Non-Banking Financial Institutions of India- Their Onset, Growth and Performance of Selected NBFCs

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Abstract

Over more than four decades since 1964, when Chapter III B was included in the Reserve Bank of India Act, 1934, assigning limited authorities to the Bank to regulate deposit taking *companies, the Reserve Bank of India has initiated measures to bring the non-banking financial* sector (NBFC) sector of the economy within the realm of its regulation. January 1997 witnessed drastic changes in the RBI Act, 1934, especially Chapters III-B, III-C, and V of the Act with the fundamental objective of putting in place a complete regulatory and supervisory structure, aimed at protecting the interests of depositors as well as ensuring the robust functioning of NBFCs.

In the period following the amendment of the Act in 1997, the non-banking financial sector has evolved substantially in terms of operations, variety of market products and instruments, technological sophistication etc. Further, in recent years the NBFCs have gained paramount significance by adding significant depth to the overall financial sector.

In light of the growing significance of NBFCs as a key player in broadening the financial base of India, it generates paramount academic and research interests to delve deep into its onset, growth and performance.

Keywords: Onset of NBFCs; Growth of NBCs; Performance

JEL Classification:- G23: Non-bank Financial Institutions

Full-length paper

Introduction

Non-Banking Financial Companies (NBFC) in India made a humble beginning way back in the 1960's to serve the need of the savour and investor whose financial requirements were not sufficient covered by the existing banking system in India. The NBFCs began to invite fixed deposit from investor and work out leasing deal for big industrial firms. Initially, they operated on a limited scale and could not make a significant impact on the financial system. However, between 1980's and 1990's, NBFCs gained good ground and started to inveigle a huge number of investors owing to them customer friendly reputation.

Non-Banking Financial Companies or NBFCs in India are registered companies conducting business activities similar to regular banks. Their banking operations encompass making loans and advances available to consumers and businesses, acquisition of marketable securities, leasing of hard assets such as automobiles, hire-purchase and insurance business. Though they are akin to banks, they differ in couple of ways. NBFCs cannot accept demand deposits, cannot issue cheques to customers and the deposits with them are not insured by DICGC (Deposit Insurance and Credit Guarantee Corporation). Either the RBI (Reserve Bank of India) or SEBI (Securities and Exchange Board of India) or both regulate NBFCs.

The NBFC sector in India has witnessed significant vicissitude over the past few years and has come to be recognized as a systematically key element of the financial system. The NBFC segment has witnessed consolidation over the recent past, especially in the NBFC-ND-SI segment. Indeed it is evident in India that with the development of NBFCs segment within the overall financial system, it challenged the other segments, i.e. banks to innovate, to improve quality and competence, and deliver at flexible timings and at competitive prices. In fact, in a number of un-treaded trajectories, NBFCs were the ones to foray first to explore the market and develop before banks entered the field.

NBFCs are broadly classified into two categories based on whether they accept public deposits, i.e. NBFC-Deposit taking (NBFC-D) and NBFCs-Non-Deposit taking (NBFC-ND). Besides, there are only two residuary non-banking finance companies (RNBCs) which are also deposit taking companies of different character. In the recent years, infrastructure finance have gained steam, and NBFCs engaged in infrastructure finance are called 'Core Investment Companies'.

Literature Review

There is universal agreement that a properly functioning financial system is required for a thriving modern economy (Kroszner, 2010). In all advanced economies, for instance, sophisticated financial systems efficiently deliver a broad range of financial services and act as a critical pillar in contributing to macroeconomic stability and sustained economic growth and prosperity (World Bank, 2003). Moreover, the well developed financial markets facilitate mobilization of savings, by offering savers and investors wider choice of instruments. With NBFCs coming up on the financial system, investors could park their funds at more lucrative returns in comparison to the bank deposits.

Referring to NBFIs, Greenspan (1999) had stated: "enhance the resilience of the financial system to economic shocks by providing it with an effective 'spare tyre' in times of need". Moreover, while short term loans needed by the industry and agriculture are offered by the banking system, the other forms of services needed by industry as well as other segments of economy are offered by NBFCs and other similar financial institutions, like factoring, venture finance and so on.

