



A Review of Role and Challenges of Non-banking Financial Companies in Economic Development of India

Afroze Nazneen^{1*}, Sanjeev Dhawan²

¹College of Business, University of Jeddah, Jeddah, Saudi Arabia, ²Department of Economics, DAV College, Jalandhar, India.

*Email: anazneen@uj.edu.sa

Received: 01 August 2018

Accepted: 14 October 2018

DOI: <https://doi.org/10.32479/ijefi.7220>

ABSTRACT

For a large and diverse country like India, ensuring financial access to penetrate growth and entrepreneurship is a critical priority. Banking penetration continues to be low, and even as the coverage is sought to be aggressively increased through programs like the Pradhan Mantri Jan Dhan Yojana, the quality of coverage and ability to access comprehensive financial services for households as well as small businesses is still far from satisfactory. In this scenario, the non-banking finance companies (NBFCs) sector has scripted a story that is remarkable. It speaks to the truly diverse and entrepreneurial spirit of India. From large infrastructure financing to small microfinance, the sector has innovated over time and found ways to address the debt requirements of every segment of the economy. To its credit, the industry has also responded positively to regulatory efforts to better understand risks and to address such risks through regulations. Over time, the sector has evolved from being fragmented and informally governed to being well regulated and in many instances, adopted best practices in technology, innovation and risk management as well as governance. In the light of this, the present study encompasses the role and challenges faced by NBFCs in Economic Development of India.

Keywords: Non-banking Finance Companies, Banks, Financial Institutions, Lease and Hire, Purchase and Assets Growth

JEL Classification: G2

1. INTRODUCTION

A sound and vibrant financial system is a prerequisite for the growth and economic development of a nation (Ebong, 2005; and Shonekan, 1997). The growth of the financial structure has a positive repercussion on economic development of an economy (Fase and Abma, 2003). For a great and diverse country like India, significant priority should be to ensure the financial access to excel development and entrepreneurship activities. Non-banking financial companies (NBFCs) are providing diverse financial services, which is an important component of the Indian financial structure. Financial services of NBFCs includes various kinds of banking services, like credit and loan facilities, retirement benefits schemes, wealth management, underwriting, and merger and acquisition services. In the last two decades the number of NBFCs has increased significantly due to the entry of industrial companies, venture capital companies and retail companies into

the business of lending. Since then NBFCs have been playing a very significant role in the development of economic structure of the nation. These companies are catering the financial requirements as well as providing livelihood sources for the un-bankable public in the semi-urban and rural segments of the country. NBFCs have strong connection at the grassroots level, and have maintained a source of touch and communication with the semi-urban and rural segments for effective financial services.

NBFCs have been providing the complementary services to the economy, like other financial institutions, including banks for fulfilling the funds requirements of the society. They assist to fill the gaps in the accessibility of financial services that only banks can provide to the public. The resources of NBFCs are not directly collected from the savers as debt. Instead these NBFCs channelize the savings of the public for rendering other financial services. All these companies are financial intermediaries and when such

companies provide loans, these are termed as non-banking financial intermediaries (NBFIs) or Investment Institutions. NBFIs consist mainly of institutions that run the activities of hire purchase finance, investment, housing loans, asset financing and leasing or mutual benefit financial companies but do not cover insurance companies or stock exchanges or brokerage companies.

2. HISTORICAL BACKGROUND OF NBFCS IN INDIA AND REVIEW OF LITERATURE

Historically, India has followed a financial intermediation-based system where banks, DFIs and NBFIs played a dominant role. The evolution of the Indian financial system from somewhat of a constricted and an undersized one to a more open, deregulated and market oriented one and its interface with the growth process reveals that it is a conscious one with the State taking the initiative. The banking system forms the core of the Indian financial system after the nationalisation of banks. Driven largely by the public sector initiative and policy activism, commercial banks have a dominant share in total financial assets and are the main source of financing for the private corporate sector. They also channelized a sizeable share of household savings to the public sector. The financial system outside the banks also exhibits considerable dynamism. The setting up of the development financial institutions and refinance institutions and the onset of reforms from about the early 'nineties', provide depth to the financial intermediation outside the banking sector. These developments, coupled with increased financial market liberalization, have enhanced competition.

Apart from the financial institutions, rapid expansion of NBFIs have taken place in the eighties and provided avenues for depositors to hold assets and for borrowers to enhance the scale of funding of their activities. Various types of NBFIs have provided varied services that include equipment leasing, hire purchase, loans, investments, mutual benefit and chit fund activities. The financial development in the banking and nonbanking financial sector supports saving and investment in the economy and contribute to growth in real activity. By pooling risks, reaping economies of scale and scope, and by providing maturity transformation, financial intermediation supports economic activity of the non-financial sectors. The emphasis in the approach to the financial system in the growth process during the 1980s and 1990s has shifted from channelization of resources by directed credit to their allocation between competing uses largely determined by market forces. In the wake of the financial crisis of the 2000s, the role of the financial system has been subjected to critical reassessment and considerations of financial stability have come to occupy equal place, if not higher with allocative efficiency. The share of banks in total financial assets of banks and NBFIs has declined over the last three decades.

