OPERATIONAL CONSTRAINTS OF NON BANKING FINANCIAL COMPANIES IN INDIA

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Abstract

Indian financial system is one of the strongest and safest monetary structures in the world. This earned several positive appreciations from several central Banks of economically forward nations. Indian financial system consists of several players, which includes Banks, NBFC’s, Micro finance companies, Small lenders etc. NBFC’s are second biggest financial players followed by Banks. RBI has taken several steps to monitor and support the performances of NBFC’s for the past 3 decades. NBFC’s posed many activities which got the attention of RBI for giving special attention towards it. Apart from this Government of India has also taken many policy based decisions towards the improvement of the NBFC’s in the recent times. This Article deals about the current challenging situation of the NBFC’s in special reference to its operational perspective.

Keywords: Non-Banking Financial Company, Credit growth, Refinance, Liquidity

Introduction

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the activity of lending loans and advances, acquisition of shares/stocks/bonds/securities issued by Government or local authority or other possible marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods or providing any services and sale/purchase/construction of immovable asset. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company. NBFC’s are also technically termed as Residuary non-banking company as well as shadow Banks.

Objectives of the Study

• To study about the fundamentals of Non-Banking Financial Companies in India
• To highlight the challenges faced by the NBFC’s in India
• To Discuss the steps taken by RBI to overcome practical difficulties faced by NBFC’s
Methodology

- Data Used: Secondary Data Collected through Journals, E-Magazines and the like
- Research Type: Descriptive

The Evolution of NBFC’s in India


Reserve Bank of India prepared Model Bill to manage the conduct of chit funds and referred to study cluster underneath the position of James S. Raj. In June 1974, study cluster counselled ban on Prize Chit and different Schemes directed the Parliament to enact a bill that ensures uniformity within the provisions applicable to chit funds throughout the country. Parliament enacted two acts specifically Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and Chit Funds Act, 1982. During Planning Era, Reserve Bank of India tried best to 'Manage Money's and evolve 'Sound Monetary' system however no abundant considerable success in realising social objectives of financial policy of the country.

Total Credit Mix Comparison in Indian Financial Sector (source RBI)

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Medium</th>
<th>Percentage as on 2008</th>
<th>Percentage as on 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PSU Banks</td>
<td>60%</td>
<td>47%</td>
</tr>
<tr>
<td>2</td>
<td>Private Banks</td>
<td>18%</td>
<td>24%</td>
</tr>
<tr>
<td>3</td>
<td>NBFC’s</td>
<td>12%</td>
<td>18%</td>
</tr>
<tr>
<td>4</td>
<td>Others</td>
<td>10%</td>
<td>11%</td>
</tr>
</tbody>
</table>

In December 1982, Dr Manmohan Singh, Governor of RBI appointed committee under the Chairmanship of 'Prof. Sukhamoychakravarty' to review functioning of standard in Indian monetary system. Committee suggested assessment of joints among the Banking Sector, the Non-Banking Financial Institutions and the Un-organised sector to examined different instruments of Monetary and Credit policy in terms of their effect on the Credit System and the economy.

Difference between NBFC and Bank

- Provides Banking services to People without holding a Bank license
- An NBFC is not required to maintain Reserve Ratios (CRR, SLR etc.)
- An NBFC cannot accept Demand Deposits
- An NBFC is not a part of the payment and settlement system
An NBFC cannot issue Cheques drawn on itself
Deposit insurance facility of the Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors, unlike banks
An NBFC cannot indulge Primarily in Agricultural, Industrial Activity, Sale-Purchase, Construction of Immovable Property
An NBFC companies working in Financial Body and Money handling

Types of NBFC’s in India

Asset Finance Company (AFC)

An AFC is a type of NBFC which is a financial institution carrying on as its primitive business the financing of physical assets supporting productive/economic. Primary business for this purpose is defined as aggregate of financing real/physical assets backing economic activity and income increasing therefrom is not less than 60% of its total assets and total income respectively.

Investment Company (IC)

IC is any company that is a financial institution which is involved in primitive business with the acquisition of securities.

Loan Company (LC)

LC means any institution that is a financial institution that are involved in principal business of allotting finance either by making loans or advances or for different activity other than its own but does not include an Asset Finance Company.

