Serendipity of NBFCs in India

The Sustainability Dimension:
A Study of Selected NBFCs

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

Abstract

Non-banking financial companies (NBFCs) constitute an integral component of the Indian Financial system. They play a significant role in nation building and financial inclusion by complementing the banking sector in reaching extending credit to the unbanked segments of the populace, particularly to the micro, small and medium enterprises (MSMEs), which champions the idea of entrepreneurship and innovation. It is essential to note that NBFCs in India have witnessed a substantial metamorphosis over the past some years and has come to be recognized as one of the systematically crucial element of the financial system. NBFCs are playing a pivotal role in the development of infrastructure, transport, employment generation, wealth creation opportunities, and financial support for economically weaker sections. Moreover, their contribution to state exchequer is also soaring.

In view of the prodigious growth of NBFCs it generates paramount academic and research interests to delve deep into the sustainability facet of NBFCs. Since they hold a key position in the financial system and as mentioned playing an important role in the economic development by expanding their wings in the form of advancing credit to almost all the sectors of the economy and various echelons of population it is extremely essential that these financial institutions should be sustainable as their financial collapse may possibly trigger uncontrollable financial cataclysm.

This research paper by considering selected NBFCs listed in either BSE Ltd. or NSE Ltd. will make an endeavor to delve into their performance on certain key parameters, i.e. Reported Net Profit After Tax (PAT), Earnings Before Interest and Tax (EBIT), Loans and Advances. On two yardsticks, i.e. PAT and EBIT, a study will be made to ascertain whether there is a significant difference or not among the selected NBFCs. Similarly the growth potential of loans and advances of the selected NBFCs will be studied. Business valuations method will be applied on the selected NBFCs to find out their sustainability.

Keywords: **NBFCs Scenario in India; Sustainability; Growth Potential**

JEL Classification Code: G2 (Financial Institutions and Services)

FULL-LENGTH PAPER

Introduction

Non-Banking Financial Company (NBFC) in India made a humble beginning in the 1960s to serve the need of the saver and investor whose financial need were not adequately covered by the then existing banking system in India. The NBFCs began to invite fixed deposit from investor and work out leasing deal for big industrial firms. In the initial years they operated on a limited scale and were unable to make substantial impact on the financial system. However, with the passage of time, their contribution to the economy rose in leaps and bounds. For instance, in terms of financial assets, NBFCs have registered a robust growth, i.e. a compound annual growth rate (CAGR) of 19% over the past few years, comprising 13% of the total credit and estimated to touch approximately 18% by 2018-19 (please refer exhibit1).

> A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

NBFCs constitute a significant branch of the finance sector. They witnessed incredible progress during the 1980s and 1990s due to rigorous endeavours of the NBFCs across the globe. These developments also resulted into haziness of demarcating lines between banks and NBFCs with some privileges being reserved for the commercial banks. NBFCs are known for their higher risk absorption capacity than the banks. Despite being an institution of beguiling investors, they have played a crucial role in the financial system. Several specialized services like factoring, venture capital finance, and financing road transport were espoused by these institutions.

The success of NBFCs can be assigned to their superior product lines, lower cost, broader and effective reach, sound risk management capabilities to check and control bad debts, and better comprehension of their customer segments. Not only they have displayed success in their conventional citadel, i.e. passenger and commercial vehicle finance but they have also managed to build significant Assets under Management (AUM) in the personal loan and housing finance sector which have been the major source of earnings for retail banks. The rise in urban demand and an enhancement in credit penetration has assisted and will continue to assist in driving the growth of consumer finance. Driven by higher disposable incomes through enhanced effectiveness of governance schemes, the consumer finance segment is going to witness more business activities.

It is heartening to note that NBFCs improved their performance on majority of yardsticks during 2015-16, as the banking sector struggled under the weight of soaring non-performing assets (NPAs). According to the Financial Stability Report released by the Reserve Bank of India, NBFCs loans expanded 16.6% in 2015-16, twice as fast as the 8.8% credit growth across the banking industry on an aggregate level. The aggregate balance sheet of NBFCs expanded 15.5% in fiscal 2016 compared with 15.7% in the previous year. The gross non-performing assets (GNPA) ratio or the NBFC sector declined to 4.6% of total advances in March 2016 from 5.1% in September 2015, according to the Financial Stability Report.

