Performance of Non-Banking Financial Institutions

Jency S
M. Phil Scholar,St. BerchmansCollege,
Changanassery,Kottayam, Kerala

Abstract

The financial sector in any economy consists of several intermediaries. Apart from banking entities, there are investment intermediaries (such as mutual funds, hedge funds, pension funds, and so on), risk transfer entities (such as insurance companies), information and analysis providers (such as rating agencies, financial advisers, etc), investment banks, portfolio managers and so on. All such entities that offer financial services other than banking, may be broadly called non-banking financial institutions. The non-banking financial companies (NBFC's) have emerged as substantial contributors to the Indian economic growth by having access to certain deposit segments and catering to the specialized credit requirements of certain classes of borrowers. A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme of arrangement of any other manner, or lending in any manner is also a non-banking financial company. This paper makes an attempt to studythe financial performance of each of the entities of NBFIs such as All India financial institutions (AIFIs), Non-banking financial companies (NBFCs) and Primary dealers in 2015-16.

Keywords: *Banking, non-banking financial institutions, All India financial institutions, Non-banking financial companies, Primary dealers*

I. INTRODUCTION

The financial sector in any economy consists of several intermediaries. Apart from banking entities, there are investment intermediaries (such as mutual funds, hedge funds, pension funds, and so on), risk transfer entities (such as insurance companies), information and analysis providers (such as rating agencies, financial advisers, etc), investment banks, portfolio managers and so on. All such entities that offer financial services other than banking, may be broadly called non-banking financial institutions.

Non-banking financial institutions (NBFIs) consist of various types of financial institutions, of which Reserve Bank of India regulates and supervises three important categories – all India financial institutions (AIFIs), non-banking finance companies (NBFCs) and stand-alone primary dealers (PDs). While AIFIs largely undertake long-term financing in specific sectors, NBFCs specialise in meeting the credit needs of niche areas such as hire purchase, financing of physical assets, commercial vehicles and infrastructure loans. PDs perform an important role as market makers for government securities in both primary and secondary markets

Since late 1980s up to mid 1990s, the number of NBFCs increased substantially on the back of easy access of funds from capital market IPOs and deposits from the public. In 1981, there were 7,063 NBFCs. The number went up to 24,009 in 1990 and there were as many as 55,995 NBFCs by 1995. The high deposit rates offered by NBFCs led investors to invest their funds in NBFCs. The deposit base of the NBFCs grew at an average rate of 88.6% per annum between the period Apr-91 to Mar-97. However, strong growth in NBFCs could not be sustained as in the late 1990s several loans granted by the NBFCs turned sticky, leading some of the large NBFCs to de fault in repayment to their depositors. This led the RBI to introduce stringent guidelines in 1997-98 which hampered the ability of NBFC's to raise deposits. Banks also became wary of lending to NBFCs, which translated into high cost of funds for NBFCs. Moreover, increasing competition from the banking system that was opened up for private sector banks in early 1990s affected the NBFCs business. Given these developments, many NBFCs with asset base in excess of Rs 1 billion had to exit their operations. NBFCs, however, recovered from this phase and witnessed strong growth during 2000-02.

II. OBJECTIVES OF THE STUDY

To study the financial performance of each of the entities of NBFIs such as All India financial institutions (AIFIs), Non-banking financial companies (NBFCs) and Primary dealers in 2015-16.

III. RESEARCH METHODOLOGY

The research is exploratory in nature. The details provides by the government of India is the primary source of this study. In addition to this it focuses on Literature review, News Papers, Journals, websites and the other reliable sources. The data is also collected from RBI websites.

IV. FINANCIAL PERFORMANCE OF NON-BANKING FINANCIAL INSTITUTIONS

Non-banking financial institutions (NBFIs) consist of various types of financial institutions, of which Reserve Bank of India regulates and supervises three important categories – all India financial institutions (AIFIs), non-banking finance companies (NBFCs) and stand-alone primary dealers (PDs). While AIFIs largely undertake long-term financing in specific sectors, NBFCs specialise in meeting the credit needs of niche areas such as hire purchase, financing of physical assets, commercial vehicles and infrastructure loans. PDs perform an important role as market makers for government securities in both primary and secondary markets.