Infrastructure Finance Company (IFC)

Infrastructure finance company advances a minimum of three-fourths of their entire assets in infrastructure loans. The net possessed funds of this company is more than 30 crore and a minimum crediting rating of 'A' and the Capital to Risk-Weighted Assets Ratio is 15%.

Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC)

IDF-NBFC is a company registered as NBFC to promote the flow of long term debt into infrastructure projects. IDF-NBFC facilitates funds through Multiple-Currency bonds of minimum 5-year maturity. Only Infrastructure Finance Companies (IFC) can finance IDF-NBFCs.

NBFC-Factors

NBFC Factors has main business of factoring. (Factoring is a financial transaction and a type of borrower finance).
Gold Loan NBFC

NBFC’s sanction jewel loans for its clients through pledge of jewels. This is a conventional method of loaning by majority of NBFC’s. In India this kind of NBFC’s are the major runners within the financial system.

Residuary Non-Banking Companies (RNBCs)

Residuary Non-Banking Company is a kind of NBFC with its principal business of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are obliged to maintain investments as per norms of RBI, in addition to liquid assets.

Provisional NBFC Data (source RBI – Amount in 1000 crores )

<table>
<thead>
<tr>
<th></th>
<th>March 2017</th>
<th>March 2018</th>
<th>March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of companies</td>
<td>115</td>
<td>126</td>
<td>107</td>
</tr>
<tr>
<td>Deposits</td>
<td>306</td>
<td>319</td>
<td>326</td>
</tr>
<tr>
<td>Borrowings</td>
<td>1841</td>
<td>2318</td>
<td>2413</td>
</tr>
<tr>
<td>Total Liabilities/Assets</td>
<td>2781</td>
<td>3460</td>
<td>3799</td>
</tr>
<tr>
<td>Total Advances</td>
<td>2453</td>
<td>3110</td>
<td>3415</td>
</tr>
<tr>
<td>Investments</td>
<td>131</td>
<td>131</td>
<td>166</td>
</tr>
</tbody>
</table>

Key concerns of NBFC’s

Here are the major factors which affect the operational aspects of NBFC’s in India.

Borrowing Cost:

NBFCs face a higher cost of borrowings which is ultimately transferred on to their borrowers in the form of higher rate of interest on loans. It increases constrains and decreases profit margin which affects the credit rating with the banks in other hand. With a flow credit rating cost of funds increases further.

Capital Adequacy:

NBFCs face more difficulty when sourcing capital. The compression in profit margin impacts the ability to absorb private equity investment and meeting capital adequacy regulations becomes a continuing challenge.

Uncertainty about retail NCDs:

The uncertainty about whether the non-deposit taking NBFCs will be permitted to continue to tap retail NCDs is different source of concern. It has become more unpleasant after the recent comment by the RBI that only banks should be allowed to access public deposits. Earlier, the Rao committee report had suggested the opinion that retail NCDs amount to be a
back-door method of raising public deposits. If the underlying criteria is that NBFCs should not raise retail funds through NCDs, which can only increase issues for NBFCs. In fact, NCDs represent a prime avenue for NBFCs to broaden base their fund sourcing. Without access to this source NBFCs become more addictive on the banks. For small NBFCs, withdrawal of NCDs would create a challenge to their ultimate existence.

NBFC’s Credit Exposure as on Sept 2018 (source RBI)

<table>
<thead>
<tr>
<th>s. No.</th>
<th>Sector</th>
<th>% of Exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Industry</td>
<td>52.3</td>
</tr>
<tr>
<td>2</td>
<td>Retail Loans</td>
<td>22.1</td>
</tr>
<tr>
<td>3</td>
<td>Services</td>
<td>18.0</td>
</tr>
<tr>
<td>4</td>
<td>Other</td>
<td>4.6</td>
</tr>
<tr>
<td>5</td>
<td>Agriculture &amp; Allied Activities</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Bearish CP market:

The Commercial Paper market is facing a bearish scenario in line with the current slowdown in the economy. This has increased the funding challenges for NBFCs. Practically an NBFC should be able to raise 1/3rd of its liabilities from retail, 1/3rd from banks and 1/3rd from CPs and institutional placements. In the present dispensation, given the move to put pause on NCDs and given the sluggish CP market, NBFCs have ended up raising their dependence on banks. It is an constrain for the NBFC’s.