Raj (1999), In India, up to the 1980s, the dominant fear of market failure has provided the rationale for state intervention in the financial system's allocative role. The 1st 5-year Plans, by and large, have ignored the role of the financial system in the development process (Patra and Roy, 2002). It has been realized

that the Indian financial system, though extensive, had only a limited role to play in terms of allocative efficiency under a regime, which prevented proper pricing (Joshi and Little, 1996).

Gurley and Shaw (1960) propounded a theory of finance that encompassed the theory of financial institutions and analyzed the role of financial intermediaries. They divided financial intermediaries into two main groups monetary and nonmonetary. Monetary institutions like banks create money and non-monetary intermediaries like non-banking intermediaries do not create money. The tremendous growth of NBFIs resulted in the diversifications and proliferation of financial assets. Goldsmith (1969) was the first to recognize the role of financial intermediaries in the growth process. He emphasized the role of financial intermediaries in the institutionalization of savings and channelizing them to productive uses. Shanker (1996) in a study pointed out that the success of NBFIs depends on their agility with which resources are raised and productively deployed in the competitive environment, where not only are the number of players large but also they are financially sound. Rengarajan (1997) observed that both from the macroeconomic perspective and the structure of the Indian Financial services, the role of NBFIs have become increasingly important. The main task before the NBFIs is therefore to play an expanded role so as to accelerate the pace of growth of financial market, including the credit market and provide wider choice to investors. One of the problems of the banking system on account of subsidized social banking are addressed, the banks would have a level playing field which may enable them to compete with NBFIs with increased levels of efficiency. Levine et al. (1999) found that economic growth was substantial in countries where the financial intermediaries were well developed. The study revealed in the case of India that if the NBFIs had raised their percentage of finance to the private sector (which was relatively low) to the average for developing countries, it would have benefited by an accelerated growth in real per capital GDP of about 0.6% points per year. Hence, there is no alternative to nurturing and developing this sector to be able to attain the desired sophistication of the financial market. Shollapur (2005) analyzed that NBFIs constituted a significant part of financial system and compliment the service provide by commercial bank in India. The efficiency of financial services and flexibilities helped them build a large body of client including small borrower and bigger corporate establishment.

Amita (1997) conducted a study on financial performance of NBFIs in India for the period from 1985-86 to 1994-95. In this study concluded that different categories of NBFIs behave differently and it is entrepreneur's choice in the light of behavior of some the parameters which go along with the category of NBFI. Vittal (1997) opines that creating new marketable securities in the area of leasing, factoring and venture capital NBFIs create long-term financial resources and provide a strong stimulus to the development of capital market. Lakshmi (1998) explained the role of NBFIs and stated that their success was due to their distribution capabilities, customer relation management, operating culture and quick processing of loans. Harihar (1998) studied the performance of all NBFIs taken together in terms of cost of debt, operating margin, net profit margin (NPM), return on net worth,

asset turnover ratio etc. The study revealed that the aggregate performance of NBFCs and does not throw light on the financial performance of different groups of NBFCs. Sorab (1999) stated that the main areas of operations of NBFCs were hire purchase, leasing and auto financing. The study estimated that nearly 60% of all trucks sold in India were through hire purchase schemes. Almost 99% of second hand trucks and taxis exchange hands through NBFC support and 75% of two - wheelers and 25% of white goods are sold with NBFC finance. Gayathri and Madhusudhanan (2000) observed NBFCs increased their deposit base aggressively by offering attractive rates of interest and reaching the far flung areas. The matter of interest differential was a motivating factor for transfer of deposits from commercial banks to NBFCs. Vaidyanathan (2001) observed that the role of non banking sector in the credit delivery system in both manufacturing and service sectors like trade, construction, hotels and restraints, transport etc was significant and they played a more dominant role compared to the commercial banks. Hossain and Shahiduzzaman (2002) focused on the role played by nonbanking sector in the economic development of the country and identifies the underlying problems existed within the sector. Kantawala's (2002) study attempted to examine the financial performance of different groups of NBFCs in terms of profitability, leverage and liquidity. Study found that different categories of NBFCs behave differently and it is the entrepreneur's choice in the light of behavior of some the parameters that go along with the category of NBFC.

Balachandran (2006) in his study on NBFCs has revealed that in the financial market, different financial products are available which provide on effective payment and credit system and thereby facilitate the channelizing of funds from savers to investors in the economy and thus the NBFCs play an important role in Indian financial system. The researcher has also traced the growth of NBFCs from 7000 in 1981 to 40,000 in 1995. Deposits in these NBFCs have been growing at a much higher rate than with commercial banks. Dubey and Shubhashish (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 started rising to have large profitability. This in turn leads to weak not compatible with strong players and fading of golden era for NBFC's. Jafor (2009) stated that the NBFCs have been playing a very significant role in the present day rigorous money-market conditions. They are serving the nation by supporting the economic reconstruction and giving a booster to industrial production. They are engaged into the business of providing loans and advances of small amounts for a short-period to small borrowers. The NBFCs play an important role in channelizing these savings into investment. They have supplemented the role played by the banks. Sundaram (2010) has analyzed the growth, profitability and Financial Performance of NBFCs. The researcher suggested that the RBI must exercise full control over the NBFCs like that of its control over commercial banks, since these companies are growing very fast as that of banks.

