

FINANCIAL PERFORMANCE OF NBFC – AN EMPIRICAL STUDY ON SELECTED ASSETS FINANCE COMPANIES

Tamal Basu

Assistant Professor

Department of Commerce (UG & PG),

P.K.College, Contai

Address:

Flat No B-2 4th Floor, Sukhsagar Apartment,

Near VTT College, Keranitola

P.O+ Town. - Midnapore, Dist. – Paschim Medinipur,

Pin- 721101, West Bengal.

Abstract

The Non-Banking Financial Companies (NBFCs) are the financial institutions that offer the banking services, but do not comply with the legal definition of a bank, i.e. it does not hold a bank license. So far classification of NBFC is concerned; with effect from December 6, 2006 the above NBFCs, registered with RBI have been classified as Asset Finance Company (AFC), Investment Company (IC), and Loan Company (LC). In the present study we have concentrated on the study of financial performance in respect to the AFC. The principal objective of the study is to assess the financial performance of NBFCs in India on selected AFC in respect of growth performance, measuring the deviations in performance and identification of most important indicator among the selected financial indicator. The growth rates are positive in case of the performance indicators ROE, DE Ratio, NPR and CR but it is negative for ROA and ROCE. But the growth rate of ROA, ROE and NPR are statistically insignificant. So far the growth rate of ROCE, DE Ratio and CR is concern, these are statistically significant. It is observed that for all the selected performance parameter the result of Chi-square test is insignificant so null hypothesis is accepted and it resulted that the actual performance in not different with the expected performance for the selected AFC (aggregate) but not depicts the good health situations for the concerned companies as because the performance achievement is not higher as it was estimated. To identify the most important indicator among the selected performance indicators no identifiable factor is found in case of selected AFC (Aggregate) since the factor analysis can't be applied in this regard.

In conclusion, it can be state that the overall performance of the selected assets companies' are not satisfactory during the period under study and the management of the selected assets finance companies need more emphasis to improve the financial performance which will finally enrich the overall performance of NBFCs.

Key Words: AFC, CR, DE, Financial Indicator, IC, LC, NBFC, NPR, RBI, ROE, ROCE, ROA.

**Assistant Professor, Department of Commerce (UG& PG), P.K.College, Contai, Purba Medinipur.*

The Background

The Non-Banking Financial Companies (NBFCs) are the financial institutions that offer the banking services, but do not comply with the legal definition of a bank, i.e. it does not hold a bank license. Basically it is a company registered under the Companies Act, 1956/ Companies Act 2013 involved in the business of giving and receiving loans and advances, acquisition of securities issued by the Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit fund business but it does not include any institution whose principal business includes agricultural activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

Section 45-I (b) of third chapter of Reserve Bank of India Act 1934, defines Non-Banking Financial Company as:

- (a) a financial institution, which is a company,
- (b) a financial institution, which is a company and which has as its principal business of receiving deposits under any scheme of arrangement or lending in any manner,
- (c) Such other non-banking institution or class of such institutions that may function as banks with the previous approval of Central Government and notification in this regard in the official gazette.

NBFCs are doing functions akin to that of banks; however there are a few differences which are as follows:

1. an NBFC cannot accept demand deposits;
2. an NBFC is not a part of the payment and settlement system;
3. as such an NBFC cannot issue cheques drawn on itself; and
4. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors like banks

So far classification of NBFC is concern, with effect from December 6, 2006 the above NBFCs registered with RBI have been classified as:

Asset Finance Company (AFC),
Investment Company (IC), and
Loan Company (LC).

Asset Finance Company (AFC) : An AFC is a company which is a financial institution carrying on as its principal business of financing physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.

Investment Company (IC): IC means any company which is a financial institution carrying on as its principal business in the acquisition of securities,

Loan Company (LC): LC means any company which is a financial institution carrying on as its principal business of providing finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

In the present study we have concentrated on the study of financial performance in respect to the Assets Finance Companies.