Hasriman Kaur A. and Dr.Bhawdeep Singh Tanghi (2013) analyzed that NBFCs played an essential role in terms of macroeconomic prospective as well as strengthening the structure of the Indian monetary system. Consolidation in the sector and better regulatory structure has become more focussed.

Dr.Amardeep (2013) analysed 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 economies in the world have relied heavily on lease finance route in their development process".

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

Research Methodology

F-Test (Two Way or Manifold Classifications): This statistical tool will assist in gauging the financial performance of three selected NBFCs, which have been selected for the study on a random basis. The three samples of NBFCs considered for the study are- L&T Finance; Mahindra & Mahindra Financial Services Ltd. and Shriram Transport Finance Corporation. The two factors that have been considered for the analysis are a) Three NBFCs as mentioned and b) Financial Performance Parameters comprising of a) Net Sales / Net Revenue from Operations; b) Profit / Loss Before Tax and c) Profit After Tax / Profit or Loss for the period.

Limitations of the study

1) The study is based on secondary data.

2) Due to technical constraints all NBFCs could not be considered.

Growth of NBFCs

It can be said without an iota of doubt that NBFCs have scripted a great success story. Their contribution to the economy has grown substantially from 8.4% in 2006 to more than 14% in March 2015. In terms of financial assets, NBFCs have registered a robust growth, i.e. a compound annual growth rate (CAGR) of 19% over the past few years, consisting of 13% of the total credit and estimated to reach nearly 18% by 2018-19.

The success of NBFCs can be clearly attributed to their superior product lines, lower cost, broader and effective reach, robust risk management capabilities to check and control bad debts, and proper comprehension of their customer segments. Not only they have displayed success in their conventional citadel (passenger and commercial vehicle finance) but they have also managed to build significant assets under management (AUM) in the personal loan and housing finance sector which have been the bread and butter for retail banks. Moving ahead, the latent credit demand of an emerging India will permit NBFCs to bridge the gap, particularly where traditional banks have been cagey to serve. Additionally, improving macroeconomic conditions, higher credit penetration, enhanced consumption and disruptive digital trends will allow NBFCs credit to rise at a robust rate of 7-10% in the coming years (Please refer exhibit 1).

Within NBFC space, different sub-segments have surfaced up which are more dominant than others. Mortgages, microfinance and unsecured loans appear to be driving growth. According to estimates, credit grew at an astounding 30 percent (y-o-y) for mortgages and 80 percent plus for microfinance as of December 2015. Housing finance companies have enhanced their share of the overall pie from 26 percent in FY09 to 38 percent in FY15. NBFCs also have giant share in niche segments, like, commercial vehicle finance, the share estimated to have risen from 42 percent to 46 percent in the last three years ending FY15.

According to a report by BCG, India's credit-GDP ratio stood at 97 percent as of FY15 versus 165 percent in China, 149 percent in Germany, 244 percent in the US and 447 percent in the UK. This means huge scope for credit market in India as a whole. Interestingly, for the same year, the NBFC-credit-to-GDP ratio in India was merely 13 percent, versus 33 percent in China, 29 percent in Germany, 130 percent in the US and 264 percent in the UK. If one observes this fact that largest segment in the banking sector is witnessing some challenges, then the opportunities to grow is expected to be higher.

Non-banking financial companies improved their performance on most metrics in the fiscal year 2015, as the banking industry struggled under the weight of a rising pile of bad loans. According to the financial stability report (FSR) released on June 2016 mentioned that NBFC loans expanded 16.6% in the year, twice as fast as the 8.8% credit growth across the banking sector on an aggregate level. The aggregate balance sheet of the NBFC sector expanded 15.5% in fiscal 2016 compared with 15.7% in the year 2015.

Looking at the non-food credit data compiled by Reserve Bank of India it can be observed that NBFCs have started moving at twice the pace of the banks. An intonation point was reached around September 2014, when, for the first time, NBFCs crossed scheduled commercial banks in terms of year-on-year credit growth (please refer exhibit 2).