Khalil (2011) analyzed the financial performance of those non-bank finance companies which are providing the services of investment advisory, asset management, leasing and investment finance for 2

years from 2008 to 2009. Ratio analysis method has been used to analyze the. The study concluded that the financial performance of NBFCs was better in 2008 as compared to the overall decline in 2009 caused by many factors. Suresh (2011) investigated the performance of NBFCs in India (other than banking, insurance, and chit fund companies) during the year April 2008–March 2009. Study highlighted that Financial and Investment Companies' growth in income, main as well as other, decelerated during the period and growth of total expenditure also decelerated but it was higher than the income growth. Sornaganesh et al. (2013) investigated the fundamental analysis of NBFC in India to analyze the profitability position of 5 sample NBFC companies, like STF, SF, BF, and M and MF for the period from April 2008 to March 2012, using Ratio Analysis. The study revealed that SF has performed better in terms of Earnings Per Share but STF and M&MF are far better than other in NPM. Perumal and Satheskumar (2013) studied on the topic "NBFCs" analyzing the Balance Sheets and income statements of two sample companies, viz., Sundaram Finance Limited and Lakshmi General Finance Limited for the period 2007–2012 using primary and secondary data. The study was performed using various statistical techniques such as average, standard deviation, co-efficient of variation, trend analysis, index number, etc. and concluded that the contribution of NBFCs to economic development is highly significant.

Kumar and Naresh (2013) conducted a study using CAMEL ranking approach to assess relative performance of Indian public sector banks. The study observed that there is significant difference between the mean values of CAMEL ratios of public sector banks. It is found that the top two performing banks are Bank of Baroda and Andhra Bank because of high capital adequacy and asset quality. The study recommends that banks has to improve its management efficiency, asset, earning quality and liquidity position. Kumar and Kumar (2013) highlighted that though ranking of ratios is different for different banks in State Bank group. But there is no statistically significant difference between the CAMEL ratios. It signifies that the overall performance of State Bank group is same; this may be because of adoption of modern technology, banking reforms and recovery mechanism. SBI needs to improve its position with regard to asset quality and capital adequacy, SBBJ should improve its management efficiency and SBP should improve its earning quality. Kumar and Afroze (2014) revealed that Loans, Management Efficiency, Liquidity and Sensitivity have statistically significant influence on the capital adequacy of private sector banks. However, the independent variable asset quality has negligible influence on capital adequacy of Indian private sector banks. Moreover, the study reveals that the Indian private sector banks maintain a higher level of capital requirement than prescribed by Reserve Bank of India. Kumar and Sanjeev (2014) applied capital adequacy, assets quality, management, earning, liquidity, systems and controls (CAMELS) model on the secondary data Indian old private sector banks the period from 2007 to 2012. The study reveal that 6 banks out of 13 selected banks have shown good and excellent financial performance. Tamil Nadu Mercantile Bank secured first position in terms of overall composite ranking followed by Federal Bank. On the basis of CAMELS criteria Tamil Nadu Mercantile Bank, Federal Bank and Nainital Bank have shown excellent financial performance. On the contrary Catholic Siyrian Bank, ING Vysya Bank and Dhanalakshmi Bank

were worst performing banks in terms of financial performance. Kumar and Sanjeev (2016) expressed that Reserve Bank of India recommended two supervisory rating models named as CAMELS and capital adequacy, assets quality, compliance, systems and controls for rating of Indian commercial, private and foreign banks operating in India. The study examined each parameter of CAMELS system by review of literature and empirical studies.

In the light of the above review of literature the main objective of the study is to provide theoretical knowledge about the role and challenges face by NBFCs in India. The nature of present study is mainly qualitative and does not make use of any statistical technique for analysis. The present study has been done mainly on the basis of literature review and secondary information available from various journals, conference proceedings and reports of professional bodies.

3. NBFC - MEANING AND DEFINITION

“NBFC,” is defined under section 45-I(f) of the Act, as under “NBFCs” means:

- (i) A financial institution which is a company;
- (ii) A non banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) Such other non-banking institution or class of such institutions, as the bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

“The company will be treated as a non-banking financial company (NBFC) if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets is more than 50% of the gross income. Both these tests are required to be satisfied as the determinant factor for principal business of a company.”

According to the Reserve Bank (Amendment Act) 1997, “A NBFC means a financial institution which is a company; A non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme or arrangement or in any other manner or lending in any manner; such other non-banking institution or class of such institutions as the Bank may with the previous approval of the Central Government specify” (Machiraju, 1998). The definition excludes financial institutions besides institutions which carry on agricultural activities as their principal business.