A. Financial performance of All India financial institutions (AIFIs)

As at end-March 2016, there were four AIFIs under the Reserve Bank's full-fledged regulation and supervision *viz.* the Export Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI).

Table 1: Financial performance of AIFIs

(Amount in Rs million)

		2014-15	2015-16	Variation	
				Amount	Percentage
A)	**Income (a+ b)**	**350,113**	**395,084**	**44,971**	**12.84**
	a) Interest Income	333,694 (95.31)	385,641 (97.61)	51,947	15.57
	b) Non-Interest Income	16419 (4.69)	9443 (2.39)	-6,976	-42.49
B)	**Expenditure (a+ b)**	**262,646**	**300,667**	**38,021**	**14.48**
	a) Interest Expenditure	243,332 (92.65)	278,544 (92.64)	35,212	14.47
	b) Operating Expenses	19,314 (7.35)	22,123 (7.36)	2,809	14.54
	of which Wage Bill	13,624	15,381	1,757	12.90
C)	**Profit**				
	Operating Profit (Profit Before Tax)	78,339	69,722	-8,617	-11.00
	Net Profit (Profit After Tax)	52,930	48,088	-4,842	-9.15

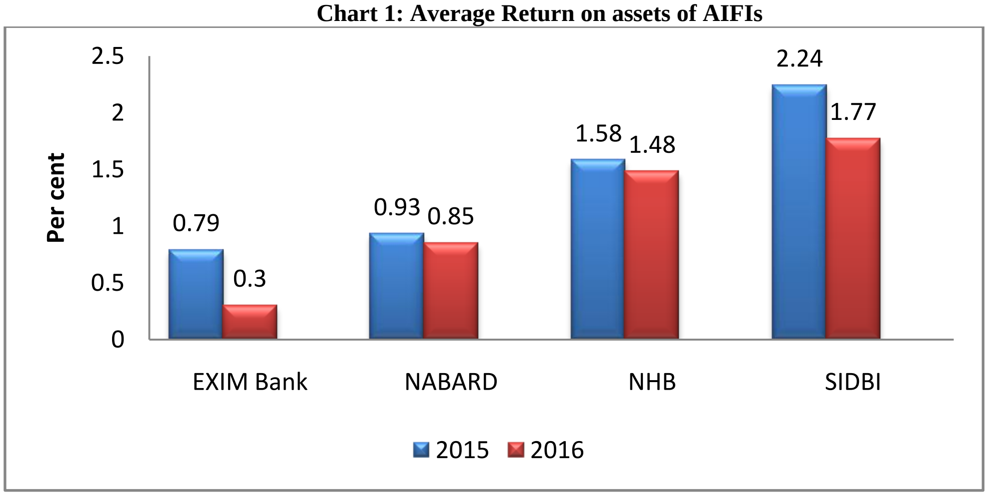
Source: RBI

On the back of strong growth in interest income, AIFIs registered a double-digit growth in income during 2015-16 despite a significant decline in non-interest income (Table 1). With the growth in expenditure exceeding income, the major indicators of profitability, such as operating profits and net profits showed a decline during the year.

1) Return on assets (RoA)

During the year, the return on assets (RoA) of all the four AIFIs showed deterioration, partially due to increasing operating costs (Chart 1). Return on assets was the highest for SIDBI followed by NHB, NABARD and EXIM Bank.