In August 2016, the union cabinet has given nod for foreign direct investment (FDI) under the automatic route in regulated NBFCs. According to a report released in the beginning of 2016 by consulting firm PwC India stated that by 2020, credit lending by Indian NBFCs is estimated to account for anywhere between 18.2% and 20.9% of the total credit off-take in the country.

Gauging Performance of Selected NBFCs

This section throws light on the performance of selected NBFCs, i.e. L&T Finance; Mahindra & Mahindra Financial Services Ltd. and Shriram Transport Finance Corporation. In order to ascertain as to whether the three mentioned NBFCs are on equal footing or not, two variables or factors that have been considered are- the three NBFCs mentioned above and Financial Performance Parameters- Net Income or Net Sales / Net Revenue from Operations; Profit Before Tax and Profit After Tax / Profit or Loss for the period.

Null Hypothesis:

H0 : a) The mean financial performance on the basis of three financial parameters (Mean Net Income or Net Sales / Net Revenue from Operations; Mean Profit Before Tax and Mean Profit After Tax / Profit or Loss for the period) is same for all the three NBFCs

b) The three NBFCs do not differ with reference to mean performance.

Alternative Hypothesis:

H1: a) The mean financial performance on the basis of three financial parameters (Mean Net Income or Net Sales / Net Revenue from Operations; Mean Profit Before Tax and Mean Profit After Tax / Profit or Loss for the period is not same for all the three NBFCs.

b) The three NBFCs do differ with reference to mean performance.

The Mean values of three financial parameters are as follows:

Years	**L & T Finance**			**Mahindra & Mahindra Financial Services Ltd.**			**Shriram Transport Finance Corporation**		
	NET INCOME	**PBT**	**PAT**	**NET INCOME**	**PBT**	**PAT**	**NET INCOME**	**PBT**	**PAT**
March 2012	2,980.90	684.25	454.80	2,884.90	961.30	644.52	6,178.74	1,957.51	1,308.75
March 2013	3,956.76	988.61	729.19	4,094.99	1,352.66	928.91	7,014.43	2,162.66	1,463.89
March 2014	5,055.94	824.88	594.84	5,275.23	1,461.53	964.77	8,476.02	1,970.46	1,357.94
March 2015	6,196.23	1,174.82	850.71	6,021.14	1,399.87	924.87	9,177.00	1,649.56	1,028.44
March 2016	7,288.79	1,252.67	853.69	6,553.87	1,224.12	787.40	10,310.29	1,789.28	1,183.62
Mean Values	5,095.72	985.046	696.646	4,966.03	1279.896	850.094	8,231.30	1,905.89	1,268.53

Financial Parameters	**NBFCs**			
	L & T Finance (in INR Crore)	**Mahindra & Mahindra Financial Services Limited (in INR Crore)**	**Shriram Transport Finance Corporation (in INR Crore)**	**Total**
Mean Net Income or Net Revenue from Operations	5,095.72	4,966.03	8,231.30	18,293.05
Mean Profit Before Tax	985.046	1279.896	1,905.89	4170.832
Mean Profit After Tax	696.646	850.094	1,268.53	2815.27
Total	6,777.41	7,096.02	11,405.72	
Mean ($\bar{X}$)	2259.14	2365.34	3801.91	**T = 25279.15**

Here N = 9

Correction Factor C = T² / N = $(25279.15)^2 / 9 = 71003936.08$

SST = Total Sum of Squares = $\sum\sum X^2_{ij} - C$

$= [(5095.72)^2 + (985.046)^2 + (696.646)^2 + (4,966.03)^2 + (1279.896)^2 + (850.094)^2 + (8,231.30)^2 + (1,905.89)^2 + (1,268.53)^2] - C$

$= 25966362.32 + 970315.62 + 485315.65 + 24661453.96 + 1638133.77 + 722659.81 + 67754299.69 + 3632416.69 + 1609168.36 = 127440125.9 - 71003936.08 = 56436189.82$

SSC = Sum of squares between Columns (NBFCs)

$= (6777.41)^2 / 3 + (7096.02)^2 / 3 + (11,405.72)^2 / 3 - C$

$= 15311095.44 + 16785351.48 + 43363482.91 - 71003936.08 = 4455993.75$

SSR = Sum of squares between rows (Financial Parameters) = $(18293.05)^2 / 3 + (4170.83)^2 / 3 + (2815.27)^2 / 3 = 111545226.1 + 5798607.63 + 2641915.06 = 119985748.8 - 71003936.08 = 48981812.72$

Residual or Error SSE = SST – (SSC + SSR) = $56436189.82 - (4455993.75 + 48981812.72) = 2998383.35$

The various sums of squares are put in the following Two-way ANOVA Table.

