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REVIEW ARTICLE

NON BANKING FINANCIAL COMPANIES IN INDIA: REVIEW OF LITERATURE

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ABSTRACT

The present Study examines literature pertaining to Non Banking Financial Companies in the India and abroad. Subject Area: Non Banking Financial Companies.

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INTRODUCTION

NBFC is defined under Sec. 45-I (f), Reserve Bank of India Act, 1934. As per the RBI Act, a "non-banking financial 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 and by notification in the Official Gazette, specify (Khan, 2005).

Organisations (excluding commercial and cooperative banks) which offer financial services such as fund facilitation and act as monetary intermediaries between savers and investors are called as Non-banking financial institutions or companies. These institutions also offer products such as mutual funds (Khan, 2005). Any company that facilitates financial products such as hire-purchase finance, loan or mutual benefit finance and an equipment leasing fall under the category of NBFC; however, insurance or stock exchange or stock broking company and merchant banking companies are not NBFCs. The RBI (Amendment) Act, 1997 defines NBFC as an institution or a company whose principal business is to accept funds in the form of deposits under any scheme, arrangement or in any other manner, and to lend the same in any manner.

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Since, the amended definition provided insights for fund investments many loan and investment companies which were registered under the Companies Act are also included as NBFCs. In the Indian financial system, the financial intermediaries are classified as public owned, monopoly or oligopoly or monopolistic market structure and these systems are centralised. However, NBFCs are small sized financial intermediaries other than commercial and cooperative banking institutions. In addition, these NBFCs are owned as private concern and are decentralised with relatively less competitive market. Some NBFCs are based on fund facilitation whereas others are based on providing financial services. In general, an NBFC company should belong to any of the following companies (Figure 1):

1) Loan Companies (LCs)
2) Investment Companies or ICs
3) Hire-Purchase Finance Companies or HPFCs
4) Lease Finance Companies or LFCs
5) Housing Finance Companies (or) HFCs
6) Mutual Benefit Financial Companies or MBFCs
7) Residuary Non-Banking Companies or RNBCs
8) Merchant Banks
9) Venture Capital Funds
10) Factors
11) Credit Rating Agencies
12) Depositories and custodial services (Pathak, 2011).