There have been a noteworthy improvement in capital adequacy levels of the NBFCs, unlike banks which witnessed capital erosion. The capital adequacy ratio for NBFCs as a whole improved to 24.3% as of March 2016 from 23.85% in September 2015. Stress tests for the sector revealed that even under the extreme stress, the probability of capital erosion of NBFCs is marginal.

Capital adequacy levels of NBFC segment have also improved, unlike banks who are facing almost insurmountable problem of non-performing assets.

However, there is a grey area too, in one of the research studies it was observed that all NBFCs are not so strong to withstand the blizzard. Of 11,682 companies surveyed 5% were found to be not so strong to comply with the minimum regulatory capital requirement. This fact generates paramount academic and research interests to delve deep into various critical facets of NBFCs in order to comprehend their sustainability.

Review of literature

Kantawala (1997) studied on "Financial Performance of Non-Banking Finance Companies in India" for the period from 1985-86 to 1994-95 based on secondary data collated from RBI Bulletins pertaining to financial and investment companies. In this study different ratios and One Way Analysis of Variance (ANOVA) have been applied and concluded that different categories of NBFCs behave differently and it is entrepreneur's choice in the light of behaviour of some of the yardsticks which go long with the category of NBFC.

Gumparthi and Manickavasagam (2010) examined on the topic "Risk Assessment Model for Assessing NBFC" (Asset Financing) Customers". The objective of this paper was to build Risk Assessment Model for NBFCs" based on market forces and observed 28 parameters to gauge the risk associated with the customer identified out of which 12 parameters are the more significant ones.

Vadde (2011) investigated on the topic "Performance of Non-Banking Financial Companies in India- An Evaluation" after analysing the performance of non-government financial and investment companies (other than banking, insurance and chit fund companies) during the year April 2008 to March 2009 based on the audited Annual Accounts of 1215 companies. The data was collected from different issues of RBI Bulletin. Financial and Investment Companies growth in income, both main as well as other, decelerated during the period and growth of total expenditure also decelerated but it was higher than the income growth.

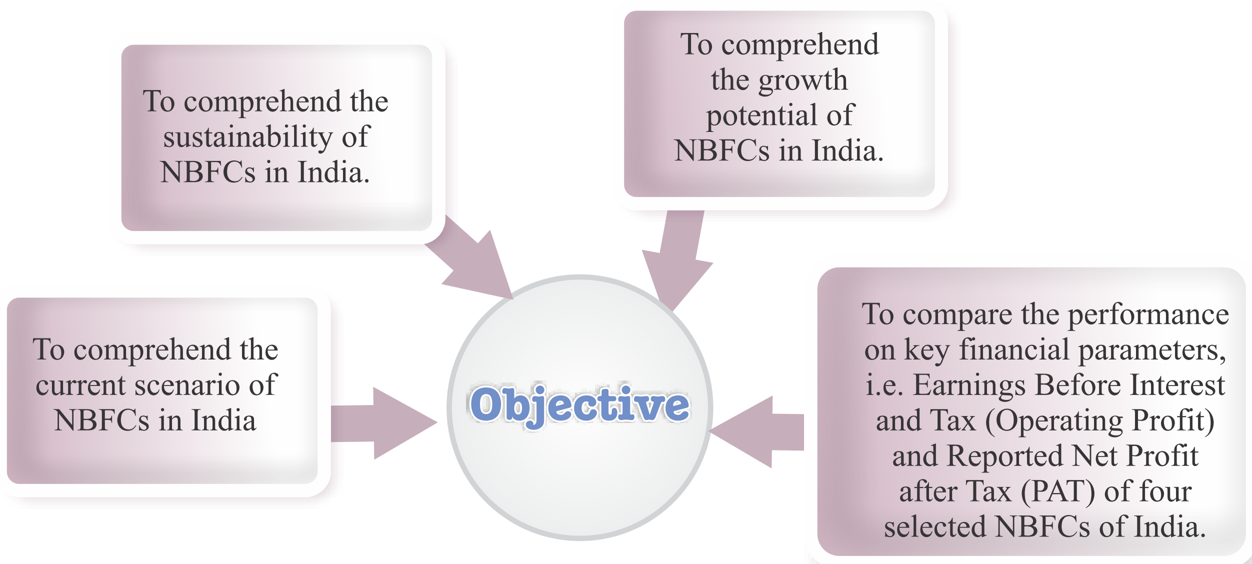
Sornaganesh and NavisSoris (2013) investigated on the topic, "A Fundamental Analysis of NBFC in India" to analyse the profitability position of 5 sample NBFC companies, such as, STF, SF, BF, and M&MF for the period from April 2008 to March 2012, using Ratio Analysis of collecting data from the Annual Reports and Balance Sheets of the sample companies. The study revealed that SF has performed better in terms of Earnings Per Share (EPS) followed by STF, BF, CF & M&MF but STF and M&MF were found to be far better than other in NPM (Net Profit Margin).

