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Recital of Non-Banking Monetary Companies in Synopsis

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Abstract

A robust banking and financial sector is critical to facilitate higher economic growth. Financial intermediaries like Non-Banking Financial Companies (NBFCs) constitute a significant element of the financial system that has penetrated into those areas where banks did not dare by taking both the operational and regulatory risks. Boom-Mushroom-Doom-Zoom, four words in a sequence tell the entire story of performance of NBFCs during the past one and a half decade. To give industry the much needed boost, service tax should be done away with. Special cells within the courts be set up to dispose cases because justice delayed is justice denied The non-banking financial sector is witnessing a consolidation process, with smaller NBFCs (deposit-taking) opting for either merger or closure and some larger ones getting converted into non-deposit-taking NBFCs. NBFCs are comfortably placed with higher capital. The financial performance of deposit-taking Non-Banking Financial Companies (NBFCs-D) showed an improvement as reflected in the increase in their operating profits mainly emanating from growth in fund-based income. Systemically Important-Non-deposit taking NBFCs (NBFCs-ND-SI) segment continued to rely on bank finances for their resource requirement. There is sign of deterioration in the quality of assets in respect of NBFCs-ND-SI. The set of regulations prescribed for NBFCs sector expected to make the NBFCs more resilient in the medium term. The combined balance sheets of financial institutions (FIs) expanded and operating profit as well as net profit have increased significantly. The impaired assets of the FIs showed growth and are a matter of concern.

Key Words: NBFC; NBFI; NBC.

Introduction

Non-banking financial institutions (NBFIs) are an important part of the Indian financial system. The NBFIs at present consist of a heterogeneous group of institutions that cater to a wide range of financial requirements. The major intermediaries include financial institutions (FIs), non-banking financial companies (NBFCs) and primary dealers (PDs).

This chapter provides an analysis on the financial performance and reliability indicators related to each segment of NBFIs during 2011-12. The chapter is organized into five sections. Section 2 analyses the financial performance of FIs, while Section 3 discusses the financial performance of NBFCs-D and NBFCs-ND-SI, including RNBCs. Section 4 provides an analysis of the performance of PDs in the primary and secondary markets, followed by the overall assessment in Section 5.

Financial Institutions

As at end-March 2012, there were five financial institutions (FIs) under the full-fledged regulation and supervision of the Reserve Bank, viz., Export Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB), Small Industries Development Bank of India (SIDBI) and Industrial Investment Bank of India (IIBI)

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However, IIBI is in the process of voluntary winding-up.

Operations of Financial Institutions

Combined balance sheets of financial institutions (FIs) expanded The financial assistance sanctioned and disbursed by FIs increased during 2011-12 due to increase in sanctions and disbursements made by investment institutions (LIC and GIC) and specified financial institutions (IVCF and TFCI). However, sanctions and disbursements made by IFCI have declined in 2011-12.

Assets and Liabilities of FIs

The combined balance sheets of FIs expanded during 2011-12. On the liabilities side, deposits and 'bonds and debentures' remain the major sources of borrowings during 2011-12. On the assets side, 'loans and advances' continued to be the single largest component, contributing more than four-fifth of the total assets of the FIs.

Non-Banking Financial Companies (NBFCs)

Non-banking financial companies (NBFCs) are fast emerging as an important segment of Indian financial system. It is a heterogeneous group of institutions (other than commercial and co-operative banks) performing financial intermediation in a variety of ways, like accepting deposits, making loans and advances, leasing, hire purchase, etc. They raise funds from the public, directly or indirectly, and lend them to ultimate spenders. They advance loans to the various wholesale and retail traders, small-scale industries and self-employed persons. Thus, they have broadened and diversified the range of products and services offered by a financial sector. Gradually, they are being recognized as complementary to the banking sector due to their customer-oriented services; simplified procedures; attractive rates of return on deposits; flexibility and timeliness in meeting the credit needs of specified sectors; etc.

Top 20 non-banking finance companies of India

Table 1: Top 20 Non-banking Finance Companies of India

Company Name	Market Cap. (Rs. Billion)*
HDFC	445.3
Power Finance Corp.	150.1
Reliance Capital	105.2
IDFC	77.1
Rural Electricity Corp.	67.4
Shree Global	**61.5**
ShriramTransport Finance	**39.7**
Bajaj Finserv	**27.1**
Indiabulls	**25.7**
Religare Enterprises	**24.5**
Bajaj Holdings	**23.5**
M&M Financial	**22.6**
LIC Housing Finance	**20.1**
Edelweiss Capital	**17.9**
KGN Industries	**17.1**
Shriram City	**15.8**
IFCI	**15.8**
JM Financial	**15.8**
India Infoline	**13.1**
Centrum Finance	**11.1**

Source*as on Jan 17, 2008.

The top finance companies of India excluding banks when ranked on their market value were following as on 17 Jan 2008.