Fear of insolvency:

There are also latent solvency fears that the IL&FS debt default threw up as it was felt that its 200 plus subsidiaries and associated institutions may have contacts with many more funding companies in the system. The unprofitable loan issues resulting from an asset liability mismatch, ALM, many feel is not about to go away anytime soon as long-term funds for a long-term infrastructure, or building project just does not exist. Also, mindsets need to change in the NBFC’s.

Sector Wise Stressed Assets of NBFC’s (source RBI)

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>4%</td>
<td>6%</td>
<td>15%</td>
</tr>
<tr>
<td>Industry</td>
<td>8%</td>
<td>7%</td>
<td>14%</td>
</tr>
<tr>
<td>Services</td>
<td>21%</td>
<td>24%</td>
<td>32%</td>
</tr>
<tr>
<td>Retail</td>
<td>24%</td>
<td>41%</td>
<td>40%</td>
</tr>
</tbody>
</table>
RBI’s Initiatives to save NBFC’s from crisis

Reserve Bank of India relaxed liquidity formulations to enable flexibility in the financial markets and allowed more Banks’ lending to non-banking finance companies (NBFCs), which are facing asset-liability mismatches. It’s estimated that this move could free up as much as Rs 50,000 crore for lending to the sector as it suffers with refinancing maturing commercial paper and short-term loans.

The central bank said banks are allowed to raise their exposure to a single NBFC that doesn’t finance infrastructure to 15% of capital from 10% until the end of the year, thus making more funds available for big companies that are registered as NBFC’s in India. To encourage banks to sanction funds for non-banking finance companies (NBFCs), the Reserve Bank of India has increased the single NBFC exposure limit for banks.

RBI has permitted loans given by banks to NBFCs for on-lending to agriculture, micro and small enterprises (MSEs), and housing to be classified as priority sector lending.

To ease the counterparty exposure limit to one NBFC with that of the general limit, the RBI has decided to raise a bank’s exposure limit to a single NBFC to 20 per cent of Tier-I capital of the bank from 15 per cent now.

Bank lending to registered NBFCs for on-lending to agriculture up to ₹10 lakh; micro and small enterprises up to ₹20 lakh; and housing up to ₹20 lakh per borrower to be classified as priority sector lending.

The Reserve Bank has front loaded the increase in Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR) by a percent. For banks, the RBI has increased the FALLCR by a percent of their NDTL (Net demand and Time Liabilities) to the extent of incremental outstanding credit to NBFCs and HFCs.

Suggestions

- Exposure norms can be made flexible for the NBFC’s in certain sectors particularly relating to real estate and infrastructure.
- Technology initiatives can be adopted to compete with financial institutions and micro finance corporations.
- Policy relaxations can be provided to the NBFC’s in sourcing finance for their primitive operations.
- Deposit related incentives can be offered to enable more access to sources of funds.
- Some high credit rated NBFC’s can be allowed to participate in the payment system to get more account holders.
- Sector wise approach can be done to overcome the financial crisis in the long run to enable smooth operations.
• Special purpose vehicle can be formed to regulate NBFC’s and Small Finance companies.
• Individual regulatory policies can be formulated to foresee the activities and growth perspective of NBFC’s in India.
• Digital initiatives can be brought inside the NBFC system to enable more convenience.
• More relaxation can be given to private equity funders with reference to NBFC financing in the system.

Conclusion

Thus it is very clear that NBFC’s does not face financial crisis but they face only financial issues. These minor setbacks can be removed from the system with clear frame work and policy initiatives to bring back the life for this huge shadow banking sector. NBFC's have been battling a credit crunch since Infrastructure Leasing & Financial Services (IL&FS) collapsed in late 2018 amid fraud allegations. The fall of IL&FS, a behemoth in the space, pushed up borrowing costs for rivals and has sharply impacted consumer spending and stung sectors such as real estate and autos that are big drivers of consumer demand. NBFC’s are the second line of finance for several unorganized sectors. The above mentioned suggestions can be implemented for the betterment of the NBFC sector in order to pull back the strings of profit and net interest margin.

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