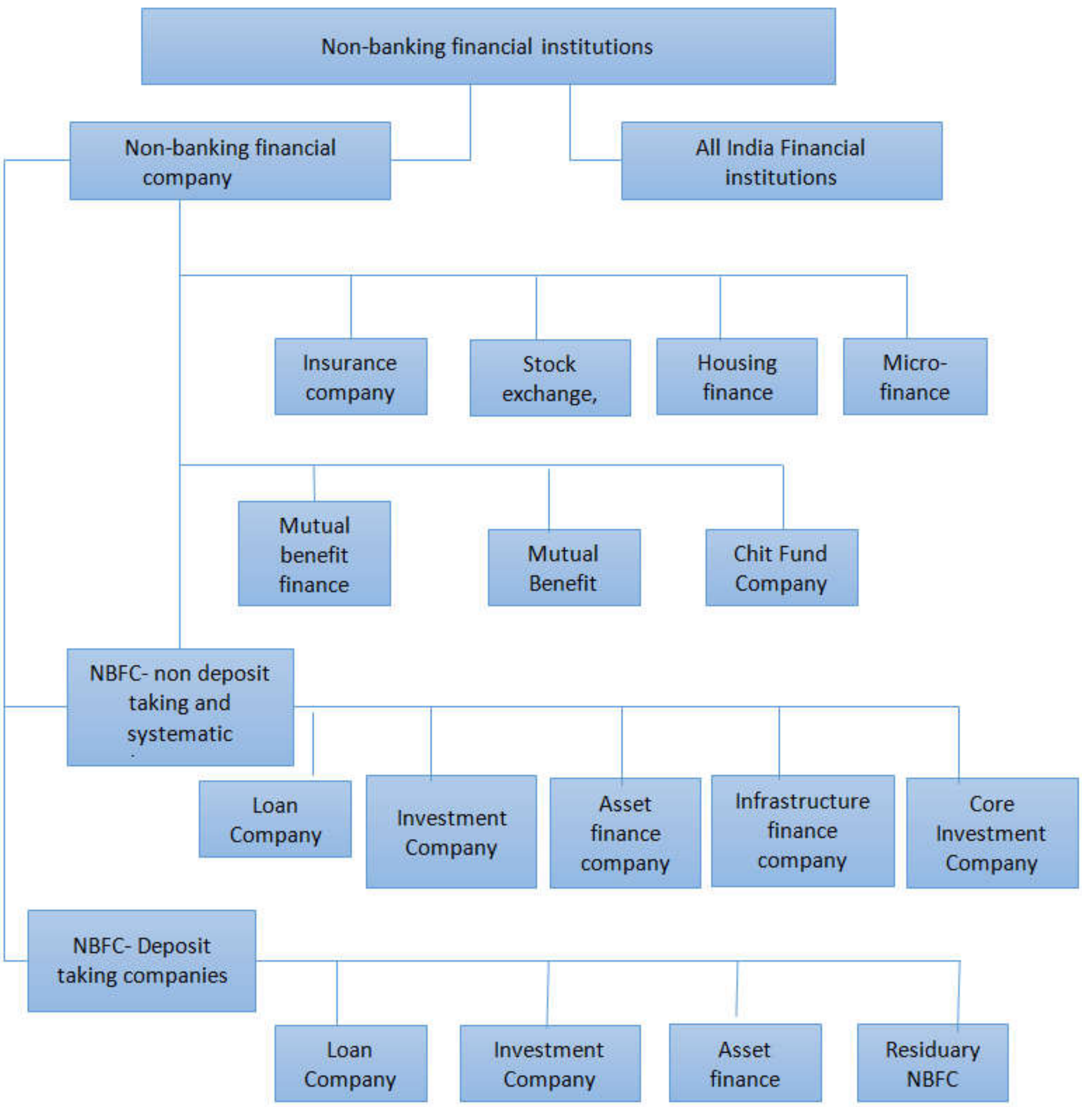
Differences between NBFCs and Banks

The nature of the liabilities and the asset structure differentiate NBFCs from banking financial institutions. In commercial banks, liabilities consist of demand and time deposits wherein in NBFCs; ordinary demand deposits are not included. Demand deposits pertain to withdrawal of the same through cheques. Cheques are identified to be components of money and hence the degree of liabilities is the main differentiating factor. In the context of assets, commercial banks hold credits in the range of short and long term and instruments such as cash credits, overdrafts and bills are used. On the contrary, the assets held by NBFCs are more specific in terms of the type of service required. For example, housing finance companies are specific towards provision of loans for housing purposes whereas hire finance companies operate mainly on financing to transport operations and requirements. However, the difference in the type of assets held by NBFCs and commercial banks does not clearly delineate the areas of operation of both since even commercial banks also provide loans for consumer credits and transport operations which were considered to be not the purview of these banks earlier (Lumpkin, 2009).

commercial and cooperative banks (Onnela et al., 2006). Albeit the similarities existing in NBFCs and banks based on their operations, some differences still prevail which include: (i) Demand deposits are not accepted by NBFCs; (ii) An NBFC is not a part of the payment and settlement system and as such an NBFC cannot issue cheque drawn on itself; and (iii) NBFC depositors are void of deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation which are facilitated by banks. The present Study examines literature pertaining to NBFC in the India and abroad. In this regard, the following studies were examined and the key findings are highlighted. The research gap in previous researches was provided in section 1.5. In addition, a summary to the entire study is provided in section 1.6.

Previous Studies

Bhole (1992) has studied the growth pattern, problems, prospects and impact of NBFCs on financial market.



Source: Adopted from Karunagaran (2012)

Figure 1. Classification of Non-Banking Financial Institutions

However, some functions and operations of both banks are NBFCs share similarities which blur the distinction between the two different types. Unlike banks, it is revealed that NBFC are not a part of payment mechanism. Similar to banks, they cannot generate money; however, due to several advantages over commercial banks, these NBFCs act as alternatives to

He maintained that as any nation become develop, NBFCs become more and more important. He compared the business volume and profitability ratio of Commercial Banks and NBFCs at aggregate level. He uses only the profitability ratio for the purpose. Saggar (1995) has examined the financial performance of 10 leasing companies at disaggregate level and

compared with other group of NBFCs for a period of 1985-90. The simple method of ratio analysis has been used to compare the financial performance. The study by Saggar does not reflect the overall performance of NBFCs as it is based on selected 10 companies. Kantawala (1997) examined the relative financial performance of different groups of NBFCs for the period 1985-86 to 1994-95 in terms of profitability, leverage and liquidity. A significant difference in the profitability ratios, leverage ratios and liquidity ratios of various categories of NBFCs was observed from the analysis and concluded that different categories of NBFCs behave differently and it is the entrepreneur's choice in the light of behavior of some the parameters which go along with the category of NBFC. A study by Harihar (1998) throws light on overall performance of all NBFCs taken together in terms of cost of debt, operating margin, net profit margin, return on net worth and asset turnover ratio. It is revealed the aggregate performance of NBFCs which does not throw light on the financial performance of different group of NBFCs. The study has used only few ratios to analyse the financial performance.
Machiraju (1998) studied the financial performance of few selected categories of NBFCs by using ratio analysis method. The study used only the Profitability ratio. The study did not throw any light on the overall performance of all categories of NBFCs.