Housing Development Finance Corporation Limited (HDFC) headquartered in Mumbai is the biggest private sector public housing mortgage company. Its major shareholders are Foreign Institutional Investors with about 59% holdings. FDI holds 15% while Insurance companies and mutual funds hold about 12% of its shares. Citigroup through its Mauritius subsidiary, Citigroup Strategic Holdings Mauritius Ltd, is the biggest shareholder with 9.1% in HDFC.

Power Finance Corporation Ltd (PFC) is one of the Navratna Public Sector Undertakings (the best government companies in India). PFC is the provider of large range of financial products in the power finance sector. It is playing an important role in developing India's power sector.

Reliance Capital Ltd, Reliance: Anil Dhirubhai Ambani Group (aka ADAG) company, is one of India's fastest growing private sector financial services firm. Reliance Capital has business spread across domains like asset management, insurance, private equity, stock broking, depository services, consumer finance etc. Promoters group holds 53% of shares in Reliance Capital.

Importance of NBFCs

Non-Banking Finance Companies play an expanded role to accelerate the pace of growth of the financial market. They also help to bridge the credit gap in several sectors. They play an important role in economic development. They play important role in the following ways:

- *Intermediary:* They collect the savings of the people and lent to various parties like household, firm, small enterprises on sustained basis. In this ways they bring the savers and lenders together and this help in mobilizing resources in the economy.
- *Promotion of Business Sector*: It helps the business sector by financing it through loans, mortgages, purchase of bonds, shares etc. in flexible terms and procedures.
- *Help the Central, State and Local Government:* NBFCs helps the local bodies by purchasing their bonds and by selling and purchasing the securities of the government.
- *Provide Liquidity:* NBFCs provide liquidity when they convert an asset in to cash easily and quickly without loss of value in terms of money.
- *Employment Generation:* NBFCs help in both direct and indirect employment generation. They have employed many persons to man their offices. Besides office staffs, institutions need the services of experts which help them in finalizing lending proposals.

The Reserve Bank of India, categorizes the NBFCs into various categories on the basis of their nature and activities:

Equipment Leasing Company

Equipment leasing company means any company, principal business of which is leasing of equipment or the financing of such activity.

Hire Purchase Company

Hire Purchase companies means any company whose principal business is hire-purchase or financing such transactions. Hire-purchase Company finances the price of the goods to be sold on a future date. The goods are in fact let on hire by the hire purchase company with a condition to pay the installments by the hirer and after all the installments are paid by the hirer will have an option to purchase it later.

Housing Finance company

Housing Finance company is a company which provides finance for acquisition and/or construction of houses, acquisition of land and development of plot/land.

Investment Company

The main business of an Investment Company is to acquire securities and resale it later. They buy new issues from security issuers and make the arrangement of resale to the investing public.

Loan Company

Loan company is a company which carry on its principal business as the providing of finance whether by making loans or advances or otherwise for any activity other than its own. These activities exclude leasing and hire purchase.

Mutual Benefit Financial Companies

Mutual Benefit Financial companies are the companies usually the *'nidhi'* which are notified by the Central Government under section 620A of the Companies Act 1956 (1 of 1956). These companies provide finance to the members of the companies and accept deposits from them.

The important features of these companies are:

- They mobilize deposits from their members and public with an assurance to provide credit when required by depositors.
- They provide credit to those who are usually not financed by banks or out of reach of commercial banking.
- MBFCs are easily accessible, local in character and follow easy and simple procedures.
- They work on sound principles of banking. Their operations are governed by the directives of the RBI.

MBFCs are very old financial institutions existing over 100 years operating mainly in South India.

Miscellaneous Non-Banking Company (MNBC)

MNBC is a company or a financial institution performing all or any of the following activities:

- Collection of money in one lump sum/ installments by way of contributions/ subscriptions, sale of units and other instruments, granting membership admission fee or in any manner.
- Manage/conduct/supervise transaction/ arrangement relating to an agreement with the subscribers, each one of whom subscribes a certain sum in installments over a definite period, and is entitled to a prize amount on the basis of draw of lots or by auction/tender.
- Carry on the activity in any other form of chit
- Undertake/carry on/ engage in any other business similar to the above.

Globalization Banking Industry

In modern time there is a huge reduction to the barriers of global competition in the banking industry. Increases in telecommunications and other financial technologies, such as Bloomberg, have allowed banks to extend their reach all over the world, since they no longer have to be near customers to manage both their finances and their risk. The growth in cross-border activities has also increased the demand for banks that can provide various services across borders to different nationalities. However, despite these reductions in barriers and growth in cross-border activities, the banking industry is nowhere near as globalized as some other industries. In the USA, for instance, very few banks even worry about the Riegle-Neal Act, which promotes more efficient interstate banking. In the vast majority of nations around globe the market share for foreign owned banks is currently less than a tenth of all market shares for banks in a particular nation. One reason the banking industry has not been fully globalized is that it is more convenient to have local banks provide loans to small business and individuals. On the other hand for large corporations, it is not as important in what nation the bank is in, since the corporation's financial information is available around the globe.