ANOVA TABLE

Source of variation	Sum of squares	Degree of freedom (v)	Mean square = Sum of squares / d.o.f.	F-Ratio
Between NBFCs	4455993.75 = **SSC**	3-1 = 2	**SSC / d.o.f. = 2227996.88**	**F_C = 2.97**
Between Financial Parameters	48981812.72 = **SSR**	3-1 =2	**SSR / d.o.f. = 24490906.36**	**F_R = 32.67**
Residual (Error)	2998383.35 = **SSE**	(3-1) (3-1) = 4	**SSE / d.o.f. = 749595.84**	
Total	**56436189.82**	**8**		

Decision: a) The computed value of F_C = 2.97 < the table value of F at $\alpha = 0.05$ and for 2 and 4 degrees of freedom = $F_{0.05}$ (2,4) = 6.94 ⇒ the null hypothesis is accepted ⇒ H1 is rejected ⇒ the mean financial performance on the basis of three financial parameters (Mean Net Income or Net Sales / Net Revenue from Operations; Mean Profit Before Tax and Mean Profit After Tax / Profit or Loss for the period) is same for all the three NBFCs.

b) Since F_R = 32.67 > the table value of F at $\alpha = 0.05$ and for 2 and 4 degrees of freedom = $F_{0.05}$ (2,4) = 6.94 ⇒ the null hypothesis is rejected ⇒ H1 is accepted ⇒ the three NBFCs do differ with reference to mean performance.

Way Forward

For a huge and diverse country like India, ensuring financial access to fuel growth and entrepreneurship is essential. With the commencement of government-backed schemes, such as the Pradhan Mantri Jan-Dhan Yojana (PMJDY), there has been a significant jump in the number of bank accounts; however, only 15% of the adults have reported using an account to make or receive payments. The government and regulatory bodies have initiated vital measures to enhance this number and subsequently financial access by granting in principal licenses to as many as 21 players to set up specialty banks in the coming time. This is over and above the focussed approach of the other industry bodies like the National Payments Corporation of India (NPCI) to further solidify and augment the payments biome by launching the Unified Payment Interface (UPI) and Bharat Bill Payments System.

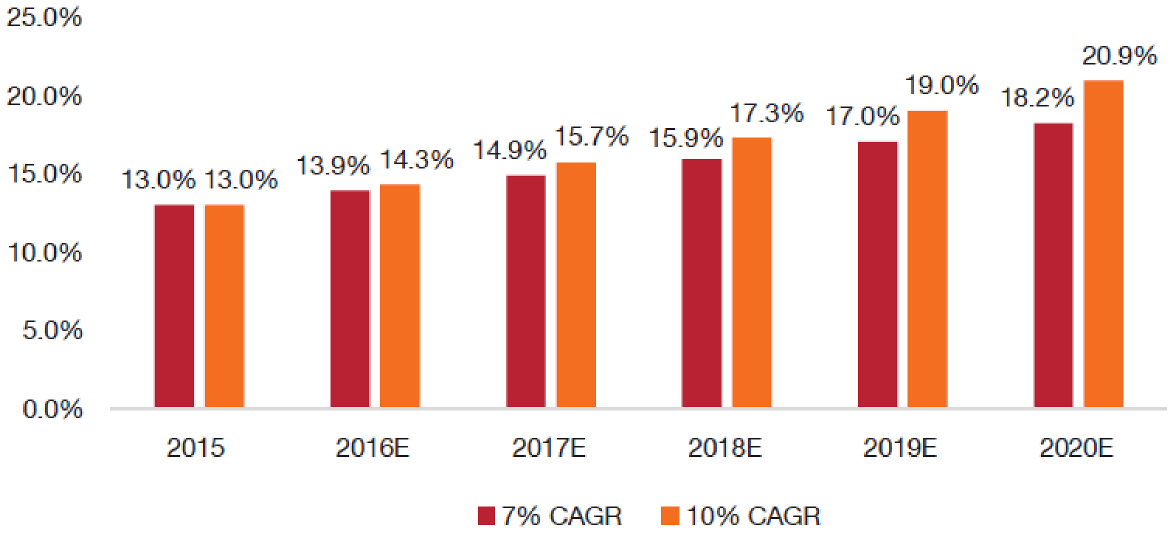
The onset of such specialized players and systems will definitely play in a crucial role in the metamorphosis of the banking value chain in its entirety. This offers a strategic opportunity for NBFCs to ensure sustainable growth over a long term. Partnerships with payment banks, bill payment providers and other financial institutions, like, insurance and asset management companies, will assist NBFCs offer the complete proposition, i.e. from deposits to lending, investments and transactions. The reach of NBFCs, along with their robust understanding of the market, can assist them position themselves as a better option to the conventional ways of banking. Further, more and more consumers are espousing digitalization in India and is currently the second biggest smartphone market, with a user base of 220 million, and is expected to surpass 300 million users by 2017. In view of this, NBFCs can rework on their strategy to increase their product portfolio (positioning and pricing), processes (internal and customer facing) and end-to-end customer experience. Additionally, they can leverage the vast digital and social customer data available to serve customers in a better manner.

