

**GROWTH & DEVELOPMENT OF NBFC IN INDIA****Mr.P.SRAVAN KUMAR,**MBA Assistant professor,  
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[munadhana1@gmail.com](mailto:munadhana1@gmail.com)**ABSTRACT**

*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.. 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.*

*NBFCs have been supplementing the role of the organized banking sector by bridging the credit gaps, i.e., in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sector and to small local borrowers. NBFCs have enjoyed a more flexible structure than banks in the organized sector. From time to time, the Central Government as well as Reserve Bank of India have been working towards regulation of these NBFCs. The Department of Non-Banking Supervision of RBI has been indulged in these activities of regulating as well as supervising the NBFCs. They are competitive and complimentary to banks and financial institutions .Many steps were taken in 1995-96 to reduce controls and remove operational constraints in the banking system. These include interest rate decontrol, liberalization and selective removal of Cash Reserve Ratio (CRR) stipulation, enhanced refinance facilities against government and other approved securities.*

**Keywords:** Cash Reserve Ratio(CRR), Liberalization, Financial Inclusion, Financial Institutions.

**INTRODUCTION**

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other 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 (other than securities) or providing any services and sale/purchase/construction of immovable property. 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 (Residuary non-banking company).

**Definition:**

**According to the Reserve Bank of India (Amendment Act) 1997, A Non-Banking Finance Company 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 specify.

## IMPORTANCE OF NBFC

India's financial services sector is huge. It is not just comprised of commercial banks, but also non-banking financial companies (NBFCs). These firms offer a wide array of financial services like loans, chit-funds, and are different from banks. NBFCs are often small players that largely go unnoticed. However, they are still important to the economy, especially in a developing country like India where 70% of the population lives in rural areas.

- **Size of sector:**

The NBFC sector has grown considerably in the last few years despite the slowdown in the economy. As of March 2013, it accounted for 12.5% of the country's Gross Domestic Product (GDP) – a measure of the size of the economy. This is up from 8.4% in March 2006. However, this only counts NBFCs with assets more than Rs 100 crore. "If the assets of all the NBFCs below Rs 100 crore are reckoned, the share of NBFCs' assets to GDP would go further," Bhaskar said in his speech.

- **Growth:**

In terms of year-over-year growth rate, the NBFC sector beat the banking sector in most years between 2006 and 2013. On an average, it grew 22% every year. Even when the country's GDP growth slowed to 6.3% in 2011-12 from 10.5% in 2010-11, the NBFC sector clocked a growth of 25.7%. This shows, it is contributing more to the economy every year.

- **Profitability:**

NBFCs are more profitable than the banking sector because of lower costs. This helps them offer cheaper loans to customers. As a result, NBFCs' credit growth – the increase in the amount of money being lent to customers – is higher than that of the banking sector. Credit grew an average 24.3% per year for NBFCs as against 21.4% for banks. This shows that more customers are opting for NBFCs.

- **Infrastructure Lending:**

NBFCs contribute largely to the economy by lending to infrastructure projects, which are very important to a developing country like India. But they require large amount of funds, and earn profits only over a longer time-frame. As a result, these are riskier projects. This deters a lot of banks from lending to infrastructure projects. In the last few years, NBFCs have contributed more to infrastructure lending than banks. NBFCs lent over one third or 35.8% of their total assets to infrastructure sector as of March 2013. In contrast, banks lent only 7.6%.

## GROWTH AND DEVELOPMENT OF NBFC

RBI's financial stability report says NBFC loans expanded 16.6% in the year, twice as fast as the 8.8% credit growth across the banking sector



Non-banking financial companies (NBFCs) improved their performance on most metrics in the last fiscal year, as the banking industry struggled under the weight of a growing pile of bad loans.

According to the financial stability report (FSR) released by the Reserve Bank of India (RBI) on Tuesday, 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% the previous year, the report said, NBFCs also performed better in terms of asset



quality, even though the bad loan norms for these firms are not as stringent as those for full-fledged commercial banks.

The gross non-performing assets (GNPA) ratio for the NBFC sector declined to 4.6% of total advances in March 2016 from 5.1% in September 2015, according to the FSR.

“While the regulatory norms for the NBFC sector are sought to be brought closer to those applicable to banks, the performance of this sector (return on equity and return on assets) seems to be much better as compared to that of banks,” the report said.

In November 2014, RBI revised the regulatory rules for NBFCs and said prudential norms would be brought on par with those for banks over a period of time. As a result, bad loan recognition rules were tightened and NBFCs were asked to label all loans on which repayment was overdue beyond 90 days as non-performing by 2018, in stages.

RBI's study covered the 11,682 NBFCs that were operating as of March 2016.

