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NBFCs in India: Scope and Challenges

Dr. Shilpa Jain*

Department of Finance, Visiting Faculty at Institute of Management Studies, DAVV, Indore

Abstract – NBFCs play salient role in culverting scarce financial resources in capital formation. They supplement the role of traditional banks by meeting the financial needs of organized and unorganized sector. The fill the credit gaps where the reach of banks is minimal. In this paper, the scope for NBFCs is examined along with challenges faced by them. They have a cutting edge over banks in serving MSMEs and unorganized sector because of customized product offerings. Digital technology has created a new arena of growth. The degrading assets quality, decreased profitability due to increased provisioning still remain challenge. The study is concluded by giving recommendation on how the efficiency of NBFCs can be increased. Creating a risk evaluating mechanism and prudent credit monitoring system can bring financial stability and protect interest of depositors.

Keywords: NBFCs, Online Lending, Inclusive Growth, Retail Credit.

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1. INTRODUCTION

Non-banking financial companies (NBFCs) play a pivotal role in promoting inclusive growth in country by serving diverse financial need of those customers which are excluded by banks. They provide innovative services to MSME sector suiting their best requirements mostly those which cannot be fit into rigid credit rating system of banks. They meet credit needs of micro small and medium enterprise sector along with providing variety of financial services to specific areas like financing infrastructure loans, commercial vehicle financing and financing of physical assets.

They play a gripping role in economic development of country by providing impetus to wealth creation, employment generation in under-served areas, providing credit facilities in rural areas and financial weaker sections of society. They channelize scarce financial resources by acting as intermediaries. They supplement banks by meeting needs of corporate sector and unorganized sector. Apart from loans and advances, NBFCs also focus on acquisition of shares, marketable securities like stocks, bonds, debentures, lease and hire purchase and insurance business (Nandani and Jayenthi, 2014).

NBFCs constitute 76% percent of non banking financial institutions in terms of balance sheet size. Others being primary dealers (PD) 1% and All Indian Financial institutions (AIFI) constitute 23%. All of these are regulated by RBI.There are around 11,522 NBFCs registered with RBI at present. Out of which 178 are deposit taking and 11,344 are non deposit taking (RBI, 2016).

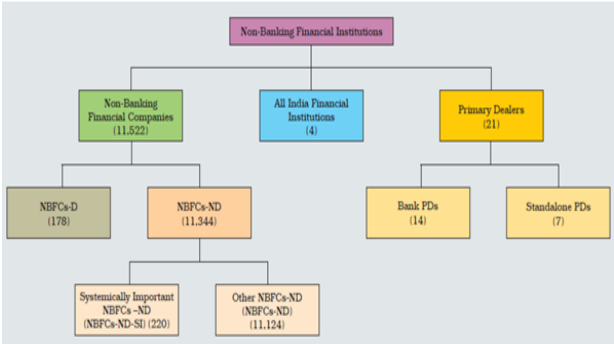

Figure.1:Non-Banking Financial Institutions regulated by Reserve Bank of India

Source: RBI Report (2016-17)

NBFCs have been evolved as important alternative channel of finance in bank dominated financial panorama of India. They promote financial inclusion by catering to need of small business and providing finance to specialized segments. They are being encouraged by government to focus on niche areas where the reach of banks in minimal. Regulations relating to NBFCs are made in tandem with commercial banks in order to bring right balance between two financial systems (Arun, 2014).

2. SCOPE

The NBFCs have exceeding product lines, wider reach and better understanding of customer segments. The substantial assets are in vehicle (both commercial and passenger) segments, personal loans and housing finances etc. They fill the gap which traditional banks wary to serve. They have been growing at CAGR of 18% and are expected to maintain same trend. Effectiveness of government scheme and greater disposable incomes will lead to persistent growth in consumer finance segment. Small business segment also display a growth trajectory. Newly evolving digital trend, increased consumption, greater credit penetration will supplement the said growth trend (Singh, 2014).

NBFC covers sector specific financing needs covering micro, small and medium enterprises (MSMEs), large industry infrastructure, and consumer and vehicle loans. About 60% of total credit goes to industry followed by retail and agriculture (RBI, 2017). Retail credit has increased at highest pace due to growth in consumer durable business and credit card receivables. While credit to agriculture and allied activities have been contracted due to demonetization and disruption in cash transacting culture of farmers.

