

STATE OF THE NBFCS IN INDIA

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Abstract:

NBFC raise the required funds through the different ways out of which deposits mobilization from public is major one. Acceptance of deposits is managed by NBFCs as per regulations and directions of Reserve Bank of India (RBI). In recent past, the four active players of Leasing and Hire purchase viz., Alpic Finance, Apple Finance, Apple Credit Corporation and Srei International Finance have announced their plans to merge. NBFCs eccentric services are most essential and indispensable in filling the gap made by the financial institutions and commercial banks in the fast changing economy. Because of only the failure of CRB capital market, RBI issued scare and difficult directives that discouraged NBFCs and made entire sector a scapegoat.

Introduction

Non-Banking Financial Companies (NBFCs) are the concern rendering financial services similar to commercial banks and financial institutions, but do not qualify to be branded banks, entered into Indian Financial System in a big way to increase resources to Indian corporate world, during 80s due to frequent credit squeezed, cash crunches and laborious procedures with Financial Institutions and commercial banks.

According to their nature, NBFCs can be grouped into different types as Loan and Finance companies, Investment companies, Hire purchases Finance Companies, equipment leasing companies, Hire-purchase Fiancée Companies, Equipment Leasing Companies, Mutual Benefit Financial Companies, Housing Finance Companies and Residuary Non-Banking Companies.

NBFCs offer eccentric and a variety of functions in different areas such as Corporate Finance Companies and Residuary Non-Banking Companies. NBFCs offer eccentric and a variety of functions in different areas such as Corporate Finance, Corporate Advisory Services, Issue management, Secondary Market

operations, Portfolio Management Services (PMS), capital market Research (CMR) and Forex Management.

NBFC raise the required funds through the different ways out of which deposits mobilization from public is major one. Acceptance of deposits is managed by NBFCs as per regulations and directions of Reserve Bank of India (RBI). These deposits should be offered for a period more than 12 months but not more than 84 months by RNBCs and 60 months by other NBFCs. Interest rates on public deposits with NBFCs are certainly higher than those on bank deposits and deposits with post offices. Unlike bank deposit rate, there was no ceiling on these rates earlier. But with effect from the beginning of the financial year 1981-82, a ceiling has been imposed on interest rates paid by companies on public deposits. The level of rates offered by different companies depends on the financial position, reputation, management, size, overall profitability and dividend history of the company concerned.

But in recent past in the immediate aftermath of the CRB and ITC Classic Fiasco, this source of deposits has evinced a distinct slowdown, which chunk of funding for NBFCs in India. The modest increase in NBFC deposits compared to previous years is testimony to the fact that depositors have turned cautious towards finance companies. With the overall easing of interest rates in the economy and the rise in their effective cost of funds caused by higher Non-performant Assets (NPAs), most NBFCs had reduced their interest rates on deposits. This could be another reason for the poor growth in deposits. Added to this bank finance remains restricted to a handful of NBFCs with a high credit rating and the equity market continues to be in the doldrums. This is likely to create impact on these finance companies in two ways. Firstly, increasing dependence on deposits and falling profits is likely to increase the gearing ratios of NBFCs. Secondly, an increase in risk-weighted assets without a proportionate increase in Tier I capital is likely to adversely affect their capital adequacy ratios.

A modest attempt has been made in the present paper to discuss on the Operational Problems, Present Scenario, Options to Survive and Merging Strategies of NBFCs.

Operational Problems of NBFCs

It is due to failure and inversion in their expectations caused by high risk of the business, unhealthy competition made by imbalance between business scope and the number of players and fallacious perceptions of management, NBFCs are becoming unable to perform the promises to their investors either on time or completely i.e interest payment and repayment of the invested amount. Consequently, they are losing investors faith and goodwill in the market adversely affecting funds mobilization and borrowing cost.

Not only that, even they are facing the problem of poor recovery due to lack of requisite policies and procedures in recovery of loans. Hence, the main operational problems of NBFCs are found as limited sources due to loss of investor's faith, conservative and regulated methods adopted by financial institutions and banks while lending to NBFCs, poor recovery position, Depressed capital market, Increasing cost of borrowing and decreasing return on lending and High competition from large competitors.

Present Scenario

NBFCs are entangled by hazardous problems and havoc, due to continuous failures caused by reforms in financial sector, misconceived philosophy of business practices, management fallacious perceptions, lack of long terms perspective and biased regulation of Reserve Bank of India (RBI) towards NBFCs. However with the failure of CRB capital market that trembled the economy, RBI released (and timely modifying) a new stringent and ruthless set of directives relating to deposit acceptance, interesting rate ceiling, maintenance of liquid assets, prudential norms, auditors reporting, etc. for NBFCs, keeping in view the present circumstances, for the protection of investors. Hence it has become very difficult to operate the business as earlier to NBFCs because the tough policy environment created by RBI.