The structure of NBFCs in India is presented with the help of following Figure 1:

4. DISTINCTION BETWEEN BANK AND NBFC

NBFCs provide loans and make investments and therefore their activities are similar to the banks; however there are following differences mentioned as below:

- (i) Bank can accept demand deposits but NBFC cannot accept demand deposits;
- (ii) NBFCs do not form part of the payment and settlement system

and cannot issue cheques drawn on it but banks are performing all of these;

- (iii) Deposit insurance facility of deposit insurance and credit guarantee corporation is not available to depositors of NBFCs, unlike that in the case of banks;
- (iv) SARFAESI Act provisions have not currently been extended to NBFCs. Besides the above, NBFCs pretty much do everything that banks do.

4.1. Classification and Types of NBFCs

The NBFCs are classified as under:

4.1.1. Based on their liability structure

On the basis of liability structure the NBFCs have been divided into following two categories.

4.1.1.1. Category “A” companies (NBFCs accepting public deposits or NBFCs-D)

Such NBFCs-D are put through the conditions of capital adequacy, liquidity maintenance, exposure norms (including restrictions on exposure to building, investments in land and unquoted shares), asset liability management (ALM) and reporting requirements.

4.1.1.2. Category “B” companies (NBFCs not raising public deposits or NBFCs-ND)

Until 2006 NBFCs-ND were subject to minimal regulation. Since April 1, 2007, non-deposit taking NBFCs with assets of 1 billion and above are considered as Systemically Important Non-Deposit taking NBFCs (NBFCs-ND-SI). These are subject to prudential regulations, like capital adequacy requirements and exposure norms along with reporting requirements. Such NBFCs are also subject to the ALM reporting and disclosure norms at different points of time.

4.1.2. Depending upon their nature of activities

On the basis of their functions, NBFCs can be categorized into the following types:

4.1.2.1. Asset finance company (AFC)

An AFC is a company which carries its principal business of financing physical assets supporting production and economic activity, like tractors, automobiles, electric power sets, earth moving trucks and general purpose manufacturing equipments. Principal business for the same is defined as summative of financing physical assets assisting economic activity. The income earned from these is not <60% of its total assets and total income respectively.

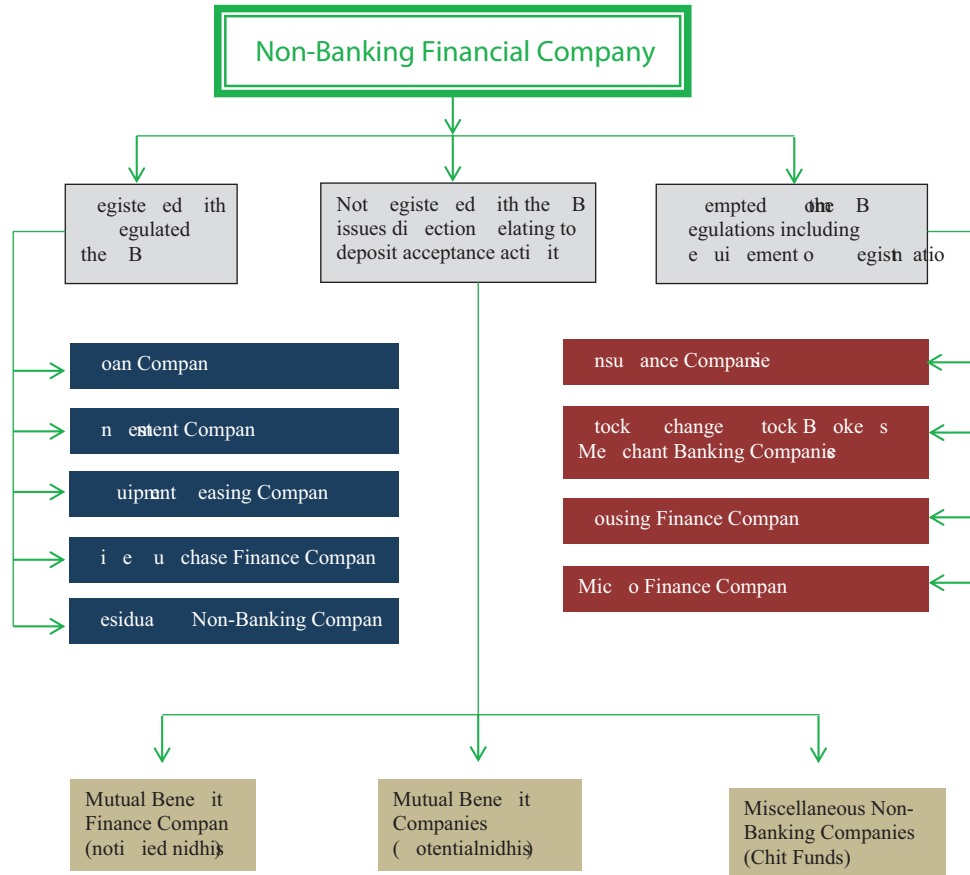
4.1.2.2. Investment company

Investment company means any company which is a financial institution having its prime business of acquisition of investment and securities.

