NBFC: GROWTH PROSPECTS, ISSUES, AND CHALLENGES IN INDIA

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ABSTRACT

*As an alternative to traditional banking, non-bank financial companies (NBFCs) are emerging. They also emerge as an integral part of the Indian Financial System and have praiseworthy contributions to the financial inclusion agenda of the government. In filling the gap in providing credit to retail customers in underserved and unbanked regions, they have been successful to some degree.NBFCs form acrucial part of the Indian Financial system. It has been intermediating a growing share of the resource flows to the commercial sector (Das, 2016). NBFCs complement the role of the banking sector in meeting the growing financial needs of the corporate sector. NBFC's in India after being in operation for a few decades have been instrumental in helping small and middle income owners to develop their businesses apart from the financial inclusion part where they provide credit to those citizens who otherwise would be eligible for organized credit for MSME Sector ("Non Banking Financial Companies" The Changing Landscape, 2016). The present paper "**NBFC: GROWTH PROSPECTS, ISSUES AND CHALLENGES IN INDIA**" have given focus on areas like defining the term NBFCs, evolution, growth and development of NBFCs, the role of NBFCs in Indian economy, their importance in the Financial Inclusion, and SWOC analysis of* ***NBFCs*** *sector.*

Keywords: *Financial inclusion, NBFCs, MSME, Financial system, RBI, SWOC*

1. Introduction

The financial services sector of India comprises not only banks, but also non-bank financial firms.The role of NBFCs is important to the economy, when a large part of the population still lives in rural/semi-urban areas. With an economic revival is pegged to the growth of rural and suburban economies, NBFCs' role in deposit mobilization and credit extension can hardly be overemphasized. The role of NBFCs as an effective intermediary has been well recognized, with the core strengths of NBFCs being strong customer relationships, excellent understanding of regional dynamics, well-developed collection systems and personalized services. In this function, they are supposed to be playing a complimentary role to banks rather than being competitors, reaching out in areas where banks have a limited presence.

At the same time, NBFCs have built a niche for themselves in terms of product profile, by prov iding the growth and development of their resp ective business sectors.NBFCs bring the much-needed diversity to the financial sector, thereby diversifying risks, increasing liquidity in the market, thus promoting financial stability and bringing efficiency to the financial sector.The role of NBFCs can't be undermined in the financial inclusion agenda. While RBI's model for financial inclusion is essentially bank-driven, NBFCs have the potential to partner banks in driving home the agenda, especially with their wider and deeper reach (Pwc, 2018).

As the significance of NBFCs has been growing over time, there arises the need for regulating these financial institutions primarily because of high leverage, the asset-liability mismatch and the capacity to engender havoc to the real sectors of the economy. The development started in the 1950-60s when several banks failed; undermining the necessity to regulate not only banks but also other financial institutions that have the potential to cause disruption. Over time, we have seen RBI tightening the regulatory structure over NBFCs, with registration requirements, enhanced reporting and supervision as their growing size and interconnectedness raise potential concerns on financial stability. The need to monitor was also reinforced after the global financial crisis, which highlighted the way through its interconnectedness with the regular banking system NBFCs has potential to mar the global financial growth (Speeches of RBI, 2014).

2. Literature Review

Literature Review is the study of the various papers, articles, and project that have been done on the topic. "NBFC: Growth Prospectus, Issues and Challenges in India”. in the past years. The data for this purpose has been collected from articles and the reports of RBI on to the NBFC sector presented by Monitory advisors of such organizations & articles in the Indian banker journal.

