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THE ROLE OF NBFC'S IN THE INDIAN ECONOMY

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Abstract

Non-Banking Finance Companies (NBFCs) have played an important role in the Indian financial system by complementing and competing with banks, and by bringing in efficiency and diversity into financial intermediation. NBFCs have evolved considerably in terms of operations, heterogeneity, asset quality and profitability, and regulatory architecture. Going forward, the growing systemic importance and interconnectedness of this sector calls for regulatory vigil.

NBFCs are financial intermediaries engaged in the business of accepting deposits delivering credit and play an important role in channelizing the scarce financial resources to capital formation. They supplement the role of the banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sector and to small local borrowers. However, they do not include services related to agriculture activity, industrial activity, sale, purchase or construction of immovable property. In India, despite being different from banks, NBFC are bound by the Indian banking industry rules and regulations.

NBFC focuses on business related to loans and advances, acquisition of shares, stock, bonds, **debentures**, securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business.

Keywords: Shares, Debentures, Bonds, Unorganized sector, Securities, Banks etc

INTRODUCTION:

NBFCs (Non Banking Financial Companies) play an important role in promoting inclusive growth in the country, by catering to the diverse financial needs of bank excluded customers. Further, NBFCs often take lead role in providing innovative financial services to Micro, Small, and Medium Enterprises (MSMEs) most suitable to their business requirements. NBFCs do play a critical role in participating in the development of an economy by providing a fillip to transportation, employment generation, and 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.

The banking sector would always be the most important sector in the field of business because of its credibility in supporting manufacturing, infrastructural development and even being the backbone for the common man's money. But despite this, the role of NBFCs is critical and their presence in a country would only boost the economy in the right direction.

Services provided by NBFCs

So many services provided by NBFC. Providing loans; car financing; home financing; personnel loans, talee mi loans.

Providing loans

The important service is provided by Mf is given loan. These loan are provided from some productive activities like; starting new; business, expansion of business; improving life etc.

Car financing

NBFCs also assist those people who cannot pay total amount at once. So, these MFI gave them car on installments like UBL car financing scheme is too popular anf too ma people taking advantage from this scheme.

Home financing

Pakistan is a poor country. Purchasing power of Pakistan is very low. So many people are living on rent. They cannot have too many amounts to purchase homes. NBFCs provide loans be considering their job stability and take security for it.

Personnel loans

NBFC also obtain personnel loans. Those people who have permanent employment and stable jobs.

This credit facility depends on the income of an individual.

Taleemi loans

NBFC also provide financial aid to the students who cannot bare educational expenses but want to study. NBFC assist them in return of some security and it would have to pay after completing the education.

Game Changers

P Vijaya Bhaskar, ex – Excutive Director, RBI, explained how NBFC companies are game-changers that are very important to the economy.

- **Size of sector:** The NBFC sector has grown considerably in the last few years despite the slowdown in the economy.
- **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. 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 with more customers 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. Since they require large amount of funds, and earn profits only over a longer time-frame, these are riskier projects and deters banks from lending. In the last few years, NBFCs have contributed more to infrastructure lending than banks.
- **Promoting inclusive growth:** NBFCs cater to a wide variety of customers - both in urban and rural areas. They finance projects of small-scale companies, which is important for the growth in rural areas. They also provide small-ticket loans for affordable housing projects. All these help promote inclusive growth in the country.

NBFCs aid economic development in the following ways

- Mobilization of Resources - It converts savings into investments
- Capital Formation - Aids to increase capital stock of a company
- Provision of Long-term Credit and specialized Credit
- Aid in Employment Generation
- Help in development of Financial Markets
- Helps in Attracting Foreign Grants
- Helps in Breaking Vicious Circle of Poverty by serving as government's instrument

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The Technology Backbone

With the increasing role of NBFCs in the Indian Economy, the Reserve Bank of India has issued the notification Master Direction - Information Technology Framework for the NBFC Sector this year. The directions on IT Framework for the NBFC sector are expected to enhance safety, security, efficiency in processes leading to benefits for NBFCs and their customers. NBFCs with asset size above 500 cores are expected to adhere to the new "recommendations" by 30th September 2018. Recommendations for smaller NBFCs include developing basic IT systems mainly for maintaining the database.