(Amount in ₹ billion)

Items	2016	2017	Share in gross advances in 2017 (Per cent)	Percentage variation
1	2	3	4	5
I. Gross advances	13,169	14,846	-	12.7
II. Non-food credit (1 to 5)	13,167	14,846	100.0	12.8
1. Agriculture and allied activities	392	346	2.3	-11.7
2. Industry (2.1 to 2.4)	8,063	8,940	60.2	10.9
2.1 Micro and small	326	508	3.4	55.8
2.2 Medium	154	172	1.2	11.7
2.3 Large	3,726	4,375	29.5	17.4
2.4 Others	3,857	3,885	26.2	0.7
3. Services	1,865	2,224	15.0	19.2
4. Retail loans	2,047	2,490	16.8	21.6
4.1 Vehicle/auto loans	1,150	1,035	7.0	-10.0
5. Other non-food credit	801	847	5.7	5.7

Figure.2: Credit to Select Sectors by NBFCs

Source: RBI Supervisory Returns

Ground level understanding of MSME customers and their profile give NBFCs a cutting edge over the banks. They innovate and customize products according to customer's need more perfectly than traditional banks. The asset base of NBFCs has increased by 53.5% from 2012-2015. The total share of credit off take is expected to grow between 18-20% by 2020(Sunkara, 2016).

Figure.3: Comparative Credit Growth by Banks and NBFCs year on year basis

Source: RBI,Pwc Report

NBFCs have tremendous growth opportunities. Digital technology creates this scope. They can enhance their product portfolio, customer experience and related processes by adopting digital technology. As India has a user base of 320 million customers in smart phone market and is expected to increase in future as well, it provides an opportunity to NBFCs to enrich their positioning of financial products. They can use the vast customer data available on digital and social media platform to improve customer servings. Credit worthiness of large and untapped market segment can also be found with help of this data which helps NBFCs increasing their business. Online customer lending has grown from 3% in 2013 to 15% in 2015 providing scope to NBFCs to enter in this space. Digital technology can help in identifying the individual, his intentions and ability to repay loans. NBFCs can increase customer satisfaction by using online calculators, knowledge centers, live chats, and live application tracking system. Credit risk can be determined by analyzing data from mobile bill payments, browsing and download history, prepaid top ups. NBFCs can enter into partnership with banks and other related agencies to do robust data capturing. Psychometric tests can also be used to widen the customer base. They evaluate borrower's ability and willingness to pay(PwC &Assocham,2015).

In this way underserved consumers which are often neglected by traditional banks also get a chance to be eligible for small loans. Lenders can use this credit scoring to provide small ticket loans. For example, a Tanzanian mobile service provider Vodacom used First Access which is a data analytics company to develop and use credit score from mobile data and provide loans to customers (Ascocham, 2016). The e-commerce business is expected to generate revenue of 120 billion USD by 2020.

3. CHALLENGE

NBFC faced deterioration in their asset quality on account of sluggish industrial growth. Both gross nonperforming assets (GNPAs) ratio and Net non performing asset (NNPAs) ratio have increased from 2014 to 2017(RBI,2017).The NNPA ration has increased from 2.5 in FY 2015 and 2016 to 4.1 in FY 2017. There has been increase in GNPA ration as well from 4.5 in FY 2016 to 6.1 in FY 2017.

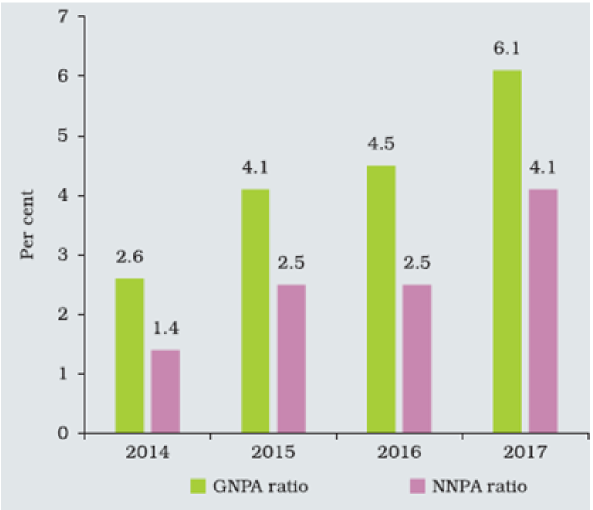

Figure.4: Asset Quality of NBFCs

Source: RBI Supervisory Returns

The profitability has also declined during 2016-17 due to increased provisioning requirement. The net profits have declined from 367 billion INR in 2016 to 314 billion INR in 2017.