Guruswamy (1998) has studied the financial performance of NBFCs for the purpose of credit rating of a few numbers of NBFCs by using the methods of ratio analysis. The study used only Leverage ratios like Borrowing/Total Assets, Bank Borrowing/Total Assets, Net Worth/Total Assets, Bank Borrowings/Borrowing, Debt/Total Assets, Debt/Net Worth, Loan to Current Assets, for the purpose of study. Kantawala (2001) has studied the financial performance of NBFCs by using the method of ratio analysis and one way analysis of variance (ANOVA). He used the Profitability ratios, leverage ratios and liquidity ratios of ten years from 1985-86 to 1994-95 of different categories of NBFCs to compare the performance. To overcome the assumption of normal distribution in case of ANOVA, Krushkal Wallies test is also applied by Kantawala but the study has not applied the modern technique of analysis like Data Envelopment Analysis (DAE).
Bakker (2004) studied the development of NBFCs in European Union. By using the ratio analysis method, he showed that NBFCs are more profitable in long run. The study used only the liquidity and profitability ratios. Khan (2005) studied the Product options of NBFCs in Bangladesh and concludes that NBFCs with multiproduct are more financially stable in comparison with NBFCs in single business. The study used simple method of ratio analysis. Only few ratios had been taken for the study. Ahmed and Chowdhury (2007) studied the problems and prospects of NBFCs in Bangladesh. By employing the method of ratio analysis, he pointed out the asset liability mismatch faced by NBFCs in Bangladesh. The study used only the leverage ratios for the purpose.

Harikrishnan (2008)in their study recognized the real issues and issues in dealing with the receivable in appreciation of vehicle financing of NBFCs. For this study, information has been gathered from the essential and auxiliary hotspots for the period 1999-2007. Essential wellsprings of information are NBFCs and their channel accomplices i.e., the borrowers of NBFCs and delegates who are the merchants of the vehicles and different sites, Reports, Diaries, and Distributions and so forth are the optional sources. Quantitative and subjective strategies have been embraced in this learn at various stages and recommended that there ought to be more straightforwardness in managing the borrowers and financing cost computation, the method of transfer of reprocessed vehicle should be completely decentralized to branches for showing signs of improvement value, end the act of transitory enlistment of vehicles, sound relationship amongst merchants and NBFCs ought to be enhanced, and so forth. Vadde (2011) analyzed the performance of non-government financial and investment companies (other than banking, insurance and chit-fund companies) during the year 2008-09. The segment of financial and investment companies in the private corporate sector was found to be highly skewed. Thus, the analysis was confined to 1,211 companies. It was observed that growth in income, both main as well as other income, decelerated during the year 2008-09. Though, growth in total expenditure also decelerated, it was higher than the income growth. The growth in expenditure was mainly driven by the growth in interest payments. As a result, operating profits of the select companies declined along with diminishing profitability during 2008-09. Business of select non-banking financial and investment companies expanded at a slower pace during 2008-09. The share of external sources in total sources declined during 2008-09 when compared with the previous years. A substantial portion of funds raised during the year was in the form of borrowings. Other significant portion of funds was in the form of raising fresh capital from the capital market. Major portion of the funds raised during the year was deployed as loans and advances in the credit market. However, its share in total uses of funds decreased. The share of 'Investments' in total uses of funds increased during 2008-09 on account of investments in the mutual funds and shares and debentures of other Indian companies.

Khalil Ahmed and Group (2011)dissected the budgetary execution of those NBFCs which are giving the administrations of speculation consultative (IAS), resource administration (AMS), IF for two year from 2008 to 2009. Proportion investigation strategy has been utilized to break down the money related execution of non-bank monetary organizations. The study presumes that the monetary execution of NBFCs was better in 2008 when contrasted with the general decrease in 2009 brought about by numerous elements. Samal and Pande (2012)inspected on innovation Suggestions in NBFCs by utilizing essential and auxiliary information and utilizing both unmistakable and explanatory Examination outline. The creators reasoned that innovation on administrations and innovation administer to recipient have all the more affecting probability in expanding recipient fulfilment. Be that as it may, NBFCs must look to all different components to expand its probability in innovation, as new recipient are more acclimated with new innovation to spare their time and vitality. Sornaganesh and Soris (2013) explored the subject of NBFC in India" to break down the gainfulness position of 5 test NBFC organizations, as STF, SF, BF, and M&MF for the period from April 2008 to Walk 2012, utilizing Proportion Examination of gathering information from the Yearly Reports and the Accounting reports of the example organizations. The study uncovers that SF has performed better regarding Income Per offer (EPS) trailed by STF, BF, CF and M&MF however STF and M&MF are much better than other in NPM. Perumal and Satheskumar (2013) concentrated on NBFC's by examining the Asset reports and salary proclamations of two specimen organizations, viz., Sundaram Fund Restricted and Lakshmi General Account