Perumal and Santheskumar (2013) studied on the topic "Non-Banking Financial Companies" analysing the Balance Sheets and Income Statements of two sample companies, i.e., Sundaram Finance Limited and Lakshmi General Finance Limited for the period 2007-2012 using primary and secondary data. The study was conducted using various statistical tools like, average, standard deviation, co-efficient of variation, trend analysis, index number etc. and concluded that the contribution of NBFCs to economic development is highly significant and there is need to integrate it with the mainstream financial system and RBI should be vested with more power to monitor NBFCs in an effective manner.

Kaur and Tanghi (2013) investigated on the topic “Non-Banking Financial Companies, Role and Future Prospects” with a focus to analyse role and importance of NBFCs in India. The paper concluded that NBFCs have to concentrate more on their core strengths and must constantly endeavour to hunt 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 foraying into more credit and suggested in the NBFC credit policy for reduction of interest rates . The study observed a research gap which is, evaluation of performance of NBFCs in India.

Objective of the study



Research Methodology

1) F-Test (One Factor Model): This statistical tool will assist in understanding whether there is a significant difference or not in the Earnings Before Tax and Reported Net Profit after Tax (PAT) of public and privately owned NBFCs of India. In case, there is a significant difference in the aforesaid important financial parameters then to a great extent it may indicate that both public and privately owned NBFCs are not performing well and if non-performance continues for long then it may jeopardise their sustainability. Two NBFCs are government owned whereas other two are privately owned.

2) Tobin's q: Acquisitions especially hostile acquisitions are a big peril for any organization, as it impact various stakeholders and continuity or sustainability of the organization. In this regard, this financial tool will assist in comprehending whether the selected NBFCs are exposed to acquisition by corporate raiders or they are cloistered from such hostile acquisitions, thereby ensuring their continuity of operations or sustainability.

3) Solvency Ratio: This ratio will assist in comprehending whether the NBFCs selected for the study will be able to meet their debt and other obligations. Since failure in honouring the payment of debt and other obligations may result into litigations and even bankruptcy.

Note:*All the four NBFCs are listed in BSE Ltd. or NSE Ltd. However, in order to maintain anonymity they have been named as A Ltd., B Ltd., C Ltd., and D Ltd. But the financial figures used for analysis are true. A Ltd. and D Ltd. are government owned NBFCs, whereas, B Ltd. and C Ltd. are privately owned NBFCs.*

Limitations of the study

1) The research study is based on secondary data.
2) There may be other statistical and financial tools also to judge the sustainability and performance of NBFCs but in this research paper only the above mentioned statistical and financial tools have been used. Hence, the conclusions drawn may not reveal the complete picture of NBFCs as far as their sustainability is concerned.
3) Due to technical constraints only four NBFCs *(two from public sector and two from private sector)* have been considered for the study. Hence, conclusions derived pertaining to sustainability of NBFCs in India may not reflect the complete scenario of sustainability.

NBFCs Scenario in India- Eye-catchy Facts

Indian economy has a huge hidden credit demand stoked by a huge self-employed population that is underserved by banks due to insufficient income proof. With public sector banks under severe stress due to rising bad debt, the appetite to lend is expected to be weak in the near future. This offers an opportunity stupendous

By referring the Financial Stability Report (Issue No.13) of Reserve Bank of India published in June 2016 reveals very interesting facts. Stress tests for non-banking financial companies (NBFCs) revealed that the CRAR at the system level was only marginally affected and remained well above the regulatory minimum required level of 15 percent. However, the CRAR of a few NBFCs were expected to fall below minimum required level, under the extreme situation of GNPAs enhancing by 3 standard deviation. As of March 2016, there were 11,682 non-banking financial companies (NBFCs) registered with the Reserve Bank of India, of which 202 were deposit-accepting (NBFCs-D) and 11,480 were non deposit-accepting NBFCs (NBFCs- ND). There were 220 systematically important non-deposit accepting NBFCs (NBFCs-ND-SI). All NBFCs-D and NBFCs-ND-SI are subject to prudential regulations like capital adequacy requirements and provisioning norms along with reporting requirements.