Because of decline in operational efficiency, their cost to income ratio has also increased from 76.0 in 2016 to 78.9 in 2017.

(Amount in ₹ billion)

Items	2014	2015	2016	2017
1	2	3	4	5
A. Income	1,713	2,009	2,142	2,310
B. Expenditure	1,279	1,495	1,628	1,822
C. Net profit	313	365	367	314
D. Total assets	14,499	17,284	17,231	19,671
E. Financial ratios (as per cent of total assets)				
(i) Income	11.8	11.6	12.4	11.7
(ii) Expenditure	8.8	8.6	9.4	9.3
(iii) Net profit	2.2	2.1	2.1	1.6
F. Cost to income ratio	74.6	74.4	76.0	78.9

Figure.5: Financial Parameters of NBFC Sector

Source: RBI Supervisory Returns

Although the number of new registrations have increased from 28 in 2014-15 to 46 in 2015-16 and further 105 in 2016-17. But the government is making stringent norms of regulations to prevent interest of customers like the revised criteria of net owned funds set by RBI. The key challenge is to maintain the asset quality of these newly registered NBFCs.

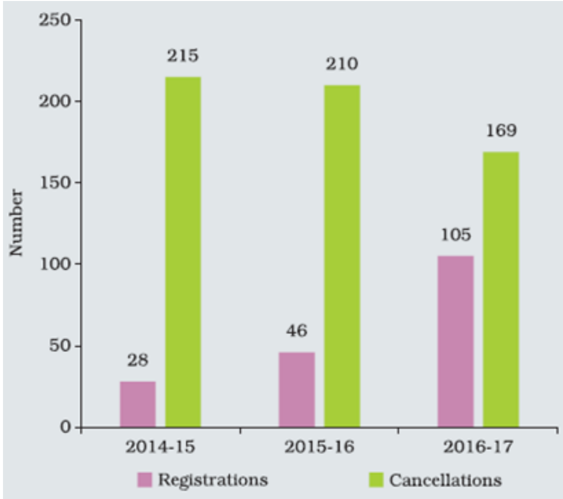

Figure.6: Number of Registrations and Cancellations of NBFCs

Source: RBI

The other challenge being while working on online lending platform, it is difficult to predict the appropriateness of the online data. Data should represent likelihood of repayment. It is difficult to integrate this alternate source of data with existing credit under writing mechanisms. It is arduous to comply data source from social and digital media with government regulations.

4. CONCLUSION

In order to safeguard financial stability and protect interest of depositors, strict regulatory norms have been framed by regulatory bodies. This resulted in exposing weak NBFCs and consequently declining their numbers.They also experienced decline in profitability and deteriorating asset quality. However, the credit growth recorded by NBFCs is higher than that for banks. Micro and small business has displayed robust credit growth. NBFCs reduced their dependence on bank borrowings and took higher recourse on market based instruments for mobilizing resources (RBI,2017).

There is a need of tweaking risk assessment capacity of NBFCs by developing appropriate risk assessment tools and credit monitoring system. This will help in establishing stability and sustainability in financial sector along with promoting financial inclusion thus supporting economic development.Harmonizing the regulation for NBFCs with those of commercial banks will also help in establishing them at par with banks (Pandya, 2015).

In order to enhance the efficiency, safety and security in processes leading to benefits from NBFCs, RBI has formulated a framework of Information Technology for these institutions. RBI has also launched a grievance redressal system called as Ombudsman Scheme to provide cost free complaint redressal system relating to deficiency in services provided by NBFCs.

NBFC sector has undergone noteworthy transformation over past few years. It is now being recognized as one of the systemically pivotal constituents of Indian financial system. It has been showing consistent year on year growth. NBFC play a critical role in development of infrastructure, transport, wealth creation and providing financial support to weaker sections of society.

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Corresponding Author

Dr. Shilpa Jain*

Department of Finance, Visiting Faculty at Institute of Management Studies, DAVV, Indore

shilpaj347@gmail.com