Constrained for the period 2007-2012 utilizing essential and optional information. The study was performed utilizing different measurable systems, for example, normal, standard deviation, co-proficient of variation, pattern examination, file number, and so on and reasoned that the commitment of NBFCs to monetary improvement is exceedingly huge and they have to incorporate it with the standard budgetary framework and RBI ought to be vested with more energy to screen NBFCs in a successful way.

Sowndharya and Shanmugham (2014) examined the profitability, efficiency and turnover aspects of the selected NBFCs. The findings indicated that the NBFCs differ significantly in terms of Profitability and Leverage indicators from one another. Kaur and Tanghi (2013)researched on "NBFC's Part and Future Prospects" with a centre to break down part and hugeness of NBFCs in India. The paper infers that NBFCs need to concentrate more on their centre qualities and should always attempt to hunt down new items and administrations so as to survive. Makhijani (2014)offers the opinion that the course of the most recent couple of years the non-banking financial companies (NBFC) part has increased critical points of interest over the saving money framework in supplying credit under-served and unbanked territories given their compass and specialty plan of action. Be that as it may, off late the Store Bank of India has presented and proposed different changes in the current administrative standards administering NBFCs with a perspective to carry NBFCs controls at standard with the banks. The continuous and proposed administrative changes for the NBFCs regarding expanded capital sufficiency, harder procurement standards, expulsion from need division status and changes in securitization rules could cut down the productivity and development of the NBFC segment. NBFCs should introspect and re-evaluate their plans of action as they will now need to battle stringent administrative standards as well as need to confront the test of increasing expense of assets, panic capital and direct rivalry from banks.

Shakya (2014)distributed a working paper where they opine that NBFC's are pioneer in their money sending, openness to the business sectors and others to tally. NBFCs are known for their higher danger taking limit than the banks. Notwithstanding being an organization of fascination for the speculators, NBFCs have assumed a huge part in the money related framework. Numerous specific administrations, for example, figuring, investment back, and financing street transport were championed by these organizations. NBFC area has all the more essentially seen a reasonable level of combination, prompting the development of huge organizations with differentiated exercises. In any case, the late monetary emergency has highlighted the significance of augmenting the centre of NBFC controls to make specific note of dangers emerging from the administrative crevices, from arbitrage opportunities and from between connectedness of different exercises and elements connected with the money related framework. The administrative administration is lighter and unique in relation to the banks. The enduring increment in bank credit to NBFCs over the late years implies that the likelihood of dangers being exchanged from all the more daintily controlled NBFC part to the saving money division in India can't be discounted. Thilakam and Saravanan (2014)state Monetary intermediation is an essential capacity of Banks, NBFCs in the post change period in India is described by marvellous development of NBFCs supplementing the part of banks in preparing subsidies and making it accessible for speculation purposes. Amid the most recent decade NBFCs have experienced wide unpredictability and change as an industry and have been seeing significant business change throughout the most recent decade as a result of business sector flow, open opinions and administrative environment. To assess the soundness of NBFCs in Tamil Nadu over 10 years, the creators made an endeavour of CAMEL criteria for examination of chose Organizations. In view of discoveries the recommendations were offered to conquer the challenges face by chose NBFCs in their improvement. Arunkumar (2014)has made an endeavour on the subject of NBFC's which is a survey based study and in the wake of watching twelve investigations of various creators he presumed that because of the directions of the Reserve Bank of India, still the NBFCs are not going into more credit and proposed to the NBFC credit arrangement to decrease rates of premium. The study finds an exploration crevice which is evaluation of execution of NBFCs in India. Mohan (2014)depicted the NBFC in India with respect to sorts, needs, difficulties, and significance in monetary incorporation and recommended to enhance Corporate Administration Guidelines and reasoned that NBFCs have ended up being motors of development and are indispensable part of the Indian monetary framework, upgrading rivalry and broadening in money related division, spreading hazards particularly on occasion of budgetary misery and have been progressively perceived as correlative of saving money framework at focused costs.