Chart 1: Average Return on assets of AIFIs

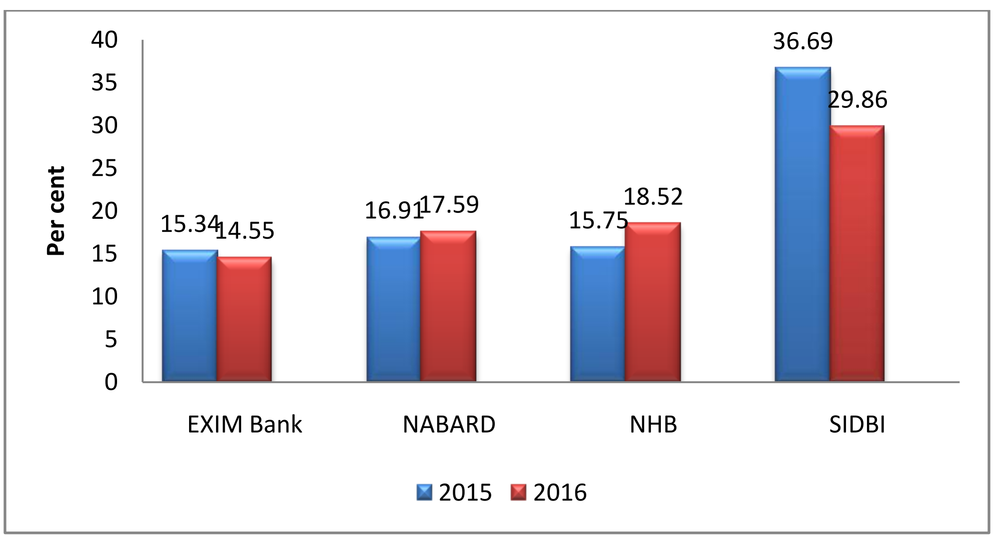


Source: RBI

2) Capital adequacy

Capital Adequacy Ratio (CAR), also known as Capital to Risk (Weighted) Assets Ratio (CRAR).AIFIs' capital adequacy witnessed marginal deterioration during 2015-16. The capital adequacy position of EXIM Bank and SIDBI deteriorated while that of NABARD and NHB improved (Chart 2). Yet, all the four AIFIs maintained CRAR higher than the minimum regulatory requirement of 9 per cent.

Chart 2: Capital to risk (weighted) assets ratio (CRAR) of AIFIs
(as at end-March)



Source: RBI

B. Financial performance of Non-banking financial companies (NBFCs)

NBFCs are categorised into two types on the basis of their liability structure: deposit-taking NBFCs (NBFCs-D) and non-deposit taking NBFCs (NBFCs-ND). As at end-March 2016, there were 11,682 NBFCs registered with the Reserve Bank out of which 202 were NBFCs-D and 11,480 were NBFCs-ND entities. There were 209 systemically important non-deposit taking NBFCs (NBFCs-ND-SI), which are subject to

more stringent prudential norms and provisioning requirements.
Amidst the consolidation process, which reduced the number of both NBFCs-D and NBFCs-ND-SI registered with the Reserve Bank, the asset side of NBFCs continued to register significant growth. Theownership pattern of NBFCs-D and NBFCs-ND-SI is given in Table 2.

Table 2: Ownership pattern of NBFCs (number of companies)