- Harsimran Kaur A. and Dr. Bhawdeep Singh Tanghi(2013) analyzed that NBFCs playing a crucial role in terms of macroeconomic prospective as well as strengthening the structure of the Indian Monitory System. Consolidation in the sector and better regulatory framework for NBFCs has become more focused.
- Dr. Yogesh Maheshwari (2013) in his paper state that “Changing Monitory scenarios have opened up opportunities for NBFCs hasto extend their global presence through self expansion strategic alliance etc. The Monitory reforms have brought Indian Monitory system closer to global standards”.
- Kaur and Tanghi (2013) investigated on the topic “Non Banking Financial Companies, Role & Future Prospects” with a focus to analyze role and significance of NBFCs in India. The paper concludes that NBFCs have to focus more on their core strengths and must constantly endeavor to search for new products and services in order to survive and grow constantly.
- Arun kumar (2014) has made an attempt on the topic “Non Banking Financial Companies: A Review” and after observing twelve studies of different authors he concluded that due to the regulations of the Reserve Bank of India, still the NBFCs are not entering into more credit and suggested to the NBFC credit policy to reduce rates of interest. The study finds a research gap which is ‘evaluation of performance of NBFCs in India’.
- Mohan (2014) observed on the topic “Non Banking Financial Companies in India: Types, Needs, Challenges, and Importance in Financial Inclusion” and suggested to improve Corporate Governance Standards and concluded that NBFCs have turned out to be engines of growth and are integral part of the Indian financial system, by increasing competition and diversification in financial sector, spreading risks specifically at times of financial pain and have been increasingly recognized as complementary of banking system at competitive prices.

3. Objectives of the study:

The main objectives of study are;

- To study the role of NBFCs in development of Indian economy.
- To analyzed SWOC analysis of NBFC sector.
- To examine challenges faced by NBFCs.

4. Research Methodology of the study:

- Research Methodology the present study based on secondary data. The data have been collected from PWC, RBI reports (Statistical Tables Relating to NBFC in India), Journals, Magazines, Books, Newspapers and Websites.
- **Data Analysis and Presentation:** This section represents the data which was drawn from the annual reports of non-banking financial industry is taken in to evaluation and analysis. Past findings journals research on-line article & other sources of secondary data is collected to justify any recommendations given throughout the research.

5. Role of NBFC developing Indian economy

Due to limited access to mainstream funding in the sector, this presents a huge opportunity for the NBFCs to the tune of INR 384 billion over the next 5 years in the MSME Small Loan Credit Market. The role of NBFCs as a credit delivery channel to micro and small business has been well acknowledged and has been primarily driven by the need to meet the unmet demand for credit by developing various innovative and tailored financial products for specific sub-segments. Though the NBFCs do not have any meet any PSL guidelines like the banks, they are governed by different set of regulations prescribed by the RBI with lower compliance requirements. Due to the simpler structure and business processes of NBFCs vis-à-vis the banks, the branch outreach is comparable to regional banks and the ability to provide timely and flexible repayments terms based on cash flow assessment to clients is quite high. This has benefited the NBFCs in better understanding the micro lending segment while also improving their credit appraisal system (Fimpact News Letter, 2014).

NBFCs have been operating a variety of businesses under sound economics. Many businesses started by the sector have afterward been taken up by banks and become regular banking services. For instance, car financing, which was started by NBFCs, has now become one of the major revenue streams for banks. The NBFCs themselves have now started on to financing second hand cars. Other businesses, namely, infrastructure finance, asset finance, hire purchase and, in the recent past, microfinance have been the key areas of operations for NBFCs. Additionally, NBFCs play a supportive role in the economy and as well in financial inclusion and therefore need to be encouraged. Several of the economic roles played by NBFCs are:

5.1 Serving unbanked customer segments

NBFCs have traditionally focused on customer segments which were not served by banks like micro, small and medium enterprises (MSMEs), funding of commercial vehicles including old vehicles, farm equipments viz. tracking, harvesters, etc. loan against shares, funding of plant and machinery; etc.

NBFCs typically are specialized vehicles –both in terms of products and the geographies in which they operate. These specializations offer them a unique framework to assess the risk in the undertaken business. Much closer market awareness provides them the ability to rate borrowers, monitor them, price the relative credit suitably and affect recoveries from them.