- **Risks to banking sector's stability up sharply: RBI report**

Capital adequacy levels of the NBFC segment have also improved, unlike banks where capital was eroded. The capital adequacy ratio for NBFCs as a whole improved to 24.3% as of March 2016 from 23.85% in September 2015.

Stress tests for the sector showed that even under extreme stress, the capital of NBFCs may erode only marginally.

To be sure, not all NBFCs are so strong. Stress tests on individual NBFCs showed that 5% of the total 11,682 companies would be unable to comply with the minimum regulatory capital requirement of 15%.

In contrast, stress tests for banks showed that under severe stress, 20 banks that hold 38.4% of total credit would fail to meet the minimum regulatory norm for capital adequacy.

The relative strength of NBFCs has allowed them to garner more business as banks focus on resolving their bad loan issue and strengthening their books. Many NBFCs are **expanding beyond their traditional lending business** to offer even working capital loans for corporate entities, *Mint* reported on 10 May.

“The key driver for the performance of NBFCs has been their business mix. The retail-heavy nature of NBFC portfolios has helped them maintain growth to some extent, while the corporate-heavy portfolio of banks has dragged down their growth. This retail focus has also helped the asset quality of NBFCs,” Crisil Ratings said in an e-mailed response to questions from *Mint*.

NBFCs that cater to niche segments have benefited immensely, said Crisil. Recently, many NBFCs have diversified their portfolio to mitigate risks to their core business, the rating agency added.

### **Evolution of the regulatory framework for NBFCs**

In 1964, Chapter III B of the Reserve Bank of India Act, 1934 was introduced to regulate NBFCs-D. Various expert committees – the most noteworthy being the Narasimham Committee and the Working Group on Financial Companies chaired by Dr. A. C. Shah – were formed to evaluate and provide their inputs on the role of NBFCs in the financial sector, their growth potential, and the regulatory changes that could be introduced to bridge the inefficiencies / gaps in the sector. Many of the recommendations of these committees were gradually interwoven into the fabric of the regulations for the NBFC sector.

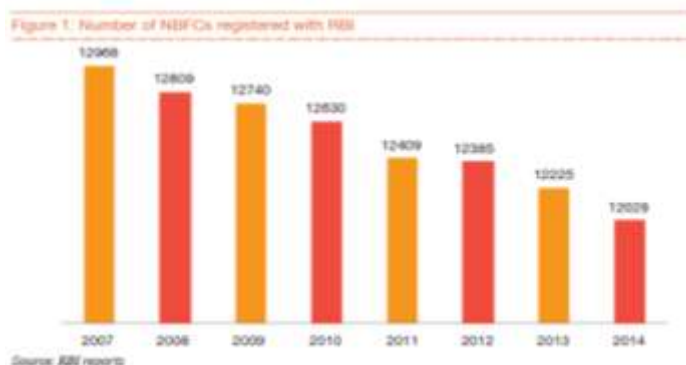
### **NBFCs asset growth and composition of advances**

NBFCs have grown rapidly in India and that is reflected from their asset growth pattern over the years. NBFCs, over a period, have created product niches in sectors like infrastructure finance, automobile finance, gold loans, personal finance and capital markets.

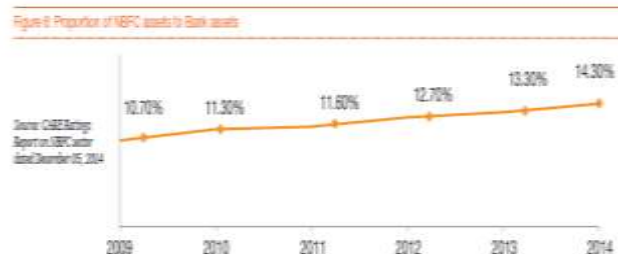


### NBFC profitability and Non-performing asset growth

The NBFC sector has shown a consistent year-on-year growth in net profits over the last few years. The effects of the market recovery are evident especially in the year 2014. With the Government and RBI's increased focus on financial inclusion, one could expect a continued growth run in the near future.



NBFCs-ND-SI were also witnessing a stress in the asset quality over the last 3-5 years due to economic slowdown and weak operating environment. The increased positivity in the business environment can be evidenced by the significant drop in the NPA levels in 2014. However, given the fact that asset classification norms have been strengthened in the revised regulatory framework, one could expect to see higher NPA levels in the upcoming years.



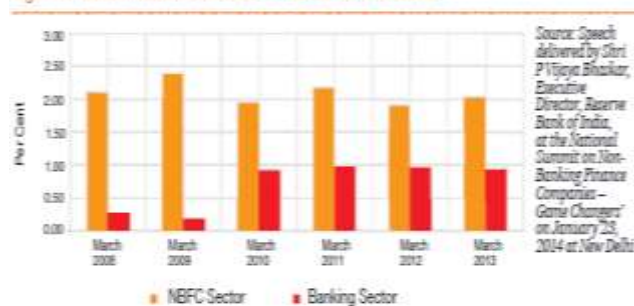
Return on Assets of NBFCs-ND-SI has shown stability with figures ranging around 2% since 2008.