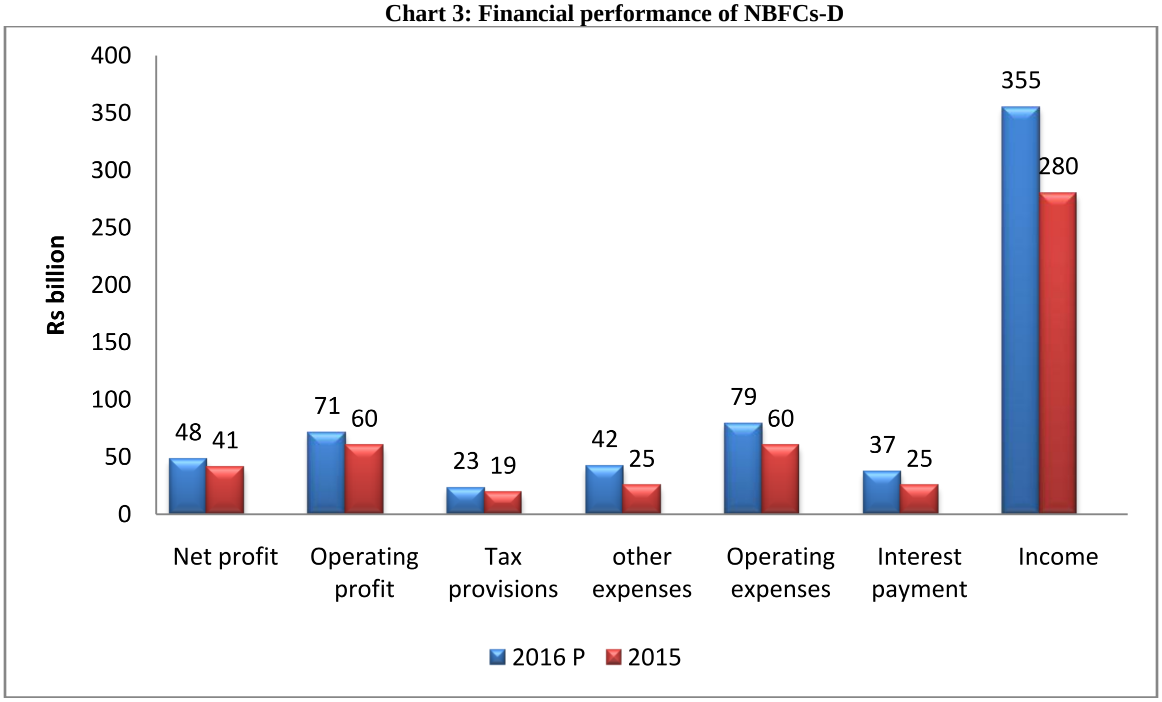
Ownership	2015 NBFCs-D	2016 NBFCs-D	2015 NBFCs-ND-SI	2016 NBFCs-ND-SI
A. Government Companies	7 (3.2)	5 (2.5)	10 (5.0)	16 (7.7)
B. Non-Government Companies	211 (95.9)	194 (97.5)	190 (95.0)	193 (92.3)
1. Public Limited Companies	209 (95.0)	188 (94.5)	105 (52.5)	105 (50.2)
2. Private Limited Companies	2 (0.9)	6 (3.0)	85 (42.5)	88 (42.1)
Total No. of Companies (A)+(B)	**220** (100.0)	**199** (100)	**200** (100.0)	**209** (100)

Source: Department of Non-Banking Supervision, RBI.

1) ***Financial performance of deposit-taking NBFCs(NBFCs-D)***

Income of NBFCs-D income recorded a growth of 26.8 per cent during the year, contributing to higher operating and net profits, despite higher operating and other expenses (Chart 3).