As far as financial performance is concerned the aggregated balance sheet of the NBFC sector expanded by 15.5 percent on a y-o-y basis in March 2016 in comparison to 15.7 percent in 2015. Loans and advances enhanced by 16.6 percent, while, total borrowings increased by 15.3 percent in March 2016 (please refer exhibit 2). It is quite interesting to note that the financial performance of NBFC sector has remained constant for the last two years. Net profit as a percentage of total income remained at 18.3 percent between March 2015 and March 2016 and RoA stood at 2.2percent during the same period. RoE enhanced to 10.6 percent from 10.3 percent(please refer exhibit 3). While the regulatory norms for the NBFC sector are sought to be brought closer to those applicable to schedule commercial banks, the performance of this sector (RoE and RoA) seems to be much better as compared to that of banks. GNPAs of the NBFC sector as a percentage of total advances reduced to 4.6 percent in March 2016 from 5.1 percent in September 2015. NNPAs as a percentage of total advances also fell to 2.5 percent from 2.9 percent during the same period.

Stress test on credit risk for the NBFC sector as a whole for the period ended March 2016 was conducted under three situations: a) GNPA increase by 0.5 SD, b) GNPA increase by 1 SD and c) GNPA increase by 3 SD. The results indicate that in the first and second scenarios, the CRAR of the sector was marginally affected while in the third scenario, it reduced to 23.3 percent from 24.3 percent. This however, was much above the regulatory minimum needed level of 15 percent.

With public sector banks under severe stress due to soaring non-performing assets, the appetite to lend is expected to be weak in the medium term till a proper resolution is found. Consequently, it will result into yawning of gap in the market which will create immense opportunities for NBFCs. Further, the recent developments in deepening of wholesale debt markets also bode well for liquidity and funding of NBFCs. Looking into the operational angle of NBFCs, they operate at higher yields as majority of them operate in underserved markets. Despite the cost of funds disadvantage, they operate at higher NIM (Net Interest Margin). Their operational costs and bad debt expenditure is lower as compared to banks resulting into much higher Return on Assets (ROA). Even being at a lower leverage in comparison to banks, NBFCs deliver higher ROE. This became a reality on account of extremely focused business model designed around a product, i.e. customer segment. This approach has assisted the NBFCs to function with better response times and service levels, resulting into faster growth as compared to banks.

Despite, such prodigious growth and impressive story of NBFCs, a blizzard also exist, i.e. nearly 200 non-banking financial companies (NBFCs) are facing the threat of closure due to non-adherence to Reserve Bank of India's mandated requirement of minimum investment grade credit rating to accept deposits. These NBFCs comprise mostly of localized small-time lenders who have knocked the doors of the regulator seeking relaxation in rating norms, citing the reason that they are being treated in the same way like a big NBFC is treated.

Going by the Financial Stability Report, December 2016 and the Report of Trend and Progress of Banking in India, 2015-16, published by RBI, the picture appears to be gloomy. The number of NBFCs in 2013 stood at 12225 which declined to 11555 by H1 FY 2017 (please refer exhibit 4). Another worrying scenario of NBFCs is regarding GNPA (Gross Non-Performing Assets). During the first half of FY16-17, the NBFCs reported GNPA of 4.9% which was 4.6% at the end of FY 15-16. A non-linearity in GNPA and NNPA of NBFCs can be observed during the period March 2013 to September 2016. In case of GNPA it was 3.6% in March 2013 which rose to the highest at 5.1% for two years, i.e. September 2014 and September 2015. The scenario improved a little in March 2016, as GNPA was registered at 4.6% but the situation aggravated in September 2016, as GNPA stood at 4.9%. On the other hand, NNPA was at its lowest in March 2013, i.e.