NBFCs also offer credit for certain sectors which are not served by banks and Financial Institutions because Banks/FIs do not have adequate market relationships and infrastructure for the same. Some of these sectors are:

a) Used Trucks
b) Used passenger vehicles
c) Consumer durable loans
d) Personal Loans
e) financial support to the Small & Medium Enterprises (SME Sector)

Usually, these sectors were financed entirely by the unorganized financiers at exorbitant high interest rates. In the last 10 years, with their retail strength, NBFCs have given significant service by extending credit to these sectors. Now banks and financial institutions are benefitedby the reach and expertise of NBFCs for employing funds in these sectors through NBFCs. This has brought in lot of funds into these sectors, thereby declining interest rates.

5.2 Strong understanding of customer segments and ability to offer customized products

The ability of NBFCs to make innovative products in consonance with needs of their clients is well recognized. This, in addition to the proximity to the clients, makes the NBFCs distinct from its banking sector counterparts. In a short period of time, NBFCs have turn out to be market leaders in most of the retail finance segments like commercial vehicles, car financing and personal loans. In the last decade or so, the Indian retail finance markets have seen a number of new products being developed and introduced by NBFCs. The following are a few cases in point - Used vehicle financing, Small ticket personal loans (ST-PL), Three-wheeler financing, Loan against shares.NBFCs have a significant economic role, particularly servicing the under-banked and unbanked populace and geographies. Bringing the diverse set of NBFCs under regulation rather than curtailing their operations would help orderly growth of the sector(Goverment of India Ministry of Finance, 2011).

a. The specific role and importance of NBFCs

a) **Term loan assistance:** Term loans are provided for (i) Setting up of new projects and for technology up gradation / modernization, diversification, expansion, energy efficiency, adoption of clean production technologies, etc. of existing MSMEs (ii) Service sector entities and (iii) Infrastructure development and up gradation. It also provides Privileged Customer Scheme, Scheme for Energy Saving and Clean Production Technology Projects in MSME Sector, Risk Capital Fund.

b) **Working capital assistance:** The objective of the Scheme is to provide term loans to MSMEs to meet up the shortfall in working capital including WC margin. It also includes Working Capital arrangement with NBFCs.

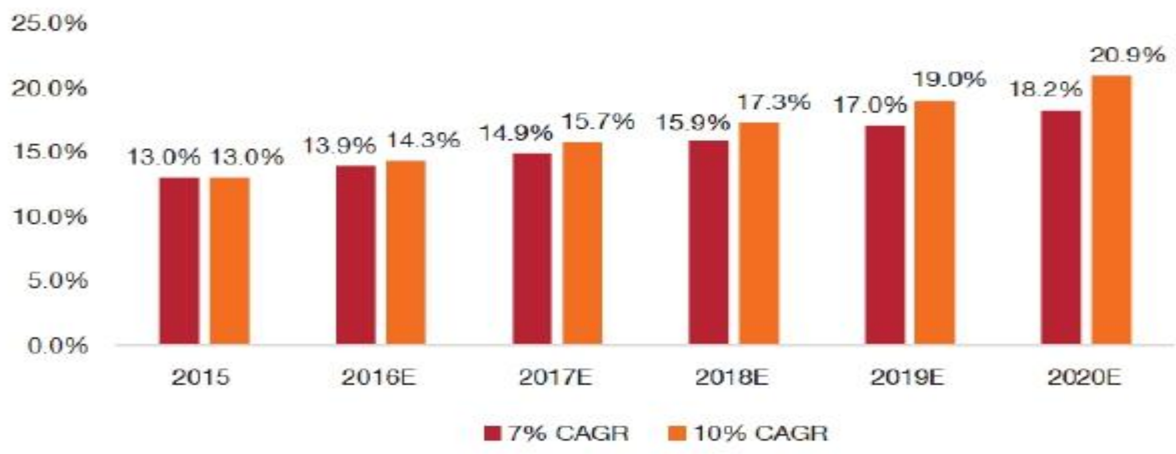
c) **Easy Credit Access:** Given the universal target access, the official procedure and processes at NBFCs are far simpler. It also provides financial access for unusual means like religious functions etc. which don't find mention in commercial banks product portfolio. The Banking sector has always been highly keeping pace, however easy approval procedures, flexibility in working approach and timeliness in meeting the credit needs and low operation cost skew the balance in favor of NBFCs in offering funding(ResurgentIndia.com, 2016).