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

The credit appraisal systems of non-banking financial companies (NBFC) have been reasonably well so far. With their inherent ability to move fast and to tap into specific customer segments, it seems that NBFCs would be able to transfer these benefits in meeting the non-corporate needs of the economy, including those of SMEs and retail customers. With an estimate suggesting that more than 50 percent of micro, small and medium enterprises (MSMEs) do not have reach to formalized credit, the need statement cannot be overstated. Other than the opportunity in SME financing, enhanced penetration for housing will surely drive double-digit growth over the next decade. India’s housing finance segment continues to display huge potential for growth, and HFCs (Housing Finance Companies) with 40 percent of the share are clearly leading the way here. Moreover, as newer customer needs emerge from a digitally savvy customer segment, NBFCs could potentially open up new avenues for growth.

Exhibit 1

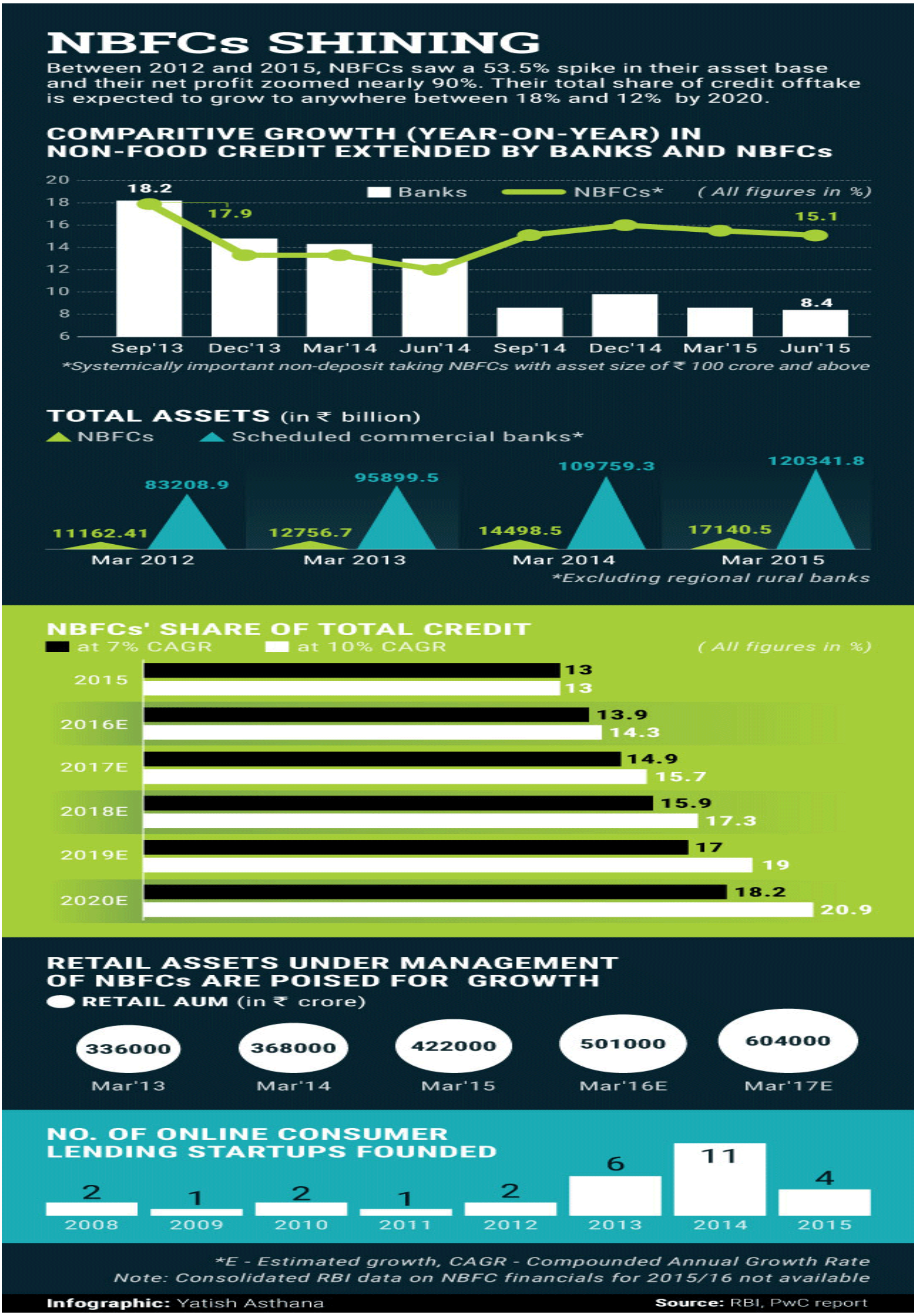
Credit Growth at NBFC as a % of Total Credit



Source: pwc

Exhibit 2

Comparative Growth (Year-on-Year) in Non-Food Credit Extended by Banks and NBFCs


NBFCs SHINING