4.1.2.3. Loan company

Loan company is defined as a company which having its prime business of affording of finance in the form of loans or advances or otherwise for any activity other than its own but does not include an AFC.

Figure 1: The structure of NBFCs in India



Source: Reserve Bank of India

4.1.2.4. Infrastructure finance company (IFC)

IFC is a NBFC (a) which invests minimum 75% of its total assets in infrastructure loans, (b) has at least net owned funds (NOFs) of Rs. 300 crore, (c) has a minimum credit rating of ‘A’ or equivalent (d) and a Capital adequacy ratio of 15%.

4.1.2.5. Systemically important core investment company

Systemically Important Core Investment Company is an NBFC which has a prime business of acquisition of shares and securities and fulfills the following conditions:

- It holds not <90% of its Total Assets has invested in preference shares, equity shares, debt or loans in group companies.
- It has investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not <60% of its total assets.
- It does not trade in its investments in shares, debt in group companies except through block sale for the purpose of disinvestment.
- It does not has any other financial activities defined in section 45I(c) and 45I(f) of the reserve Bank of India act, 1934 except investment made in bank deposits, government securities, money market instruments, investments made in debt instruments or guarantees issued on behalf of group companies.
- It has asset size is Rs. 100 crore or above, and
- It accepts public funds.

4.1.2.6. NBFCs - Infrastructure debt fund

NBFC (infrastructure debt fund) is a company registered as NBFC to provide long term debt for infrastructure projects. These companies raise funds by issuing of Rupee or Dollar denominated bonds of having maturity period of minimum 5 years. Only infrastructure finance companies can support NBFC (infrastructure debt fund).

4.1.2.7. NBFC - micro finance institution (NBFC-MFI)

NBFC-MFI is a non-deposit accepting NBFC, which has not <85% of its assets in the form of qualifying assets and fulfills the following condition:

- Loan issued by an NBFC-MFI to a borrower who have a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000.
- The amount of loan does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in the subsequent cycles.
- Total indebtedness of the borrower does not exceed Rs. 50,000.
- Term of the loan not to be <24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty.
- The period of loan to be extended without collateral
- Aggregate amount of loans, given for income generation, is not <75% of the total loans issued by the MFI.
- Loan is repayable on weekly, fortnightly or monthly installments at the convenience of the borrower.

4.1.2.8. NBFC - Factors (NBFC-factors)

NBFC-factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 75% of its total assets and its income derived from factoring business should not be <75% of its gross income.

5. ROLE OF NBFCs

NBFCs like banks and other financial institutions act as intermediaries between the ultimate savers and the ultimate borrowers. Financial intermediaries can provide a more economical service because of the economies of scale, their professional expertise and their ability to spread the risk over a large number of units. Thus, their operations give to the saver the combined benefits of higher return, lower risk and liquidity. The borrowers on the other hand also get a wider choice on account of intermediation of financial institutions. It may be of relevance to note that while the loans granted by commercial banks are, by and large, for industrial, commercial and agricultural purposes, those granted by NBFCs are generally for transport, trading, acquisition of durable consumer goods, purchase and repair of houses or just for plain consumption. Since their activities are not controlled by monetary authorities to the same extent as those of commercial banks, the credit extended by NBFCs may not necessarily be in consonance with national objectives and priorities. The major function of financial intermediaries is to transfer the savings of surplus units to deficit units; hence, they can play a useful role in the economy of the country.

The Reserve Bank of India expert committees identified the need of NBFC in the following areas:

- Development of sectors like transport and infrastructure
- Substantial employment generation
- Help and increase wealth creation
- Broad base economic development
- Irreplaceable supplement to bank credit in rural segments
- Major thrust on semi-urban, rural Areas and first time buyers/users
- To finance economically weaker sections
- Huge contribution to the state exchequer.

5.1. Contributions in Financial Services (NBFCs vs. Banks)

In India financial institutions including banks and NBFCs provide some or all of the following core financial services. These services are often provided in combinations:

- (i) Some financial institutions provide payments services - by issuing claims that have the capacity to be used in settling transactions. To serve as an effective means of payments, a claim must have a highly stable and reliable value, be widely accepted in exchange and must be linked to the arrangements for ultimate settlement of value.
- (ii) Liquidity is the ease with which an asset's full market value can be realized once a decision to sell has been made. Financial institutions enhance liquidity through specialization and scale.
- (iii) Divisibility is the extent to which an asset can be traded in small denomination. Financial institutions break up large

denomination claims and aggregate small denomination claims to meet divisibility preferences of the community.