d) **Reduce Credit Funding Gap:** There is a vast latent credit demand in the country that gets aggravated for specific segments like self-employed or small businesses with little or low income proof. The gap is more compounded with public sector banks already under severe bad-debts. This impacts the credit appetite for banks in medium to short run, which is offered by NBFCs, thereby reducing the credit funding gap (Resurgent India Ltd, 2016).

e) **Promote Economic Growth and Inclusion:** The role of NBFCs as engine of development through creation of a multi layered finance system that enables universal access is well acknowledged. They allow small scale businesses by providing them awareness, access and diversification of securities and investment. They also have an active role in the capital markets and its stability(Resurgent India Ltd, 2016).

f) **Credit to MSMEs:** MSME sector has high employment potential of 59.7 million persons over 26.1 million enterprises and is considered as adriving force for economic growth and promoting financial inclusion in rural areas. The outstanding credit provided by the NBFC sector to MSMEs stand at Rs.625 billion as at end March 2013 compared Rs.464 billion in the previous year. Statistics based on 4th Census on MSME sector revealed that only 5.18% of the units (both registered and un-registered) had availed finance from institutional sources. 2.05% got finance through non-institutional sources the majority of units say 92.77% had no finance or depended on self-finance. In reality large segment in the micro and small industries sector does not have access to formal credit provides a window of opportunity for the NBFCs to design appropriate innovative products. [RBI Speech, 2014].

Fig.1 Credit Growth of NBFC as % of total credit



Source: Pwc 2016

6. SWOC analysis of NBFC

A scan of the internal and external environment is asignificant part of the strategic planning process. The SWOT analysis helps to identify strategies and techniques that need to be adopted for increasing strengths and reducing weakness and to oppose threats and turn them into opportunities. Environmental factors internal to the institution generally are classified as strengths (S) or weaknesses (W) and those external to the institution are classified as opportunities (O) or challenges (C). Such an analysis of the strategic environment is referred to as a SWOC analysis.

Strengths	**Weakness**
• High on service aspect • Strong last-mile approach • Focus on recovery n Easy and fast appraisal & disbursements • Regional kshatraps • Able to generate higher yield on assets • Attained critical mass in terms of size • Own employees vs DSAs	• Weak in urban market • Weak credit history of most NBFCs n Largely restricted to the south India market • Weaker risk-management & technology systems • Too much of diversification from core business • Higher regulatory restrictions
Opportunities	**Challenges**
• Augmentation of capital and leveraging for growth • Large untapped market, both rural & urban and also geographically • Demographic changes and under-penetration • New opportunities in credit card, personal finance, home equity, etc • Tie-up with global financial sector giants • Blurring gap with banks in terms of cost of funds • Securitization, to liberate funds to fuel asset growth	• Weak financial health of many of the NBFCs • High cost of funds • Asset quality deterioration may not only wipe out profits but also net worth • Entry of foreign players in post-2009 scenario • Growing retail thrust within banks

Table 1 SWOC Analysis **Source: (Jay Prakash Sinha, 2005)**.

7. Challenges faced by NBFCs

Though the NBFCs are well placed to take advantage on a variety of aspects such as vast financing gap in the MSME sector, lower regulatory requirements, and wide branch coverage along with improving micro/small segment evaluation process, they are heavily challenged by way of their funding requirements. NBFCs are dependent on the commercial banks for the majority part of the debt requirement besides equity from promoters or other investors. There has been financing aid from SIDBI to provide the credit facility to the NBFCs operating in the MSME sector. NBFCs too are faced with a gamut of challenges. Some of the key challenges have been outlined:

- Increasing NPAs and lower recovery of loans owing to economic slowdown, poor business climate and absence of special powers like SARFESI Act. improved competition viz. from banks which have a competitive advantage owing to regulatory bias
- Giving rise to an uneven playing field. Regulatory tightening and convergence (with banks) leading to uncertainties and less flexibility.