Non-Banking Company (NBFCs)

NBFCs account for 12.3 per cent of assets of the total financial system. there are two broad categories of NBFCs based on whether they accept public deposits ,namely deposit-taking NBFCs (NBFCs-D) and non-deposit taking NBFCs (NBFCs-ND).Total number of NBFCs registered with RBI ,consisting of NBFCs and NBFCs-ND, declined from 12630 at end June 2010 to 12409 at end June 2011.the number of NBFCs-D declined from 308 to 297,mainly due to the exit of many NBFCs-D from deposit-taking activity, while non-deposits taking systematically important NBFCs(NBFCs-ND-SI with asset Rs100 crore and above)increased from 260 to 330 during the same period reaming the 370 incresed.Under the NBFCs-D category there are two residuary non-banking companies (RNBCs).

Number of NBFCs Registered with RBI

End June	Number of Registerd NBFCs	Number of NBFCs-D	Number of NBFCs-ND-SI
2005	13261	507	---
2006	13014	428	149
2007	12968	401	173
2008	12809	364	189
2009	12740	336	234
2010	12360	308	260
2011	12409	297	330
2012	12385	271	370

Source: RBI

Major Policy Development

The regulatory and supervisory framework of NBFCs continued to focus on prudential regulations with specific attention to the Cs-ND-SI. Following are some of the important development:

1. NBFC-Micro Finance Institutions (NBFC-MFIs): Provisioning Norms-Extension of Time and Modification
2. Lending against Security of Single Product Gold Jewellery
3. The Non-Banking Financial Company Factors (Reserve Bank) Directions 2012
4. Core Investment companies (Reserve Bank) Directions2011 Clarification on CICs Issuing Guarantees
5. Infrastructure Debt Fund (IDFs)
6. Revision to the Guidelines on Securitization of Transactions

The types of NBFCs registered with the RBI are:

- *Equipment Leasing Company:* is any financial institution whose principal business is that of leasing equipments or financing of such an activity.
- *Hire-Purchase Company:* is any financial intermediary whose principal business relates to hire purchase transactions or financing of such transactions.
- *Loan Company*: means any financial institution whose principal business is that of providing finance, whether by making loans or advances or otherwise for any activity other than its own (excluding any equipment leasing or hire-purchase finance activity).
- *Investment Company:* is any financial intermediary whose principal business is that of buying and selling of securities.

NBFCs have been reclassified into three categories:

- Asset Finance Company (AFC)
- Investment Company (IC) and
- Loan Company (LC). Under this classification, 'AFC' is defined as a financial institution whose principal business is that of financing the physical assets which support various productive/economic activities in the country.

Type of Services Provided by NBFCs

NBFCs provide range of financial services to their clients. Types of services under non-banking finance services include the following:

1. Hire Purchase Services
2. Leasing Services
3. Housing Finance Services
4. Asset Management Services
5. Venture Capital Services
6. Mutual Benefit Finance Services (Nidhi) banks.

The above type of companies may be further classified into those accepting deposits or those not accepting deposits.

Now we take a look at each type of service that an NBFC could undertake.

Banking & Non-Bank Financial Markets (BNFM) Practice Area

IBTCI has gained repute as a company for creating excellence in financial sector reform projects worldwide. Our Banking and Non-Bank Financial Markets Practice entails reform of government policy, strategy, project oversight, and implementation of financial systems including: Banking, Capital Markets, Non-Bank Financial Institutions (inclusive of Insurance Companies, Development Financial Institutions), Corporate Governance, Market Integrity and Payment Systems.

Since the commencement of the practice in 1994, IBTCI has implemented small-scale and large-scale projects in more than 25 countries in emerging markets across the globe. The primary clients for our practice have been ADB, First Initiative, USAID, and the World Bank.

Conclusion

Governance, like regulation, is an evolving concept and is continuously fine tuned to suit the dynamic economic and business environment. Global financial crisis has given us an opportunity for strengthening both the regulatory as well as governance frameworks, by high lighting gaps that exacerbated the crisis. There is an interesting debate over whether and how much regulation can substitute board level governance. While regulation is imposed from outside, corporate governance is internal and is more in the nature of self regulation which ensures that the principles and rules laid down by the regulations are scrupulously adhered to. Prior to the crisis, the emphasis was increasingly on self regulation through robust corporate governance so that the regulation could remain largely principle based and less prescriptive. However, serious lapses observed in governance framework during the crisis, tilted the balance in favour of more rigorous regulation. I am of the view that both regulation and corporate governance have to complement each other. Effective regulation furthers corporate governance and effective corporate governance ensures that the objectives of the regulation are met, with a minimal regulatory intervention.

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