Review of Literature

Some of the notable studies that are available in this sector are briefly outlined as follows:

1. **Kantawala, Amita S. (2000)** in his study “**Financial Performance of Non-Banking Finance Companies in India**” examined the financial performance of 10 leasing companies at disaggregate level and compared them with other groups of NBFCs for a period of 1985-90. The study concluded that there exists a significant difference in the profitability ratios, leverage ratios and liquidity ratios of different categories of NBFCs. When two categories were examined against each other, it was observed that majority of the ratios were not statistically different except where TS+IH (Trading in Shares and Investment Holdings) were compared with leasing. When all the categories were taken together, null hypothesis was accepted for only three ratios. From this, it followed that the ratios for all the categories of NBFCs were generally different from each other.
2. **Rani, K. Martina (2008)** in his thesis “**Impact of Financial Sector Reforms on Non-Banking Financial Companies**” studied the comprehensive legislation of Narasimham Committee II which empowered RBI with sweeping powers in all respects of control over the performance and existence of NBFCs. The growth rate of NBFC in respect of deposits continued to rise till the year 1997, but declined after 1998 as the regulatory framework in 1998 came as a source of excessive control to the real and genuine players in the market. However, the main source of NBFCs was always been the fixed deposits.
3. **Samal and Pande (2012)** examined on the topic “**A Study on Technology Implications in NBFCs: Strategic Measures on Customer Retention and Satisfaction**” by using primary and secondary data and by using both descriptive and analytical research design. The authors concluded that technology on services and technology care for beneficiary had more influencing potentiality in increasing beneficiary satisfaction. But NBFCs must look to all other factors to increase its potentiality in technology, as new beneficiary are more accustomed with new technology to save their time and energy.
4. **Kaur and Tanghi (2013)** investigated on the topic “**Non Banking Financial Companies, Role & Future Prospects**” with a focus to analyze the role and significance of NBFCs in India. The paper concluded that NBFCs had to focus more on their core strengths and must constantly endeavour to search for new products and services in order to survive and grow constantly.
5. **Kaushal, H.R (2016)** in his study “**Impact of Non Banking Financial Companies (NBFCs) in Indian Economic Growth**” observed that after the proliferation phase of 1980 and early 1990s, the NBFC witnessed consolidation and now the number of NBFCs eligible to accept deposit in around 600 down from 40000 in early 1990s. The number of assets financing NBFCs would even lower, around 350, the rest are investment and loan companies. Almost 90% of assets financing NBFC were engaged in financial transportation equipments and the balance in financing equipments for infrastructure projects. Therefore, the role of Non Banking sector in both manufacturing and service sector was significant and they played the role of an intermediary by facilitating the flow of credit to end customers particularly in transportation and other organised sector. NBFC represented an extremely heterogeneous group of intermediaries concerned with mobilisation of resources and their profitable development. NBFC played the vital role of intermediaries between savers and the investors.

Objectives of Study

The principal objective of the study is to assess the financial performance of Non-Banking Financial Companies (NBFCs) in India on selected Assets Finance Companies. To attain this principal objective, the following sub-objectives are sought to be achieved:

1. To assess the growth of selected financial indicators of selected Assets Finance Companies (Aggregative) in India.
2. To measure the deviations if any between the actual performances with respect to the estimated performance of selected financial indicators of selected Assets Finance Companies in India.
3. To identify the key indicator among the selected financial indicators of selected Assets Finance Companies (Aggregative) in India.

Hypotheses of the Study

1st Hypothesis:

H₀: There has been no significant growth in respect of various performance parameters of selected Assets Finance Companies during the period of study.

H_A: There has been significant growth in respect of various performance parameters of selected Assets Finance Companies during the period of study.

2nd Hypothesis:

H₀: There is no significant difference between actual performance and estimated performance of selected performance indicator of selected Assets Finance Companies during the period of study.

H_A: There is a significant difference between actual performance and estimated performance of selected performance indicator of selected Assets Finance Companies during the period of study.

Research Methodology

Sample Selection: As per the list published by RBI on 30th November, 2015 and on the availability of data we have selected 13 companies belonging to the group of assets finance companies for our study.

Data Source: The data have been collected mainly from Secondary sources i.e. from the website of RBI, published annual reports of the selected companies, some annual reports collected personally by visiting the office of the companies.

Study Period: The starting year has been selected from the financial year 2006-07 on the basis of new category of classification of NBFC by RBI on December, 2006. The study was carried out for a span of nine years i.e., from 2006-07 to 2014-15.

Tools and Techniques of the study:

1. **Trend Growth Analysis:** To calculate the trend growth rate of selected performance indicator, semi- log regression model has been applied in the study. Further the semi log regression model has been selected since it gives the growth rate directly at a point of time.
2. **Chi Square Test:** To measure the deviations of actual performance and estimated performance we have employed the chi-square test.
3. **Factor Analysis:** We have carried out factor analysis with respect to selected profitability ratios to identify the most important ratio that drives the aggregate profitability performance of the selected Investment companies under study.

Results and Discussion

In our study, we have singled out NBFC companies for our research. Considering the nature of the companies' i.e. financing companies, no production activity is involved in it.