1.6% which after witnessing ups and downs touched 2.7% in September 2016. In case of NNPA also, the situation have worsen. Even comparing the NNPAs of March 2016- 2.5% and September 2016- 2.7%, i.e. a rise of 0.2% can be observed (please refer exhibit 5). The deterioration in the asset quality of NBFCs can be attributed to the interconnectedness of the NBFC sector with the banking sector and appalling performance of the banking sector in terms of asset quality.

But the silver lining is that despite the mentioned bottlenecks, NBFCs are gradually making their way into balance sheet of companies, particularly those in the small and medium size category and in the real estate business irrespective of size.

Reserve Bank of India formulated a new category of NBFCs as NBFC-account aggregators (AAs) in September 2016 aimed at facilitating a consolidated view of individual investors' financial asset holdings, especially when the entities fall under the purview of different financial sector regulators.

Sailable or Sinkable- Sustainability Dimension

In this section the sustainability of selected NBFCs of India will be studied with the help of various statistical and financial tools. As mentioned above, the NBFCs considered for the study are- A Ltd., B Ltd., C Ltd. and D Ltd (*names have been changed but financial figures are true*).

F-test (One Factor Model)

Period covered for the study- 2012 to 2016

Null Hypothesis (H0):

There is no significant difference in the Earnings before Tax of public and privately owned NBFCs

Alternative Hypothesis (H1):

There is a significant difference in the Earnings before Interest & Tax (EBIT) of four NBFCs- A Ltd., B Ltd., C Ltd. and D Ltd.

Years	A Ltd. (in Cr.) (X1)	B Ltd. (in Cr.) (X2)	C Ltd. (in Cr.) (X3)	D Ltd. (in Cr.) (X4)
March 2012	4,144.98	519.00	2,172.67	1,235.13
March 2013	5,984.60	830.00	2,593.56	1,418.04
March 2014	7,624.19	847.00	2,562.65	1,833.86
March 2015	8,443.73	1,231.00	2,346.14	2,119.31
March 2016	9,165.04	1,732.00	-959.32	2,575.06
Total	**35,362.54** $\bar{X}1$ = 7,072.51	**5159** $\bar{X}2$ = 1031.8	**8,715.70** $\bar{X}3$ = 1,743.14	**9,181.40** $\bar{X}4$ = 1,836.28

Grand Mean ($\bar{\bar{X}}$) = 7,072.51 + 1031.8 + 1,743.14 + 1,836.28 / 4 = 2921

ANOVA Table

Source of variation	Sum of squares	v (degree of freedom)	Mean squares
SSC = Between samples	116,861,670	3	116,861,670/3 = 38953890
SSE = Within samples	27,590,641	16	27590641/16 = 1724415
Total	**SST = 144452311**	**19**	

Test Statistic: F = 38953890 / 1724415 = 23

For v1 = 3 and v2 = 16 and for α = 0.05, the table value of F is $F_{0.05}$= 3.24

Decision: *Since the calculated value of F= 23 is greater than the tabled value* $F_{0.05}$ *= 3.24, so that the null hypothesis is rejected. Hence there is a significant difference between the Earnings Before Tax of government or public and privately owned NBFCs.*

Null Hypothesis (H0) = There is no significant difference in the Reported Net Profit after Tax (PAT) public / government and privately owned NBFCs of India.

Alternative Hypothesis (H1) = There is a significant difference in the Reported Net Profit after Tax (PAT) public / government and privately owned NBFCs of India.

Years	A Ltd. (in Cr.) (X1)	B Ltd. (in Cr.) (X2)	C Ltd. (in Cr.) (X3)	D Ltd. (in Cr.) (X4)
2012	3,058.85	328.00	1,550.81	916.33
2013	4,437.74	743.00	1,842.43	1,054.00
2014	5,461.84	681.00	1,824.19	1,321.41
2015	6,004.40	1,052.00	1,749.87	1,397.52
2016	6,184.00	1,353.00	-591.86	1,667.61
Total	25,146.83	4157	6,375.44	6356.87
	$\bar{X}1$ = 5029	**$\bar{X}2$ = 831**	**$\bar{X}3$ = 1275**	**$\bar{X}4$ = 1271**

Grand Mean ($\bar{\bar{X}}$) = 5029 + 831 + 1275 + 1271 / 4 = 2102

ANOVA Table

Source of variation	Sum of squares	v (degree of freedom)	Mean squares
SSC = Between samples	57786300	3	57786300 / 3 = 19262100
SSE = Within samples	12066630	16	12066630 / 16 = 754164
Total	**SST = 69852930**	**19**	