What Makes NBFCs Crucial To India's Economy?

Non-banking financial companies (NBFCs), the financial intermediaries that recently have caught the country's attention, are an imperative part of the Indian financial system, catering to the diverse financial needs of millions of small firms as well as individuals.

Certain sections of the society, primarily the economically weaker sections, for whom banks are perhaps unaffordable and inaccessible, rely solely on NBFCs to meet their credit requirements. These companies are the primary financers to those small and medium sized businesses, whose growth is critical for the growth of the Indian economy.

ROLE OF NBFC'S: NBFCs like banks and other financial institutions act as intermediaries between the ultimate savers and the ultimate borrowers. Financial intermediaries can provide a more economical service because of the economies of scale, their professional expertise and their ability to spread the risk over a large number of units. Thus, their operations give to the saver the combined benefits of higher return, lower risk and liquidity. The borrowers on the other hand also get a wider choice on account of intermediation of financial institutions. It may be of relevance to note that while the loans granted by commercial banks are, by and large, for industrial, commercial and agricultural purposes, those granted by NBFCs are generally for transport, trading, acquisition of durable consumer goods, purchase and repair of houses or just for plain consumption. The Reserve Bank of India expert committees identified the need of NBFC in the following areas:

- Development of sectors like transport and infrastructure
- Substantial employment generation
- Help and increase wealth creation
- Broad base economic development
- Irreplaceable supplement to bank credit in rural segments
- Major thrust on semi-urban, rural Areas and first time buyers/ users
- To finance economically weaker sections
- Huge contribution to the state exchequer.

Contributions in Financial Services (NBFCS vs. Banks) In India financial institutions including banks and NBFCs provide some or all of the following core financial services. These services are often provided in combinations:

(i) Some financial institutions provide payments services - by issuing claims that have the capacity to be used in settling transactions. To serve as an effective means of payments, a claim must have a highly stable and reliable value, be widely accepted in exchange and must be linked to the arrangements for ultimate settlement of value.
(ii) Liquidity is the ease with which an asset's full market value can be realized once a decision to sell has been made. Financial institutions enhance liquidity through specialization and scale.
(iii) Divisibility is the extent to which an asset can be traded in small denomination. Financial institutions break up large denomination claims and aggregate small denomination claims to to meet divisibility preferences of the community.
(iv)Store of value is the extent to which an asset provides a reliable store of purchasing power overtime – this is fundamental to satisfying savings preferences.
(v) Information is costly to access and process. Providing economies of scale in processing and assessing risks is an important role of financial institutions.
(vi)Risk pooling is the extent to which an asset spreads the default risk of the underlying promises by pooling. By pooling assets, financial institutions have much scope to risk pool than do individuals.

Role of NBFCs in economic development:

There is a growing body of hard evidence to suggest that the development of financial intermediaries contribute strongly to economic development of the country. This contribution is increased where intermediation is provided through a balanced combination of banks and NBFCs. In particular, there is a strong correlation between the depth and activeness of non-banks and stock markets on the one hand, and economic development on the other hand.

Role of NBFCs in financial stability:

In a financial sector in which NBFCs are comparatively undeveloped, banks will inevitably be required to assume risk that to otherwise might be borne by the stock market, collective investments schemes or insurance companies. However, there is basic incompatibility between the kinds of financial contracts offered by the banks and those offered by the financial institutions. Thus, banks are more likely to fail as a result. One way of minimizing financial fragility in the developing economies may be to encourage a diversity of financial markets and institutions, where investors are able to assume a variety of risks outside the banking system itself.