Moreover, the profit and loss account mainly comprises of interest expenses and interest income. Hence, in our analysis, the following ratios have been purposely selected which are indicated below

Return on Assets (ROA), Return on Capital Employed (ROCE), Return on Equity (ROE), Debt Equity Ratio (D/E Ratio), Net Profit Ratio (NPR) and Current Ratio (CR)

Trend Growth Rates of Different Ratios As Financial Performance Indicator Of Selected Assets Finance Companies (Aggregative)

Table: 1: Trend Growth Rates of selected Financial Performance Indicator of Selected Assets Finance Companies (Aggregative)

Performance Indicators	R ²	Constant (a)	Growth Rate (b)	F Value
ROA	0.368	-0.005 (-0.115)	-0.037 ⁱ (-2.020)	4.082
ROCE	0.514	-1.546 (-47.403)	-0.034 ^{**} (-2.720)	7.401
ROE	0.198	-0.822 (-44.066)	0.009 ⁱ (1.315)	1.728
D/E Ratio	0.847	0.629 (28.250)	0.054 ^{***} (6.215)	38.622
NPR	0.035	-0.838 (-35.026)	0.005 ⁱ (0.505)	0.255
CR	0.846	0.296 (8.705)	0.082 ^{***} (6.204)	38.484

Source: Computed

Notes:

- i. *** marked values indicates significant at 1% level (Two tailed)
- ii. ** marked values indicates significant at 5% level (Two tailed)
- iii. *i* marked valued indicates insignificant.
- iv. Figures in bracket indicate 't' value.
- v. d.f = n-k-1 > 9-1-1=7

From table 1 it is observed that ROA of all the sample assets finance companies taken together shows a negative growth rate (3.7%) which is found to be insignificant at 5% level of significance. ROCE of all the sample assets finance companies has taken together shows a negative growth rate (3.4%) which is found to be significant at 5% level of significance. It is observed that ROE of all the sample assets finance companies taken together shows a positive growth rate (0.9%) which is found to be insignificant at 5% level of significance. It is found that DER of all the sample assets finance companies taken together shows a positive growth rate (5.4%) which is found to be significant at 5% level of significance. Lower growth in debt equity ratio is favorable as it indicates lower external liability. NPR of all the sample assets finance companies has taken together shows a positive growth rate (0.5%) which is found to be insignificant at 5% level of significance. It is observed that CR of all the sample assets finance companies taken together shows a positive growth rate (8.2%) which is found to be significant at 1% level of significance.

Overall Observation: From the above it is observed that growth rates are positive in case of the performance indicators ROE, DE Ratio, NPR and CR but it is negative for ROA and ROCE. But the growth rate of ROA, ROE and NPR are statistically insignificant. So far the growth rate of ROCE, DE Ratio and CR is concern, these are statistically significant. So it may be concluded that the performance of most of the financial indicators are not satisfactory although four performance indicators among the selected six indicators are accounted the positive growth rate.

Measuring Actual Performance with respect to Expected Performance of each category of NBFCS

In order to determine whether the actual performance with respect to selected performance parameter are satisfying or not during the study period we have employed the technique of Chi-square test. For this purpose we have estimated the performance of selected parameters by using the popular ordinary least square technique ($y = a + bt$).

Chi-Square Test: Selected Assets Finance Companies (aggregate)

Table 2 Chi-square test for Return on Assets (ROA) for Selected Assets Finance Companies (Aggregate)

Year	ROA-Actual	ROA-Expected	Deviation (Actual - Expected)
2006-07	0.46	0.77	-0.31
2007-08	0.74	0.84	-0.10
2008-09	1.07	0.91	0.16
2009-10	1.69	0.98	0.71
2010-11	0.91	1.05	-0.14
2011-12	0.81	1.12	-0.31
2012-13	1.34	1.19	0.15
2013-14	1.18	1.26	-0.08
2014-15	1.25	1.33	-0.08
Result of Chi-square test (two tailed): $\chi^2_g = 0.817$ (Insignificant at 5% level of significance with 8 degree of freedom)			

Source: Computed

From Table 2 it is evident that in majority of the years the negative deviations are found only four years the deviations are positive out of total nine years under the study in case of ROA and it also shows a moderate performance. The result of Chi-square test ($\chi^2 = 0.817$) is found to be insignificant at 5 % level of significance. This implies that the return on assets (ROA) performance of assets finance companies (aggregate) is satisfactory during the study period. This also confirms the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance.