Test Statistic: F = 19262100 / 754164 = 26
For v1 = 3 and v2 = 16 and for α=0.05, the table value of F is $F_{0.05}$= 3.24
Decision: *Since the calculated value F=26 is greater than the tabled value $F_{0.05=}$3.24, so that the null hypothesis is rejected. Hence, there is a significant difference in the Reported Net Profit after Tax (PAT) of public / government and privately owned NBFCs.*

Tobin's q

Tobin's q ratio = Equity Market Value / Equity Book Value
Period covered for the study- 2012-2016

Years	A Ltd.	B Ltd.	C Ltd.	D Ltd
2012	12144 / 20,792.95 **= 0.58**	9624 / 11,768.00 **=0.82**	20431 / 12285.04 **= 1.67**	13274 /5,710.21 **=2.32**
2013	11979 / 24,157.69 **= 0.49**	7680 / 11,971.00 =0.64	21759 /13682.62 **= 1.59**	11351 / 6,533.37 **= 1.74**
2014	12764 / 27,522.27 **= 0.46**	8442 / 12,391.00 **=0.68**	18528 /15040.31 **= 1.23**	11893 /7,585.88 **= 1.57**
2015	18002 / 32,411.35 **= 0.56**	10724 / 13,324.00 **=0.80**	26576 / 17274.51 **= 1.54**	22064 /7,880.06 **= 2.8**
2016	11343 / 36,028.31 **= 0.31**	9299 / 14,143.00 **=0.66**	6440 /10103 **= 0.64**	24746 / 9,214.58 **= 2.69**

Solvency Ratio

$$\text{Solvency Ratio} = \frac{\text{Net Income (PAT)} + \text{Depreciation}}{\text{Short Term Liabilities} + \text{Long Term Liabilities}}$$

Years	A Ltd.	B Ltd.	C Ltd.	D Ltd
2012	0.026	0.016	0.033	0.016
2013	0.031	0.028	0.033	0.014
2014	0.033	0.023	0.031	0.015
2015	0.031	0.033	0.024	0.013
2016	0.029	0.028	-0.009	0.014

Data Analysis or Findings

From F-test (One Factor Model) it can be observed that is on both the financial parameters, i.e. Earnings Before Tax and Reported Net Profit After Tax there is a significant difference among public / government or privately owned NBFCs, which is a harbinger of an unimpressive performance, as non-difference of performance on the aforesaid yardsticks would have provided solace that both government and privately owned NBFCs future is bright as they are moving at the same pace. Variability or difference on the above mentioned two financial parameters may be considered as fault line since in sufficiency of Earnings before Tax and Profit After Tax may endanger the sustainability and growth of the four NBFCs and assuming that the performance of other NBFCs also moves on the same trajectory then it may give birth to sustainability issue.

By applying Tobin's q ratio, it can be observed that A Ltd. and B Ltd. have Tobin's q ratio of less than 1 for the period 2012-2016, thereby indicating that these two NBFCs are undervalued company and are susceptible to corporate raiders or potential purchasers, thereby affecting their sustainability. C Ltd. and D Ltd. have Tobin's q ratio of more than 1, which implies that they are overvalued NBFCs and are not vulnerable to hostile takeovers but in the long-run they have to embrace robust business strategies to stay alive and thrive in the industry, since other players may be tempted to foray into the industry thereby enhancing the competition. But for C Ltd. the situation may change as its Tobin's q for 2016 stood at 0.64, implying that it is gradually getting exposed to hostile takeovers. It is interesting to note that A Ltd. and D Ltd. which are government owned NBFCs have Tobin's q ratio of less and more than 1 respectively. Similarly, B Ltd. and C Ltd. which are privately owned NBFCs have Tobin's q ratio of less and more than 1 respectively. A Ltd. and B Ltd. which are exposed corporate raiders need to espouse measures that can prevent hostile takeovers. Some of the measures to preclude hostile takeovers are- Poison Pill Defence; Voting Rights Plans; Staggered Board of Directors; Greenmail; White Knight; Increasing Debt; Making an Acquisition; Acquiring the Acquirer; Triggered Option Vesting etc. On the other hand, C Ltd. and D Ltd. needs to work out better marketing strategies, like, pricing of products, superior client service, exploring new markets, giving attractive offers on various schemes etc. in order to increase their foothold and retain their existing markets.