Between 2012 and 2015, NBFCs saw a 53.5% spike in their asset base and their net profit zoomed nearly 90%. Their total share of credit offtake is expected to grow to anywhere between 18% and 12% by 2020.
COMPARITIVE GROWTH (YEAR-ON-YEAR) IN NON-FOOD CREDIT EXTENDED BY BANKS AND NBFCs
Banks
NBFCs*
(All figures in %)
20
18
16
14
12
10
8
6
18.2
17.9
15.1
8.4
Sep'13
Dec'13
Mar'14
Jun'14
Sep'14
Dec'14
Mar'15
Jun'15
*Systemically important non-deposit taking NBFCs with asset size of ₹ 100 crore and above
TOTAL ASSETS (in ₹ billion)
NBFCs
Scheduled commercial banks*
11162.41
83208.9
Mar 2012
12756.7
95899.5
Mar 2013
14498.5
109759.3
Mar 2014
17140.5
120341.8
Mar 2015
*Excluding regional rural banks
NBFCs' SHARE OF TOTAL CREDIT
at 7% CAGR
at 10% CAGR
(All figures in %)
2015
13
13
2016E
13.9
14.3
2017E
14.9
15.7
2018E
15.9
17.3
2019E
17
19
2020E
18.2
20.9
RETAIL ASSETS UNDER MANAGEMENT OF NBFCs ARE POISED FOR GROWTH
RETAIL AUM (in ₹ crore)
336000
Mar'13
368000
Mar'14
422000
Mar'15
501000
Mar'16E
604000
Mar'17E
NO. OF ONLINE CONSUMER LENDING STARTUPS FOUNDED
2
2008
1
2009
2
2010
1
2011
2
2012
6
2013
11
2014
4
2015
*E - Estimated growth, CAGR - Compounded Annual Growth Rate
Note: Consolidated RBI data on NBFC financials for 2015/16 not available
Infographic: Yatish Asthana
Source: RBI, PwC report

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