With the boundaries between different financial intermediaries disappearing, NBFCs are facing severe competition even on their core turf. Both banks and financial institutions have moved into retail financing which was the forte of NBFCs. ICICI has become a universal bank with car finance, housing finance, equipment leasing and other products suitable for retailers. SBI is in the process of setting up 100 branches exclusively for retail clients. The NBFCs forte has been credit delivery to areas not covered by banks and financial institutions. Thus NBFCs are better acquainted and more sensitive to the latent needs of the retail customers. Banks have the benefit to access resources at the lowest cost. Financial Institutions access funds at a slightly higher cost but unlike banks they do not have higher operating cost, cost of funds for NBFCs is the highest. The main handicap of the NBFCs is the small size of the balance sheet vis-à-vis banks and limited access to resources. Financial Institutions have the smallest reach and their structure is not suitable for large-scale retail operations. Public sector banks have the major advantages in terms of reach and their structure is not suitable for large-scale retail operations. Public sector banks have the major advantages in terms of reach but this advantage is offset by the culture of nationalized banks. NBFCs are offset by the culture of nationalized banks. NBFCs have the reach but are region specific. On the other hand the foreign players, like GE Capital and City Bank have taken large portion of the business of the NBFCs. These large intermediaries are able to raise funds at PLR due to better credit rating, while the NBFCs are able to raise funds at 3-4 percent above PLR. However the situation led NBFCs to choose the options to survive in the market provided by increasing intensive competition and dynamic regulatory environment.

Options to Survive

NBFCs have the following options to survive and shape themselves fit into the new regulatory environment

1. Increase share capital in the form of equity shares or preference shares that compulsorily convertible into equity shares.
2. Substitute public deposits through other funds raising sources such as secured debentures, bonds, commercial papers, financial institutional lending bank finance etc.
3. Non-Banking Finance Companies which want to get rid of public liabilities but who are not in a position to do so, have to deposit in an escrow account an amount which along with the interest it generate will be adequate to meet all future payments of interest and principle to the NBFCs fixed deposit holders.
4. NBFCs with a net-owned funds not less than Rs.500 crore and Rs.2 crore have been allowed to enter into insurance business as a joint venture participant and an agent of insurance companies

on fee basis without any risk participation to undertake insurance business respectively. But NBFCs proposing to set up insurance companies should have net non-performing assets (NPAs) of less than 5 per cent and a three-year continuous profitability track record.

5. Strategic Mergers.

MERGER –THE KIT

Since the present environment is very critical to NBFCs to survive and enjoy in the market due to increasing difficulty of capital raising and completion, intensification with the entry of banks, FIs and foreign intermediaries into the arena, the best survival kit seems to be Mergers and Acquisitions. Merger is just the beginning, the merged entity should undertake rational cost cutting programs of both branches and manpower without affecting reach. Not only that even the merged entity must aim at cutting the cost of operations for a better credit rating to reduce the cost of funds. The smaller players must aim at a particular niche segment in which they should aim to become leaders. In the new retail era the aim is to achieve economies of scale, but NBFCs have the ability to contain risk, adapt to changes and tap demand in markets that are likely to be avoided by the bigger players. In riskier areas top-rung NBFCs have proved to be the most effective. Lower proportion of loan to corporate and better recovery mechanisms have kept the NPAs of NBFCs lower, compared to their banking counterparts.

In recent past, the four active players of Leasing and Hire purchase viz., Alpic Finance, Apple Finance, Apple Credit Corporation and Srei International Finance have announced their plans to merge. This signals the first serious attempt for consolidation in the mezzanine-financing sector, which has been seeing a shakeout ever since the CRB Capital scam. The main reason for the merger was to reduce the cost of operations. They expect the merger to reduce the cost of operation by 75 percent. This achieved by cutting down, the overlapping branches and efficiently synergizing the merger. It will also help them to get a better credit rating by reducing the cost of funds. This will enable these firms to compete effectively in the cutthroat world of finance companies. The merged entity is expected to concentrate on leasing to become a leader in the niche segment. This will also enable the entity leverage its reach and distribution power to offer a bouquet of financial services.

CONCLUSION

The break-down of the traditional barriers has led to every players trying to move into retail finance, there has been a major churning within the NC industry over the last few years, triggered by a combination of quickly changing regulatory guideline industrial slowdown. This has eliminated many weaker players and making others to run after consolidating. The consolidation is likely to take place in three ways: One being that most weaker players will simply die a natural death, while others will merge to survive and at the same time there will few who will merge with top to survive and grow organically.

As the NBFC sector is dotted with an increasing number of small players and a handful of large players with all India presence, the large NBFC look like pygmies before even the smaller banks. But the competition between banks and NBFCs is hotting up. The former are increasingly getting into areas like auto and consumer durable finance etc.

NBFCs eccentric services are most essential and indispensable in filling the gap made by the financial institutions and commercial banks in the fast changing economy. Because of only the failure of CRB capital market, RBI issued scare and difficult directives that discouraged NBFCs and made entire sector a scapegoat. On the whole we can say that the sector is combating with the present era like *Abhimanyu* in the *Padmavyuham* in the great *Mahabharatha Yuddh* with the mighty Kauravas and their forces. But like *Abhimanyu*, the sector should not die, so government must give some privileges on par with commercial banks to surmount all the problems of the sector and RBI should have to classify the NBFCs on the basis of their capital and soundless management rather than allowing the credit rating agencies to decide their fate.

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