The last tool, i.e. solvency ratio reveals that all the four NBFCs considered for the study will have tough time to honour debt and other obligations as their solvency ratio is abysmal. The situation may turn worse for C Ltd. in near future as it has a negative solvency ratio in 2016, i.e. -0.009.

Way Forward- Growth Potential

Referring the report of ICRA, retail credit of non-banking finance companies (NBFCs) stood at INR 5.2 trillion as on June 30, 2016 recording a y-o-y growth of approximately 21.5% in Q1 FY2017 (19.9% in FY2016) as compared with 14.8% in FY2015. Microfinance and mortgage/SME segments continued to register strong growth, while a sturdy revival in the commercial vehicle credit, especially new CVs, gold loans and passenger vehicle segments supported overall growth. ICRA expects credit off-take in the Construction Equipment (CE) segment to pick up in H2FY2017 on the back of the Government of India's (GoI's) initiatives to drive infrastructure investments. Further, the report states that competitive pressures for retail focused NBFCs are going to intensify as bank credit growth to the retail segment continues to remain high at nearly 18.5% vis-à-vis the overall bank credit growth of 7.3% in Q1FY2017.

Cost of funds has moderated steadily over the recent past for NBFCs, with a fall in systemic rates a shift in funding profile towards capital market instruments (NCD / CPs). The quarterly average cost of funds for NBFCs witnessed a 20-30bps reduction in Q1FY2017 q-o-q. The overall funding mix of NBFCs remained largely stable over the last few quarters. The banking system continues to remain the prime source of funding for retail-focussed NBFCs, accounting for close to 41% of the total borrowings as on June 30, 2016. The share of funding from long term debentures accounted for 34% of NBFC borrowings against 33% in March 2015, while the share of CP borrowings was 12% against 10% in March 2015. Overall, capitalization levels of retail-focused NBFCs remained at comfort level with net worth in relation to managed assets at 15.7% as on June 30th, 2016. Return on average assets (excluding one-time gains and captive financiers) for retail NBFCs improved to 1.8% (based on trailing 4 quarters ended June 2016) from about 1.7% in March 2016 as the interest spreads widened with declining funding costs. ICRA expects profitability to remain range bound as credit costs are likely to remain high because of the transition to tighter NPA recognition and provisioning norms.

It is essential to note that NBFCs are expanding their wings by enhancing their exposure to real estate as well as expanding the spectrum of investments beyond residential projects, thereby giving strong competition to private equity (PE) funds. Sluggish sales volume and piling up of unsold inventory in the residential segment have forced domestic PE firms to moderate their investment momentum and foray into the office segment as well. But NBFCs have not decelerated their pace and continued to lend heavily to real estate. According to March 2017 report by property advisory Knight Frank, NBFCs have gained substantial market share over the previous two years and currently contribute nearly 18% of the total institutional funding need of this sector. While NBFCs have gained a larger chunk , from 12% in 2015 to 18% in 2016, PE funding has reduced from 61% to 58% in the same period.

However, to provide impetus to the growth of NBFCs, the following challenges needs to be addressed-

a) Margin pressure: NBFCs are witnessing margin pressure due to soaring interest rates. Since, its borrowings are generally linked to G-sec yields, rise in the rates push fund cost northward, while a slower rise in lending rates due to competitive pressure may put margins under pressure, thereby impacting its profitability. Moreover, NBFCs have miniscule exposure to the retail segment. It also does not have access to low-cost deposits and high yielding retail loans.

b) Competition from banking sector: As the infrastructure sector provide mammoth growth potential and offers tax breaks, banks have started shifting their attention to fund such projects. Banks unlike NBFCs have also got access to low cost deposits, due to extensive operations in the shape of retail deposits and thus can lend at competitive rates. However, NBFCs have an advantage over banks in term of expert domain knowledge, project structuring skills and proven experience in infrastructure lending