- (iv) Store of value is the extent to which an asset provides a reliable store of purchasing power overtime – this is fundamental to satisfying savings preferences.
- (v) Information is costly to access and process. Providing economies of scale in processing and assessing risks is an important role of financial institutions.
- (vi) Risk pooling is the extent to which an asset spreads the default risk of the underlying promises by pooling. By pooling assets, financial institutions have much scope to risk pool than do individuals.

5.1.1. Specific roles of NBFCs

The NBFCs play a range of roles that are not suitable to banks:

- (i) Through the enhancement of equity promises (adding liquidity, divisibility, informational efficiencies and risk pooling services), NBFCs broaden the spectrum of risks available to investors. In this way they encourage investment and savings and improve the efficiency of investment and savings.
- (ii) Through the provision of contingent promises they foster a risk management culture by encouraging those who are least able to bear risk to sell those risks to those better able to manage them.
- (iii) They can enhance the resilience of the financial system to economic shock. NBFCs complement banks by providing services that are not well suited to banks; they fill gaps in financial services that otherwise occur in bank based financial systems.
- (iv) Equally important, NBFCs provide competition for banks in the provision of financial services. NBFCs unbundle bank services and compete with them as providers. They specialize in particular sector and target particular groups.

5.1.2. Role of NBFCs in economic development

There is a growing body of hard evidence to suggest that the development of financial intermediaries contribute strongly to economic development of the country. This contribution is increased where intermediation is provided through a balanced combination of banks and NBFCs. In particular, there is a strong correlation between the depth and activeness of non-banks and stock markets on the one hand, and economic development on the other hand.

NBFCs play many important roles that are not suitable for banks and through their provision of liquidity divisibility, informational efficiencies, and risk pooling services, they broaden the spectrum of risks available to foster a risk management culture by attracting customers who are least able to bear risks and fill the gaps in financial services that otherwise occur in bank based financial systems.

5.1.3. Role of NBFCs in financial stability

In a financial sector in which NBFCs are comparatively undeveloped, banks will inevitably be required to assume risk that otherwise might be borne by the stock market, collective investments schemes or insurance companies. However, there is basic incompatibility between the kinds of financial

contracts offered by the banks and those offered by the financial institutions. Thus, banks are more likely to fail as a result. One way of minimizing financial fragility in the developing economies may be to encourage a diversity of financial markets and institutions, where investors are able to assume a variety of risks outside the banking system itself. Without this diversity, there is a tendency for all risks to be bundled within the balance sheet of the banking system, which may lead to severe financial crises more likely. This point was widely noted by policymakers in their analysis of the lessons of the Asian currency crisis, for instance.

5.1.4. Role of NBFCs in financial inclusion

Financial inclusion has been defined as the “provision of affordable financial services” to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include “payments and remittance facilities, savings, loan and insurance services”. Micro finance has been looked upon as an important means of financial inclusion in India. Microfinance is not just provision of micro credit but also other services in small quantities to the poor i.e. providing essential financial services to the poor in an affordable way. Financial Inclusion also is aiming at the same by providing the poor with not only deposit accounts or credit but also insurance and remittance facility.

As articulated by the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Mor Committee) in its report, on both Financial Inclusion (defined as the spread of financial institutions and financial services across the country) and Financial Depth (defined as the percentage of credit to GDP at various levels of the economy) the overall situation remains very poor and, on a regional and sectoral basis, very uneven.

While the Reserve Bank’s model for financial inclusion is essentially bank-led, we believe that non-bank entities do have space to partner banks in the financial inclusion initiatives. We have enabled non-bank entities as Business Correspondents of banks to achieve the larger goal of financial inclusion. NBFCs and MFIs form the significant part of the financial sector which has deeper reach in the rural areas. NBFC-MFIs do not formally figure in the bank led model of financial inclusion but they by their wider and deeper reach can be catalysts in providing the necessary handhold to the poor borrowers to gain access to essential financial services. The Mor Committee has observed that each of the channels, be they large National Banks, regional cooperative banks, or NBFCs have a great deal of continuing value to add by focusing on its own differentiated capabilities and accomplish the national goals of financial inclusion by partnering with others that bring complementary capabilities to bear on the problem.

5.1.5. Role of NBFCs in capital market

Investment activity of NBFCs sector comprises a significant of their total assets. These constitute mainly investments in capital market. There are specialized NBFCs that are exclusively engaged in capital market investment i.e. trading in securities. These NBFCs therefore help in giving liquidity to the capital market. Further, NBFCs also lend to investors for investing in capital market. Regulatory challenges in this regard might come in the form of probable overheating of the market, which could

be addressed through appropriate regulatory measures including enhanced disclosures.