- NBFCs lacking the benefits of access to CASA like benefits. Funding / resource mobilization challenges given a range of constraints in the banking and capital markets –
- Squeeze on flow of bank credit, regulatory tightening with respect to raising funds through NCDs under private placement, and changes in assignment rules Increased cost of borrowings/ funds due to economic and regulatory reasons and significant reliance.
- On banks for borrowing lesser leveraging capacity due to higher risk weights and higher capital adequacy requirement.
- Insufficient and unsupportive legal framework which renders recovery of dues very difficult and
- Expensive Challenge of meeting 75/25 core factoring asset/income ratio by July 2014, while maintain profitability of an operations.

NBFCs have also turn into riskier segments such as unsecured loans, purchase finance for used commercial vehicles, capital market lending, etc. Moreover, NBFC's customer profile is concentrated on the self-employed segment. The earlier mentioned factors increase their risk profile which could have unfavorable impact on the financial health of NBFCs (CARE Ratings, 2014).

8. Area of future research of NBFC sector

Non Banking Finance Companies have been the talk of the town with their significant ability to cater to the diverse entrepreneurial demands of the country. The sector has been an essence of innovation and has turn into infrastructure financing and micro-finance, mitigating the debt crunch of every segment of the Indian Economy.While conventional banks have been hampered by the weight of their Non Performing Assets, NBFCs have responded positively to regulatory norms by addressing such risks through regulations. It has been a noteworthy story of progress for the sector which began as an informally governed fragmented entity to being well-regulated and in most cases adheres to state of the art technological upgrading, risk management and governance.

NBFC's are rapid turning out to be a clear alternative to mainstream banking. The sector is also growing as an integral part of the Indian financial system and has actively contributed to the Government's agenda of financial inclusion. They have lead from the front in providing credit to retail consumers beyond the reach of traditional banking. NBFC Regulations which has been generally derived from the banking framework has been modified overtime by the RBI to ensure the ease of doing business in the midst of universal volatilities. NBFCs have been playing a very essential role both from the macroeconomic point of view and the structure of the Indian financial system. NBFCs are the perfect or even better alternatives to the conventional banks for meeting various financial requirements of a business concerns. They offer efficient and quick services without preparing one to go through the complex rigmarole of conventional banking formalities. However to sustain and to constantly grow, NBFCs have to center on their core strengths while improving on weaknesses. They will have to be very vibrant and constantlyendeavor to search for innovative products and services in order to survive in this ever competitive financial market (Dr. Y. Maheshwari, 2013).

Since NBFCs have been kept outside the purview of SARFAESI Act, a reform in this area is quite urgently needed. A suitable legislative amendment extending the operation of the said Act to NBFCs too would go a long way in fortifying the faith of the investors and which in turn would greatly contribute to the growth of this Sector.

9. Conclusion

NBFCs have proven to be growth engines and are an integral part of the Indian financial system, improving competitiveness and diversification in the financial sector, spreading risks especially in times of financial crisis, and increasingly being recognized as complementary to the competitive pricing banking system. The banking industry has always been highly regulated, but sanctuary has been simplified as per a Fitch Report, the Compounded Annual Growth Rate of NBFCs was 40% in comparison to the CAGR of Banks which was only 22% (2, 2016).

It is clear from the SWOC Analysis that NBFCs themselves can take steps to minimize their vulnerability and face all threats by making better use of their defined strengths and opportunities. The areas that need effective action are the debt recovery area that requires policy support and encouragement. The NBFC sector's future is bright with enough the future of the NBFC sector is bright with ample opportunities thrown open to the NBFC sector. Those NBFCs with staying power and long term vision would be in the sector and others will be forces to leave the financial services sector.

NBFCs as innovators, serving unbanked and under banked geographies and non-banked consumer segments and products, it is crucial that some degree of priority be given to the growth and development of the sector. With sufficient regulatory oversight of systemically important NBFCs, prudential standards enforcement, regular reporting and monitoring, etc. NBFCs may be look at playing a major part in the financial services sector.

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