Mondal (2015)compared the growth between Banks and NBFCs in India wherein the contribution of both these entities to the growth of the nation's economy was examined. Data was collected from secondary data sources wherein statistical analysis is performed on the collected data. The results of the previous research revealed that in the time frame of 2006 to2013, there is an increase in the total assets of NBFCs than Banks in India wherein the contribution of the NBFCs was also witnessed to increase GDP. Das (2015) compared the performance of growth of Non Banking Financial Companies with Banks and their contribution in the Indian economy. For this study, data have been collected from secondary sources and simple statistical tools, tables have been used. The results showed that during the study period, i.e. from the year 2006 to 2013, total assets of Non Banking Financial Companies have been increasing at higher rate than the Banking Sector in India and also contribution to GDP of NBFC sector has been increasing more steadily than that of banks. The return on assets was found to be better than that of banking sector. NBFCs have been growing at a steady rate and its growth rate was higher than that of banking sector. Proportion of credit provided by the NBFCs to infrastructure sector was also higher than that of banks during the study period.

Pellissery and Koshy (2015) analyzed the financial performance of the selected groups of NBFCs and banking companies during the periods 2007-2011. From the study it was found that NBFC's are showing better position in the capital markets than the selected banking companies. The companies differed significantly in terms of their financial performance indicators from one company to another. This may be due to the different services they provide and the differential interest rates. The study found no significant differences in the management of financial performance of each of the companies, except marginal deviations in some cases during the study period. Earnings per share of the selected companies also increased, whereas the operating profit per share of all companies showed an increasing trend from the year 2007 to 2010 and depicted a slight dim in the year 2011. Overall, the NBFC's have performed well, as and when compared to the banking companies. Das (2016) also examined the growth and performance of NBFCs by comparing the same with that of Indian Banks. Data was collected from the Reserve Bank of India website wherein the time period considered for the research is 2006- 2014. For the analysis, statistical table, line chart and column charts were used. During the study period considered, it is revealed that there is an increase in the proportion of NBFCs when compared to the banking sector. Kaushal (2016) examined the impact of NBFCs to the growth of Indian economy. The previous researcher conducted a descriptive research paper based on secondary data wherein it was revealed that the financial health and profitability of Indian NBFCs have improved over the years; however, NBFCs should open venues for overseas investors to make tie-ups in the form of technology transfer and requisite expertise.

Research Gap: The NBFCs assume a huge part in meeting monetary necessities of the medium measured and little estimated commercial enterprises and advancement of Indian economy by implication. Then again, approaches of NBFCs are additionally given speculation security to the speculators. It is highlighted that because of the directions of the Reserve Bank of India, still the NBFCs do not develop more credit. It is proposed to the NBFC credit strategy to lessen rate of interests, which serves to little ventures to get advances for their distinctive capital prerequisites. The studies made above demonstrates that the exploration in NBFCs is not at all that dynamic with the same number of the distributed and published papers that indicate just the periphery of the NBFCs. Very few, meager, limited and sporadic studies have been done on NBFCs in India and even abroad. Even the available study did not focus on the overall performance of the NBFCs as a whole. Moreover, in term of methodology only traditional ratio analysis was employed to assess the performance.

Summary

From the above review it can be stated that the NBFC's form a vital part of the financial system in India, especially as per the recent policy measures. Additionally, regulation that is activity based is most likely to lead to cost the rationalisation of the cost of compliance so as to create a model that fits more appropriately between both the regulations as well as the regulatory activities. However, the areas of restriction that occurs on debentures funding, loss of priority sector, securitisation and on-lending continue to restrict the funding ability of NBFC's. With the almost unenthusiastic growth environment coupled with regulatory constraints have made the banks realise as well as notice the sector of direct and indirect lending to the priority sector borrowers. However, it has been stated that this has been pegged for a reversal once the need for project finance and large scale funding is commenced. Here, banks have a different costing structure and have revamped to accommodate for a different customer base. In this view, the NBFC's have focused their businesses to target consumers so to as make their enterprises more profitable in the priority borrower segment. The segregated approach to the licensing of the finance sector for the different types of banks can help create the right dynamic with the increase in the market penetration through making available a wider range of products, thereby paving the way for the growth of NBFCs. This can be deemed difficult for the larger players in the market as the move from banking to non-banking firms without the adequate regulatory framework can prove to be risky. In this view, even though the differential licensing will eventually come to be accepted, the NBFCs can carry on business that is lucrative especially to those organisations that are focused on assets and others that have access to viable sources of funding. In this context evaluation of the financial performance of the NBFC's in the context of the growing economy can help to enable a stable regulatory environment which further provides for the growth of the NBFCs.

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