Role of NBFCs in financial inclusion:

Financial inclusion has been defined as the "provision of affordable financial services" to those who have been left unattended or under attended by formal agencies of the financial system. These financial services include "payments and remittance facilities, savings, loan and insurance services". Micro finance has been looked upon as an important means of financial inclusion in India. Micro finance is not just provision of micro credit but also other services in small quantities to the poor i.e. providing essential financial services to the poor in an affordable way. Financial Inclusion also is aiming at the same by providing the poor with not only deposit accounts or credit but also insurance and remittance facility.

Role of NBFCs in capital market:

Investment activity of NBFCs sector comprises a significant of their total assets. These constitute mainly investments in capital market. There are specialized NBFCs that are exclusively engaged in capital market investment i.e. trading in securities. These NBFCs therefore help in giving liquidity to the capital market. Further, NBFCs also lend to investors for investing in capital market. Regulatory challenges in this regard might come in the form of probable overheating of the market, which could be addressed through appropriate regulatory measures including enhanced disclosures.

Role of NBFCs in factoring:

Factoring as defined in the factoring regulation act, 2011 involves acquisition of receivables (by a factor) thereby getting entitled to undivided interest on the receivables or financing against the security interest over any receivables but does not include credit facilities provided by a bank in its ordinary course of business against security of receivables. Subsequent to the notification of the Factoring Regulation Act by the Government, Reserve Bank formed a new category of NBFCs called NBFC-factors and issued directions to them. NBFC-Factors are almost exclusively engaged in providing factoring service.

Role of NBFCs in infrastructure financing:

Infrastructure Finance Companies and Infrastructure Debt Funds are NBFCs exclusively into financing the infrastructure sector. Some of these companies have asset books running to lacks of crores of rupees and are experts in long term project financing. Recognizing their significance, the Reserve Bank has given special dispensations in the form of enhanced bank credit, higher exposure norm ceiling and provision of ECB under automatic route for on lending to infrastructure sector. The asset liability pattern however, is a matter of concern in the case of IFCs as these are lending long term against comparatively shorter term liabilities.

Problems and Challenges of NBFCs in India:

The new regulations announced by the RBI are welcome in certain aspects as it is necessary to have higher capital adequacy norms and also better management of funds. But there is confused thinking about how NBFCs should mobilize resources and increase their hire purchase and leasing business. The failure of CRB Corporation and the fiasco following default by many nidhis in their obligations to depositors have obviously been responsible for the monetary authorities to take a severe view of the operations of NBFCs. However, the latest moves are in strong contrast with those adopted in earlier years when it was pointed out that NBFCs should mobilize resources on their own and not depend to any great extent on bank finance or term loans from financial institutions. The ratios for accepting deposits from the public in relation to owned funds were liberally conceived and only recently AAA companies were allowed to accept deposits or fix interest rates without any limit.

The new stipulations relating to the acceptance of deposits by differently rated companies will cause hardship to those which have been placing greater reliance on deposit mobilization rather than on securing credit from banks. The latter also were adopting a step-motherly attitude towards NBFCs due to an impression that they were competitors and transacting business with banks funds which could have been handled by them.

CONCLUSIONS

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. This role has been well recognized and strongly advocated for, by all the Expert Committees and Taskforces setup till date, by Government of India and Reserve Bank of India. 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. They have been to some extent successful in filling the gap in offering credit to retail customers in underserved and unbanked areas. The relevance of the findings of this study lies in the fact that risk plays an important role in NBFCs performance. Risk management should be within the purview of risk managers as well as the Central Bank of the country.

The findings of the study suggest that prudent risk management practices or lower risk-taking incentives on the part of Indians NBFCs lead to a significant increase in their performance. It is further suggested that regulatory authorities should take into consideration the impact of the risk-taking activities of NBFCs on their performance and embark on more close inspection and enforcement of regulations. These actions will go a long way to help improve the performance of the NBFI sector which would aid in strengthening the financial system of the country.

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