Chart 3: Financial performance of NBFCs-D

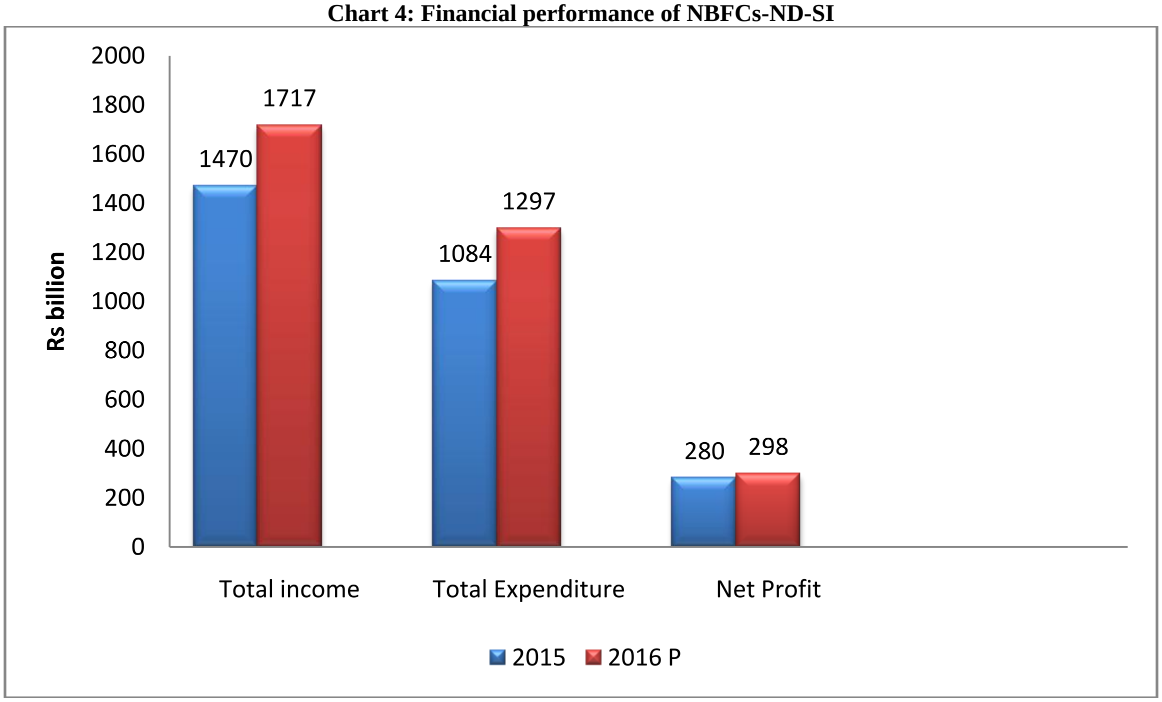


Source: RBI(P: Provisional)

2) *Financial performance of Non-deposit taking systemically important NBFCs (NBFCs-ND-SI)*

During the year, NBFCs-ND-SI raised funds mainly through debentures, borrowings from banks and commercial papers. Investments by NBFCs-ND-SI showed marginal growth. Loans and advances extended by NBFCs-ND-SI posted a growth of 12.5 per cent during 2015-16, thoughthis was lower than the previous year due to slow growth in credit extended by infrastructure finance companies (NBFCs-IFCs) and loan companies (LCs).Profits of NBFCs-ND-SI witnessed a modest improvement during 2015-16

Chart 4: Financial performance of NBFCs-ND-SI



***Source: RBI*(**P: Provisional)

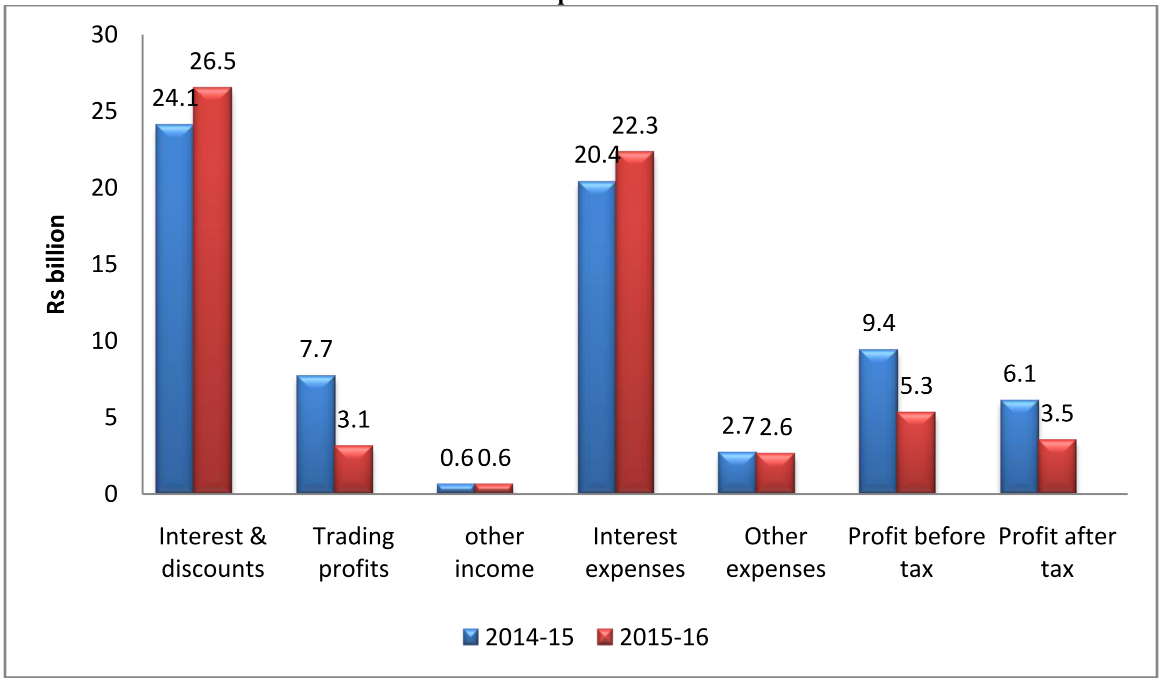
C. *Financial performance of Primary dealers (PDs)*

As on March 31, 2016 there were 21 PDs of which 14 were banks and the remaining seven were non-bank entities (standalone PDs) registered as NBFCs. During 2015-16, all the PDs achieved the stipulated minimum success ratio (bids accepted to the bidding commitment of 40 per cent for T-bills and cash management bills [CMBs] put together every half year) both in the first half as well as in the second half of the year. The PDs subscribed 75 per cent of the T-bills issued during 2015-16 as against 62 per cent during 2014-15. The underwriting commission paid to PDs during 2015-16 was marginally higher during the year as compared to last year.