Table 3 Chi-square test for Return on Capital Employed (ROCE) for Selected Assets Finance Companies (Aggregate)

Year	ROCE-Actual	ROCE-Expected	Deviation (Actual - Expected)
2006-07	0.02	0.02	0.00
2007-08	0.02	0.02	0.00
2008-09	0.02	0.03	-0.01
2009-10	0.03	0.03	0.00
2010-11	0.04	0.03	0.01
2011-12	0.04	0.03	0.01
2012-13	0.04	0.03	0.01
2013-14	0.03	0.04	-0.01
2014-15	0.03	0.04	-0.01
Result of Chi-square test (two tailed): $\chi^2_8 = 0.009$ (Insignificant at 5% level of significance with 8 degree of freedom)			

Source: Computed

From Table 3 it is observed that, we found positive deviations in most years (includes three years where no deviations are found) and in three years there are no deviations, only in three years the deviations are negative out of total nine years under the study in case of ROCE so it shows that majority of the years the performance is satisfactory. The result of Chi-square test ($\chi^2=0.009$) is found to be insignificant at 5 % level of significance. This implies that the return on capital employed (ROCE) performance of assets finance companies (aggregate) is satisfactory during the study period. It implies the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance.

Table 4 Chi-square test for Return on Equity (ROE) for Selected Assets Finance Companies (Aggregate)

Year	ROE-Actual	ROE-Expected	Deviation (Actual - Expected)
2006-07	0.14	0.17	-0.03
2007-08	0.17	0.16	0.01
2008-09	0.15	0.16	-0.01
2009-10	0.18	0.16	0.02
2010-11	0.17	0.15	0.02
2011-12	0.15	0.15	0.00
2012-13	0.16	0.15	0.01
2013-14	0.14	0.14	0.00
2014-15	0.12	0.14	-0.02
Result of Chi-square test (two tailed): $\chi^2_8 = 0.016$ (Insignificant at 5% level of significance with 8 degree of freedom.)			

Source: Computed

From Table 4 it is evident that in majority of the years the deviations are positive (including one year where there is no deviations) and only in three years there are negative deviations out of total nine years under the study in case of ROE and it also shows in most of the cases the performance is desirable. The result of Chi-square test ($\chi^2=0.016$) is found to be insignificant at 5 % level of significance. This implies that the return on equity (ROE) performance of assets finance companies (aggregate) is satisfactory during the study period. This also confirms the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance.

Table 5 Chi-square test for Debt- Equity Ratio (D/E) for Selected Assets Finance Companies (Aggregate)

Year	Debt Equity Ratio- Actual	Debt Equity Ratio- Expected	Deviation (Actual - Expected)
2006-07	7.24	6.84	0.40
2007-08	6.63	6.27	0.36
2008-09	6.06	5.69	0.37
2009-10	5.05	5.11	-0.06
2010-11	3.23	4.53	-1.30
2011-12	3.19	3.95	-0.76
2012-13	3.12	3.38	-0.26
2013-14	3.14	2.80	0.34
2014-15	3.12	2.22	0.90
Result of Chi-square test (two tailed): $\chi^2_8 = 1.016$ (Insignificant at 5% level of significance with 8 degree of freedom.)			

Source: Computed

From Table 5 it is found that in four years there is negative deviations and rest in five years positive deviations are observed out of total nine years under the study in case of D/E ratio and it also shows in most of the cases the performance is desirable. The result of Chi-square test ($\chi^2=1.016$) is found to be insignificant at 5 % level of significance. This implies that the debt-equity ratio (D/E ratio) performance of assets finance companies (aggregate) is satisfactory during the study period. This also leads to the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance

Table 6 Chi-square test for Net Profit Ratio (NPR) for Selected Assets Finance Companies (Aggregate)

Year	NPR- Actual	NPR- Expected	Deviation (Actual - Expected)
2006-07	0.14	0.15	-0.01
2007-08	0.14	0.15	-0.01
2008-09	0.12	0.15	-0.03
2009-10	0.17	0.15	0.02
2010-11	0.18	0.15	0.03
2011-12	0.16	0.15	0.01
2012-13	0.16	0.14	0.02

2013-14	0.13	0.14	-0.01
2014-15	0.11	0.14	-0.03
Result of Chi-square test (two tailed): $\chi^2_8 = 0.028$ (Insignificant at 5% level of significance with 8 degree of freedom.)			

