companies, information and analysis providers, investment banks, portfolio managers etc. All the entities that offer financial services other than banking may be called as Non Banking Financial Institutions (NBFIs). NBFIs have been intermediating a growing share of the resource flows to the commercial sector. NBFIs regulated by the Reserve Bank are All India Financial Institutions, Non Banking Financial Companies and Primary Dealers (PDs). AIFIs, largely an outcome of development planning in India, were created as apex public entities for providing long term financing/refinancing to specific sectors. NBFCs are mostly private sector institutions that specialize in meeting the credit needs and a variety of financial services which include financing of physical assets, commercial vehicles and infrastructure loans. PDs which came into existence in 1995 play an important role in both primary and secondary markets for government securities.

Chart 1: Non-Banking Financial Institutions Regulated by the Reserve Bank of India



Note: Figures in parentheses are the number of institutions.
Source: Report on Trend and Progress of Banking in India 2016-17

NON BANKING FINANCIAL COMPANIES

Non Banking Financial Companies (NBFCs) constitute an important segment of Indian Financial System. (NBFCs) are financial institutions that provide certain types of banking services, but do not hold a banking license. NBFCs can offer banking services such as loans and credit facilities, retirement planning, money markets, underwriting and merger activities. (NBFC) is a company registered under the companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire- purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/ construction of immovable property. NBFCs are classified according to their liability structure, type of activities and their systematic importance. On the basis of the liability structure it is classified into – Deposit taking NBFCs (NBFCs-D), which accept and hold public deposits and non deposit taking NBFCs (NBFCs-ND), which do not accept public deposits. NBFCs-ND with an asset size of Rs. 5 billion or more are classified as non deposit taking systematically important NBFCs (NBFCs-ND-SI). Their role is significant in channelising the scarce financial resources to capital formation. As NBFCs have more flexible structure than banks they can take quick decisions, assume greater risks, and widen their services and charges according to the needs of the clients.

Classification of NBFCs according to Activities performed

- Asset Finance Company- Financing of physical assets supporting productive/economic activities including automobiles, tractors and generators.
- Loan Company- Providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an asset finance company
- Investment company – Acquiring securities for purpose of selling
- Infrastructure Finance Company – provides infrastructure loans
- Systematically Important Core Investment Company - acquiring shares and securities for investment mainly in equity market.
- Infrastructure Debt Fund – Facilitates flow of long term debt into infrastructure projects
- Micro Finance Institution – Extending credit to economically disadvantaged groups
- Factor – Undertaking the business of acquiring receivables of an assignor or extending loans against the security interest of the receivables at a discount.
- Non Operative Financial Holding Company- For permitting promoters/ promoter groups to set up a new bank
- Mortgage Guarantee Company- Undertaking mortgage guarantee business
- Account Aggregator - collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer.
- Peer to Peer Lending Platform – providing an online platform to bring lenders and borrowers together to help mobilise funds.

OBJECTIVES OF THE STUDY

- To understand the growth of Non Banking Financial Companies
- To study the development of NBFCs
- To analyse the role of NBFCs in the Indian Financial System

GROWTH & DEVELOPMENT OF NBFCs

Growth of India's financial system contains many institutions other than banks engaged in financial services and non financial services and non financial activities. Despite the unavailability of insurance for non banking deposits, the higher rates of return have drawn large numbers of small savers to them. The gradual integration of domestic and external markets also contributed significantly to the growth of this sector. With innovative market strategies, the NBFCs have mopped up public savings and command large resources.

The Government of India has permitted foreign direct investments in lease and finance, housing finance, micro credit and rural credit activities. Any company incorporated under the Indian Companies Act, 1956 and engaged as its principal business in finance is identified as NBFC. While the Reserve Bank of India is vested with powers to supervise the deposit taking activities of all NBFCs, various authorities like SEBI, National Housing Bank, IRDA have been set up for closer regulations of the diverse functions of the companies such as capital market intermediaries, housing finance and insurance.

A new RBI regulatory framework was devised in Jan 1998 to ensure that the NBFCs functions on economically sound lines and strengthen the financial system of the company while affording protection to depositors. The NBFCs flourished in India in the decade of 1980's against the back drop of a highly regulated banking sector while the simplified sanction procedures and low entry barriers encouraged the entry of a host of NBFCs. Numerous bankruptcies of NBFCs in the early 1990's prompted RBI to take action. The measures sanctioned in 1997, most notably minimum Net Owned Funds (NOF) and a Maximum Deposit to NOF ratio of 1.5 and 4 (depending upon the company's rating) brought NBFC standards closer to those of banking sector. Subsequently the number of registered NBFCs shrank by seventy percent by 2003. At the end of March 2017, there were 11,522 NBFCs registered with Reserve Bank, of which 178 were NBFCs-D and 220 were NBFCs-ND-SI. The number of NBFCs has been declining over time with cancellations of registrations exceeding new registrations on account of voluntary surrender or cancellation of CoR due to non-compliance of revised criteria of net owned fund.