5.1.6. Role of NBFCs in factoring

Factoring as defined in the factoring regulation act, 2011 involves acquisition of receivables (by a factor) thereby getting entitled to undivided interest on the receivables or financing against the security interest over any receivables but does not include credit facilities provided by a bank in its ordinary course of business against security of receivables. Subsequent to the notification of the Factoring Regulation Act by the Government, Reserve Bank formed a new category of NBFCs called NBFC-factors and issued directions to them. NBFC-Factors are almost exclusively engaged in providing factoring service. Factoring service which is perceived as complimentary to bank finance is expected to enable the availability of much needed working capital finance for the small and medium scale industries especially those that have good quality receivables but may not be in a position to obtain enough bank finance due to lack of collateral or credit profile. By having a continuous business relationship with the Factor in place, small traders, industries and exporters get the advantage of improving the cash flow and liquidity of their business as also availing ancillary services like sales ledger accounting, collection of receivables, credit protection etc. Factoring helps them to free their resources and have a one stop arrangement for various business needs enabling smooth running of their business.

5.1.7. Role of NBFCs in infrastructure financing

Infrastructure Finance Companies and Infrastructure Debt Funds are NBFCs exclusively into financing the infrastructure sector. Some of these companies have asset books running to lakhs of crores of rupees and are experts in long term project financing. Recognizing their significance, the Reserve Bank has given special dispensations in the form of enhanced bank credit, higher exposure norm ceiling and provision of ECB under automatic route for on-lending to infrastructure sector. The asset liability pattern however, is a matter of concern in the case of IFCs as these are lending long term against comparatively shorter term liabilities.

5.2. Problems and Challenges of NBFCs in India

The new regulations announced by the RBI are welcome in certain aspects as it is necessary to have higher capital adequacy norms and also better management of funds. But there is confused thinking about how NBFCs should mobilize resources and increase their hire purchase and leasing business. The failure of CRB Corporation and the fiasco following default by many nidhis in their obligations to depositors have obviously been responsible for the monetary authorities to take a severe view of the operations of NBFCs. However, the latest moves are in strong contrast with those adopted in earlier years when it was pointed out that NBFCs should mobilize resources on their own and not depend to any great extent on bank finance or term loans from financial institutions. The ratios for accepting deposits from the public in relation to owned funds were liberally conceived and only recently AAA companies were allowed to accept deposits or fix interest rates without any limit.

The new stipulations relating to the acceptance of deposits by differently rated companies will cause hardship to those which have been placing greater reliance on deposit mobilization rather than on securing credit from banks. The latter also were adopting a step-motherly attitude towards NBFCs due to an impression that they were competitors and transacting business with banks funds which could have been handled by them. Judging by the reaction of the managements of even the better placed NBFCs, the ratios relating to deposits and NOFs would have to be revised for preventing a stunting of growth of those NBFCs which have been functioning efficiently and against whom there were no complaints from depositors about repayments on maturity date or regular payment of interest charges. Apart from the fact, further growth can be ensured only with higher cash credit limits and gathering of resources through NCDs. The compulsion to refund excess deposits may have nullifying effects during the interregnum as additional resources raised in other forms will have to be utilized for refunding excess deposits.

It has therefore been represented by many NBFCs that the maximum ratios should be revised to five times of NOFs and a period of two or three years should be allowed for refunding excess deposits or effecting the necessary adjustments. If the scope for securing funds in the desired manner is made available, the monetary authorities can have effective supervision of the operations of the NBFCs concerned and prevent an increase in non-performing assets and help also the small and medium borrowers to get their requirements from NBFCs without undue delay at fairly reasonable interest rates. Since NBFCs may have to play a more important role when economic growth gets accelerated there will be need for larger volume of assistance against hire purchase and lease contracts. There should thus be a pragmatic approach to outstanding issues, as stated above, for securing a better coordination of the activities of banks financial institutions, NBFCs and others.

6. CONCLUSIONS

NBFCs form an integral part of the Indian financial system. They have been providing credit to retail customers in the underserved and unbanked areas. Their ability to innovate products in consonance to the needs of their clients is well established. They have played a key role in the development of important sectors like Road Transport and Infrastructure which are the life lines of our economy. This role has been well recognized and strongly advocated for, by all the Expert Committees and Taskforces setup till date, by Government of India and Reserve Bank of India. NBFCs are emerging as an alternative to mainstream banking. Besides, they are also emerging as an integral part of Indian financial system and have commendable contributions towards Government's agenda of financial Inclusion. They have been to some extent successful in filling the gap in offering credit to retail customers in underserved and unbanked areas. The relevance of the findings of this study lies in the fact that risk plays an important role in NBFCs performance. Risk management should be within the purview of risk managers as well as the Central Bank of the country.

The findings of the study suggest that prudent risk management practices or lower risk-taking incentives on the part of Indians NBFCs lead to a significant increase in their performance. It is further suggested that regulatory authorities should take into consideration the impact of the risk-taking activities of NBFCs on their performance and embark on more close inspection and enforcement of regulations. These actions will go a long way to help improve the performance of the NBFI sector which would aid in strengthening the financial system of the country.