Source: Computed

From table 6 it is observed that in majority of the years the deviation is negative and in only four years positive deviations is accounted out of total nine years under the study in case of NPR and shows a moderate situation. The result of Chi-square test ($\chi^2=0.028$) is found to be insignificant at 5 % level of significance. This shows that the net profit ratio (NPR) performance of assets finance companies (aggregate) is satisfactory during the study period. So finally it shows the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance.

Table 7 Chi-square test for Current Ratio (CR) for Selected Assets Finance Companies (Aggregate)

Year	CR-Actual	CR-Expected	Deviation (Actual - Expected)
2006-07	3.87	3.93	-0.06
2007-08	3.39	3.52	-0.13
2008-09	4.05	3.10	0.95
2009-10	2.91	2.69	0.22
2010-11	1.43	2.27	-0.84
2011-12	1.31	1.86	-0.55
2012-13	1.17	1.45	-0.28
2013-14	1.20	1.03	0.17
2014-15	1.14	0.62	0.52
Result of Chi-square test (two tailed): $\chi^2_8 = 1.314$ (Insignificant at 5% level of significance with 8 degree of freedom.)			

Source: Computed

From Table 7 it is found that in most of the years i.e. in five years there is a negative deviation and in four years positive deviations are accounted out of total nine years under the study in case of CR and it seems to the moderate situation. The result of Chi-square test ($\chi^2=1.314$) is found to be insignificant at 5 % level of significance. This shows that the current ratio (CR) performance of assets finance companies (aggregate) is satisfactory during the study period. This shows the acceptance of the 2nd null hypothesis (H_0) of the study that there is no significant difference between the actual performance and expected performance.

Overall observations of Chi-square test of performance parameter for Selected Assets Finance Companies (Aggregate): From the above it is finally observed that for all the selected performance parameter (i.e. ROA,ROCE,ROE,D/E,NPR and CR) the result of Chi-square test is insignificant so null hypothesis is accepted and it resulted that the actual performance in not different with the expected performance for the selected assets finance companies (aggregate i.e. all the sample companies taken together) under the study and shows apparently a sound situations statistically for the concerned companies. But practically if the actual performance is higher than estimated performance and more positive values of deviations (i.e. Actual-Estimated) are found then it will be more desirable in respect to the performance of the NBFCs.

Factor Analysis for the selected Ratios as Performance Indicators

The aim of Factor analysis is to group the original input variables into factors which underlie the input variable. By performing factor analysis, the total number of factors in the study can be reduced by dropping the insignificant factors based on certain criterion.

As stated earlier the ratios selected in the study are as follows

1. Return on Assets (ROA)
2. Return on Capital Employed (ROCE)
3. Return on Equity (ROE)
4. Net Profit Ratio (NPR)
5. Debt Equity Ratio (D/E Ratio)
6. Current Ratio (CR)

Among the selected ratios an attempt is made to carryout factor analysis with respect to selected profitability ratios (ROA, ROE, ROCE and NPR) in order to identify the most important ratio that drives the aggregate profitability performance of the selected assets finance companies under study.

The other two ratios namely D/E Ratio and CR have not been considered since they represents single ratio under the category of capital structure and liquidity ratios.

Factor Analysis – Assets Finance Companies (Aggregate)

Table 8 KMO and Bartlett's Test of Assets Finance Companies (Aggregate)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.262
Approx. Chi-Square	14.481
Bartlett's Test of Sphericity df	6
Sig.	.025

Source: Computed

According to Table 122 the KMO measure of sample adequacy of performance indicators of selected Assets Finance Companies (Aggregate) is observed to be 0.262(i.e. 26.2%). Hence the factor analysis with respect to performance indicator of Assets Finance Companies (aggregate) can't be applied in the study since the KMO measure is less than 60%. (For small sample it is recommended 60%)

So in can be concluded from the above that there is no driving factor which can be identifiable in case of Assets Finance Companies (Aggregate) since the factor analysis can't be applied in this regard.

Concluding Observations

From the above it has been observed that the growth performance of the selected performance indicator is not satisfactory during the study period. The actual performance compare to estimated performance of selected performance indicators are not so notable that it can say the selected assets finance companies are doing well although statistically a sound situation is found as there is no difference between actual performance and estimated performance. Generally a higher actual performance compare to estimated performance is more desirable which is not found in our present study. To identify the most important indicator among the selected performance indicators to improve the performance of the selected assets finance companies we are unable to found or identify the most influencing factor which can drive to enhance the overall performance of the selected assets finance companies. In conclusion, it can be state that the overall performance of the selected assets companies' are not satisfactory during the period under study and the management of the selected assets finance companies need more emphasis to improve the financial performance which will finally enrich the overall performance of NBFCs.

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