During 2015-16, in the secondary market, all the 21 PDs had individually achieved the required minimum annual total turnover (outright and repo transactions) ratio of 5 times in G-Secs and 10 times in T-bills. Partial devolvement of the PDs took place on seven occasions for Rs 109.99 billion as compared to two instances for Rs 52.71 billion in 2014-15.

All seven standalone PDs, except Goldman Sachs (India) Capital Markets Pvt. Ltd. posted profits in 2015-16. Profit after tax (PAT) decreased on account of limited trading opportunities due to lack of fresh triggers and a relatively flat yield curve during a large part of the year

Chart 5: Financial performance of standalone PDs



Source: RBI

V. OVERALL ASSESSMENT OF THE NBFC SECTOR

The NBFC sector assumes a critical role in financial inclusion as it caters to a wide range of financial activities particularly in areas where commercial banks have limited penetration. NBFCs are expected to play a crucial role in fostering inclusive growth, especially in sectors like MSMEsConsolidation within the NBFC sector continued during 2015-16, resulting in a reduction in the number of both NBFCs-D and NBFCs-ND-SI. Their assets continued to register substantial growth. The accelerated growth in credit deployment by NBFCs was due to their ability to contain risks and tap demand in niche markets. The profitability of NBFCs was significantly higher as compared to commercial banks.

The NBFC sector continued to raise funds mainly through debentures, borrowings from banks and commercial papers. The Reserve Bank also eased the norms for external commercial borrowings (ECBs) for NBFCs that lend to the infrastructure sector, to raise ECBs with a minimum maturity of five years. In addition, the Reserve Bank also allowed NBFCs to raise funds through rupee denominated bonds overseas. The quality of assets of the NBFC sector has, however, showed steady deterioration since 2012, though their NPAs have remained relatively lower than those of the banking sector. On the policy front, the revised regulatory framework for NBFCs, introduced in 2014 by the Reserve Bank of India, is beginning to be phased in to harmonize the prudential norms.

VI. CONCLUSION

The non-banking financial companies (NBFC's) have emerged as substantial contributors to the Indian economic growth by having access to certain deposit segments and catering to the specialized credit requirements of certain classes of borrowers. Recent developments in non banking financial companies will improve the activities of NBFC's in India. The NBFC sector assumes a critical role in financial inclusion as it caters to a wide range of financial activities particularly in areas where commercial banks have limited penetration. NBFCs are expected to play a crucial role in fostering inclusive growth, especially in sectors like MSMEs Consolidation within the NBFC sector continued during 2015-16, resulting in a reduction in the number of both NBFCs-D and NBFCs-ND-SI. Their assets continued to register substantial growth. The accelerated growth in credit deployment by NBFCs was due to their ability to contain risks and tap demand in niche markets. The profitability of NBFCs was significantly higher as compared to commercial banks.

REFERENCES

[1] SeemaSaggar, "Financial Performance of Leasing Companies, During the Quinquennium Ending 1989-90" Reserve Bank of India: Occasional Papers, Vol. 16, No. 3 September 95, pp. 223-236.

[2] Harihar T.S. "Non-Banking Finance Companies, The Imminent Squeeze", Chartered Financial Analyst, February 1998, p. 40-47.

[3] Reserve Bank of India Bulletin,2015-16

[4] Bhole, L.M., Financial Institutions and Markets,Tata MC Graw Hill Publishing CO. Ltd., 1992.

[5] Ardener, " The Evolution o f a n Informal Financial Institution: T he Rotating Savings and Credit Associations in Cameroon" (1964)

[6] M.S. Joshi, "Financial Intermediaries in India " ,University of Bombay, Series in Monetary and International Economics, No. 8, 1965.