REFERENCES

- Amita, S.K. (1997), Financial performance of non-banking finance companies in India. *The Indian Economic Journal*, 49(1), 86-92.
- Balachandran, V. (2006), Financial performance of non-banking financial companies. *Southern Economics*, 12, 34-42.
- Dubey, Shubhashish. (2007), NBFCs: Is the Future Bright? Available from: <http://www.123eng.com/forum/viewtopic.php?t=11936&start=0&postdays=0&postorder=asc&highlight>.
- Ebong, B.B. (2005), The banking industry and the Nigerian economy: Post consolidation. *Union Digest*, 9, 17-30.
- Fase, M.G.G., Abma, R.C.M. (2003), Financial environment and economic growth in selected Asian countries. *Journal of Asian Economics*, 14, 11-21.
- Gayathri, B., Madhusudhanan, T.P. (2000), Developed financial sector in NBFCs-an investigation of the Indian case. *Management and Accounting Research*, 13, 33.
- Goldsmith, R.W. (1969), *Financial Structure and Development*. New Haven, CT: Yale University Press.
- Gurley, J.E., Shaw, E.S. (1960), *Money in a Theory of Finance*. Washington, DC: The Brooking Institution.
- Harihar T.S. (1998), Non-Banking Finance Companies, the Imminent Squeeze. *Chartered Financial Analyst*. p40-47.
- Hossain, M., Shahiduzzaman, M. (2002), Development of non-bank financial institutions to strengthen the financial system of Bangladesh. *Journal of Bangladesh Institute of Bank Management*, 28(1), 1-21.
- Jafor, A.A. (2009), Non-performing assets management of non-banking financial companies: An introspection. *The Management Accountant*, 44(2), 132-137.
- Joshi, V., Little, I.M.D. (1996), *Indian Economic Reforms*. Oxford: Oxford University Press.
- Khalil, A. (2011), Financial performance of non-banking finance companies in Pakistan. *Interdisciplinary Journal of Contemporary Research in Business*, 2(12), 732-744.
- Kumar, A.P., Afroze, N. (2014), An empirical analysis of capital adequacy in the Indian private sector banks. *American Journal of Research Communication*, 2, 28-42.
- Kumar, A.P., Naresh, M. (2013), Performance appraisal of Indian public sector banks. *World Journal of Social Sciences*, 3, 71-88.
- Kumar, A.P., Sanjeev, D. (2014), Financial performance assessment of banking sector in India: A case study of old private sector banks. *The Business and Management Review*, 5, 196-211.
- Kumar, A.P., Sanjeev, D. (2016), CAMELS rating model for evaluating financial performance of banking sector: A theoretical perspective. *International Journal of System Modeling and Simulation*, 1, 10-15.
- Kumar, M.S., Kumar, A.P. (2013), A camel model analysis of state bank group. *World Journal of Social Sciences*, 3(4), 36-55.
- Lakshmi, R. (1998), Promotion, Diversification and Growth Strategies of NBFCs. Vol. 1998. Bangalore: Indian Institute of Management. p13.
- Levine, R., Loayza, N., Beck, T. (1999), Financial intermediation and growth: Causality and causes. *Journal of Monetary Economics*, 46, 31-77.
- Machiraju, H.R. (1998), *Indian Financial System*. London: Sangam

Books Limited.

- Patra, M.D., Roy, S. (2002), *Financial Stability-A Survey of Indian Experience*. Reserve Bank of India.
- Perumal, A., Satheskumar, L. (2013), *Non-banking financial companies*. Asia Pacific Journal of Research, 2(8), 128-135.
- Raj, J. (1999), *A Study of Non-Banking Financial Intermediaries in India with Special Reference to their Implications for Monetary Policy*. Mumbai: Unpublished Thesis Indian Institute of Technology. As Quoted in Report and Currency, Reserve Bank of India.
- Rengarajan, C. (1997), *Roles of NBFCs Non-Banking Finance Companies*. Indian Express.
- Shanker, R. (1996), *Winds of Change, India Leasing Year*. Mumbai: Popular Prakashan Pvt. Ltd.
- Shollapur, M.R. (2005), *The process of strategic marketing in non-banking financial companies*. The Indian Journal of Commerce, 58(4), 101-112
- Shonekan, E.A. (1997), *The relevance of financial sector to vision 2010*. The Nigerian Banker, 1, 17.
- Sorab, S. (1999), *Non-banking financial companies in the present Indian scenario-strategic analysis*. Asian Economic Review, 141(2), 309.
- Sornaganesh, V., Soris, N., Maria, N. (2013), *A fundamental analysis of NBFC in India, outreach*. A Multi-Disciplinary Refereed Journal, 6, 119-125.
- Sundaram, S.M. (2010), *Performance of non-banking financial companies-a study with reference to Karaikudi based companies*. Industrial Herald, 12, 12-21.
- Suresh, V. (2011), *Performance of non-banking financial companies in India - An evaluation*. Researchers World Journal of Arts Science and Commerce, 2(1), 123-131.
- Vaidyanathan, R. (2001), *Indian Financial System: The Unorganized Sector, Integration is the Key*. Chartered Financial Analyst.
- Vittas, D. (1997), *The role of non-bank financial intermediaries in Egypt and other Mena countries*. World Bank Policy Research Working Paper; No. 1892. p1-41.