ANALYSIS & INTERPRETATION

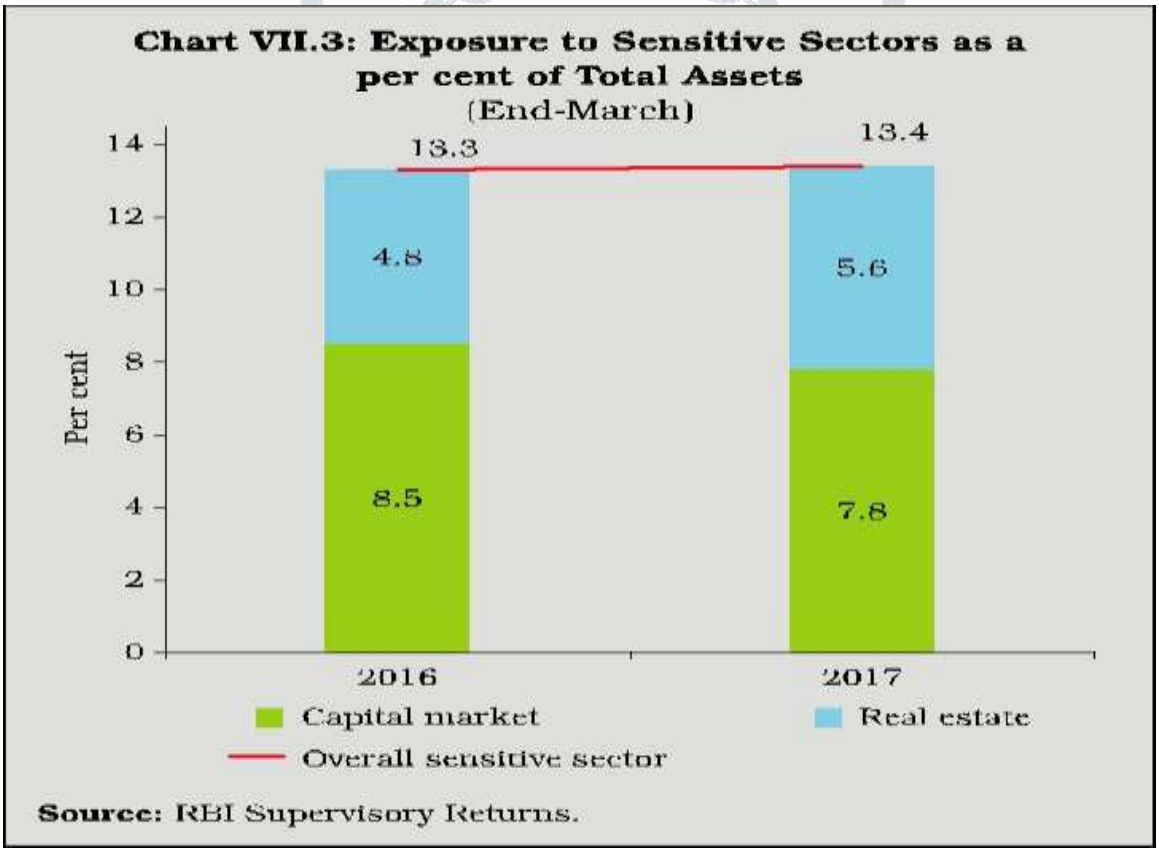
Table No.1.Progress of NBFCs in India from 2014-2017
Rs. In Billion

Year	Number of NBFCs	NBFCs accepting Public Deposits	Public Deposits	Share Capital	Reserves & Surplus	Loans & Advances	Investments	Net Profit
2013-14	12,029	241	131	737	2723	10782	2159	313
2014-15	11,842	220	205	851	3117	11864	2603	365
2015-16	11,522	178	271	761	3033	13169	2253	367
2016-17	11,522	178	306	921	3538	14846	2673	314
Average CGR	**(-) 4.21%**	**(-) 26.14%**	**133.59%**	**24.97%**	**29.93%**	**37.69%**	**23.81%**	**(-) 0.32%**