The Return on Assets for NBFCs is typically higher than that for banks on account of lower operating costs and no statutory requirements like Statutory Liquidity Ratio and Cash Reserve Ratio.

The graph below shows the profitability of NBFCs vis-à-vis banks.



Figure 7: Trends in Returns on Assets – NBFCs vis-a-vis Banks



Source: Speech delivered by Shri P Vijaya Bhaskar, Executive Director, Reserve Bank of India, at the National Summit on Non-Banking Finance Companies – 'Game Changers' on January 23, 2014 at New Delhi

### Growing bank advances to NBFCs

Banks have been a major funding source of NBFCs and the rapid growth in bank advances reflects an increasing dependency of NBFCs on leverage from banks. The graph below depicts the growth in bank advances obtained by NBFCs over the last seven years. The increasing inter-linkage between banks and NBFCs has spurred the RBI to introduce additional safeguards to contain systemic risks.

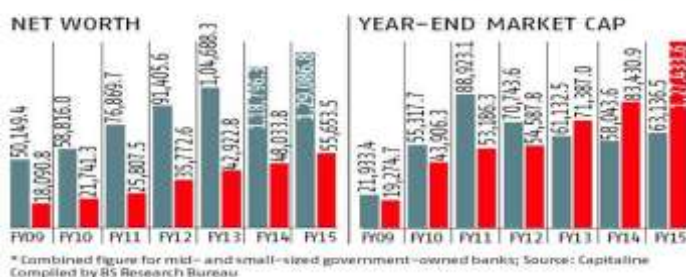
Figure 8: Growth of bank advances to NBFCs-ND-SI (INR billion)



In the past six years, the combined net worth of top-10 non-specialised NBFCs has grown at a compound annual rate (CAGR) of 20.6 per cent, against the small and mid-sized government banks' 17.1 per cent. During this period, NBFCs' assets under management grew at a CAGR of 22.9 per cent, against the 15.3 per cent annualised growth seen by the government banks in the sample.

### THE CHANGING ORDER

Net worth and market capitalisation of state-run banks and non-banking finance companies (₹ cr)



\* Combined figure for mid- and small-sized government-owned banks; Source: Capitaline  
Compiled by RS Research Bureau

### Non-Banking Financial Company- Boosting economic growth

Banks are the most important institutions which are responsible in managing and securing the wealth of the common man. The banking industry, whether public banks or private banks, are the most trusted business entities, where people with all their trust deposit their hard earned money for safety. However, there is another institution which has gradually made its presence felt in this field- Non Banking Financial Company.



- A NBFC cannot accept demand deposits i.e. funds deposited at a depository institution that are payable on demand immediately or within a very short period, which are similar to current accounts or savings accounts.
- NBFC's cannot issue cheques to its customers as they are not a part of the transactions system.
- Deposit insurance facilities are also not available for NBFC depositors unlike in case of banks.

For an institution to become a NBFC, it is mandatory for it to be registered with the Central Bank i.e. RBI in India, to carry out its operations. However, certain NBFC's i.e. venture capital fund/merchant banking companies/stock broking companies registered with Sebi, insurance company holding a valid certificate of registration issued by IRDA etc are exempted from being registered under the RBI. The list of institutions which need to be registered under the RBI to become NBFC's are:

- loan company
- investment company
- equipment leasing company
- hire-purchase company

The different types of NBFCs registered with RBI have been reclassified as

- Asset Finance Company (AFC)
- Investment Company (IC)
- Loan Company (LC)

However, NBFC's do play a critical role in participating in the development of an economy by development in sectors like transport, employment generation, wealth creation, bank credit in rural segments and to support financially weaker sections of the society.

Emergency services like financial assistance and guidance is also provided to the customers in the matters pertaining to insurance.



## CONCLUSION

NBFC are gaining momentum and have come a long way over the decades. The banking sector is financing only 40% of the trading sector the rest is by the NBFC's. They play a major role in economic development of a nation.

NBFCs in India have become prominent in a wide range of activities like hire purchase finance, equipment lease finance, loans, and investments. NBFCs are doing more fee-based business than fund-based. They are focusing now on retail sector-housing finance, personal loans and marketing of insurance. The strong NBFCs have successfully emerged as 'financial institutions' in a short span of time and are in the process of converting themselves into 'financial supermarket' – a one-stop financial shop. The growth trend of NBFCs in India is still catching momentum. Their role in the economy cannot be neglected and RBI should also make certain policies which should help them to flourish along with care for its investors.

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