Source: Annual Reports of RBI (various years) cited on 05-03-18

The progress of NBFCs on the basis of number has shown volatility over the study period. There were12,029 NBFCs by the end of March 2014 and the number of NBFCs shows a decreasing trend due to the various actions taken by the Reserve Bank of India. By the end of March 2017 the total number of NBFCs were11, 522 and it shows a negative growth rate of 4.21%. While reviewing the progress made by the NBFCs during the last 4 years, it was observed that the growth in terms of Owned Fund, mobilisation of Deposits and the disbursement of Loans has by and large been satisfactory. Share capital was 737 billion on 31stMarch2 014 has increased to 921 billion by the end of March 2017 shows an average growth rate of 24.97%. The Reserves & Surplus was 2,723 billion on 31st March 2014 has increased to 3,538 billion by the end of March 2017 shows an average growth rate of 29.93%. The amount of Deposits mobilised by the NBFCs shows an average growth rate of 133.59% during the study period. The total amount of Advances disbursed by the NBFCs increased from 10,782 billion to 14846 billion having an average growth rate of 37.69%. The amount of investments made by the NBFCs shows an average growth rate of 23.81%. The Net profit of NBFCs is fluctuating during the study period. The amount of Net profit was 313 billion during the year 2014 and increased to 365 billion during 2015 and further reduced to 314 billion showing an average growth rate of 0.32%.

Table No.2: Exposure to Sensitive Sectors as a percent of Total Assets



Source: Annual Report of RBI 2016-17

Table No. 2 shows NBFCs exposure to sensitive sectors as a percent of total assets. The Reserve Bank defines the capital market, real estate as sensitive sectors in view of the risks associated with these sectors due to the fluctuations in the prices of such assets. During the year 2016 its exposure to capital market was 8.5% and it has reduced to 7.8% during 2017. Exposure to real estate was 4.8% during 2016 and it has become 5.6% during 2017 reflects its search for higher yields. The total exposure to sensitive sector was 13.3% during the year 2016 and it was 13.4% during 2017.

Table No. 3. Credit to select Sectors by NBFCs
(Amount in Rs. Billion)

Items			2016	2017	Share in gross advances in 2017 (Per cent)	Percentage Variation
1			2	3	4	5
I. Gross advances			13,169	14,846	-	12.7
II. Non-food credit (1 to 5)			13,167	14,846	100.0	12.8
1.	Agriculture and allied Activities		392	346	2.3	-11.7
2.	Industry (2.1 to 2.4)		8,063	8,940	60.2	10.9
	2.1	Micro and small	326	508	3.4	55.8
	2.2	Medium	154	172	1.2	11.7
	2.3	Large	3,726	4,375	29.5	17.4
	2.4	Others	3,857	3,885	26.2	0.7
3.	Services		1,865	2,224	15.0	19.2
4.	Retail loans		2,047	2,490	16.8	21.6
	4.1	Vehicle/auto loans	1,150	1,035	7.0	-10.0
5.	Other non-food credit		801	847	5.7	5.7

Source: Annual Report of RBI 2016-17

The Gross Advances of NBFCs was Rs. 13,169 billion on 31st March 2016 and it was Rs. 14,846 billion on 31st March 2017. During 2017 the entire amount of Advances was deployed to non food credit. NBFCs specialise in catering to sector specific financial needs covering retail, consumer and vehicle loans; micro, small and medium enterprises; large industry/ infrastructure and micro finance among others. Credit to retail and services during the year were 15% and 16.8% and show a percentage variation of 19.2% and 21.6%. Growth in credit to retail and services segment is remarkable and it shows their increasing role in financial inclusion. About 60% of the credit of NBFCs goes to industry followed by retail services. Retail credit increased at the highest pace on account of consumer durables and credit card receivables. Other non food credit is 5.7% shows 5.7% variation compared to the previous year.

CONCLUSION

NBFCs are gaining momentum and have come a long way over the decades. The banking sector is financing only 40% of the trading sector and the remaining is done by NBFCs. The number of NBFCs has declined because of the regulatory initiatives aimed at protecting depositors' interests and safeguarding financial stability. The overall balance sheet size of NBFCs has expanded with their credit growth recording a higher reading in 2016-17 when bank credit witnessed historically low growth. Credit to Micro and Small segments displayed tremendous growth. Their exposure to sensitive sectors such as capital markets and real estate at 13.4 percent of their total assets at the end of March 2017 was higher than the previous year. NBFCs have become prominent in a wide range of activities like hire purchase finance, equipment lease finance, loans and investments in India. The growth of NBFCs in India is remarkable. Their role in the economic development is noteworthy. Credit to retail and services during the year were 15% and 16.8% and show a percentage variation of 19.2% and 21.6%. Growth in credit to retail and services segment is remarkable and it shows their increasing role in financial inclusion. The total amount of Advances disbursed by the NBFCs showed an increase of Rs. 4,064 billion during the study period. The Deposits mobilised by NBFCs increased by 175 billion during the study period. It shows the contribution of NBFCs in channelizing the scarce financial resources to capital formation. The Non Banking Financial Companies have emerged as major contributors to the economic growth in India by having access to certain deposit segments and catering to the specialised credit requirements of certain classes of borrowers. It can be concluded that there is tremendous growth in this sector and it contributes significantly towards the economic development of the country.

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