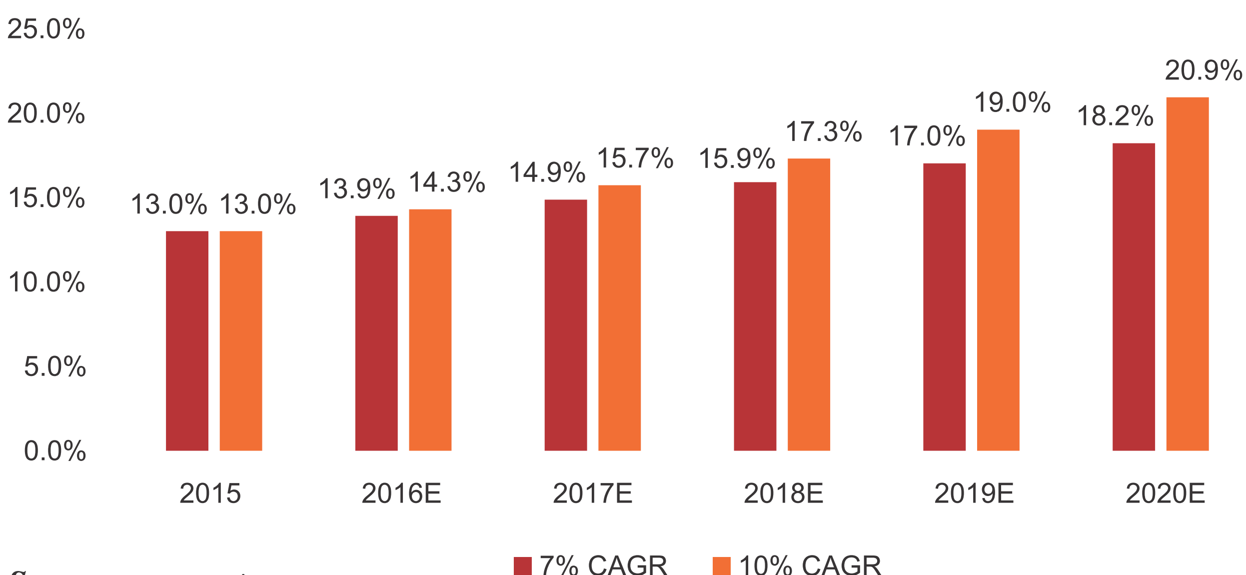
c) Dependency on Government Policies: It is to be noted that NBFCs profitability is directly linked to government policies and regulations. Any flabbergasted decisions, policy reversals, compulsory lending to particular sectors, which may not have the potential to generate profits may incapacitate the company's growth prospects.

d) Need for capital: NBFCs would require capital in order to expand their operations and enter new markets. A capital starved NBFC cannot lend or meet the financial requirements of various business organizations hunting for finance either for commencing the operations or for expansion. Further, to provide fillip to the growth of start-ups, NBFCs need to be strengthened as they can also play a pivotal role in their setting up and further development.

It can be stated without an iota of doubt that if the aforesaid challenges are addressed appropriately then NBFCs can scale astral heights. Being a customer centric with deep acuity of customer needs, presenting distinct last mile credit delivery makes it an impeccable financial institution. However, prudent managerial approach and formulation of robust business strategies keeping in view the PESTLE factors (Political, Economic, Social, Technological, Legal and Environmental) will go a long way in enhancing the profitability, sustainability and growth of NBFCs.

Exhibit 1

Credit Growth at NBFCs as a % of total credit



Source: *www.pwc.in*

Exhibit 2

Consolidated Balance Sheet of the NBFC sector: y-o-y growth

S.No.	er cent	Item-15	Mar-16
1.	Share capttal	6.3	4.8
2.	Reserves and surplus	13.5	14.3
3.	Total borrowings	16.9	15.3
4.	Current liabilities and provisions	14.1	31.8
Total Liabilities / Assets		**15.7**	**15.5**
1.	Loans &. advances	17.1	16,6
2.	Investments	11.5	10,8
3.	Other assets	10.6	12,7
Loans & advances		**17.1**	**16.6**
1.	Total Income	15.3	15.8
2.	Total expenditure	15.5	15.8
3.	Net profit	15.0	15.6
Source: RBI supervisory returns.			

Exhibit 3

Financial Performance of NBFC Sector

per cent	Item-15	Mar-16	
1.	Capital market exposure (CME) to total assets	7.4	8.5
2.	Leverage ratio	3.7	3.9
3.	Net Profit to total income	18.3	18.3
4.	RoA	2.2	2.2
5	RoE	10.3	10.6
Source: RBI supervisory returns.			

Exhibit 4

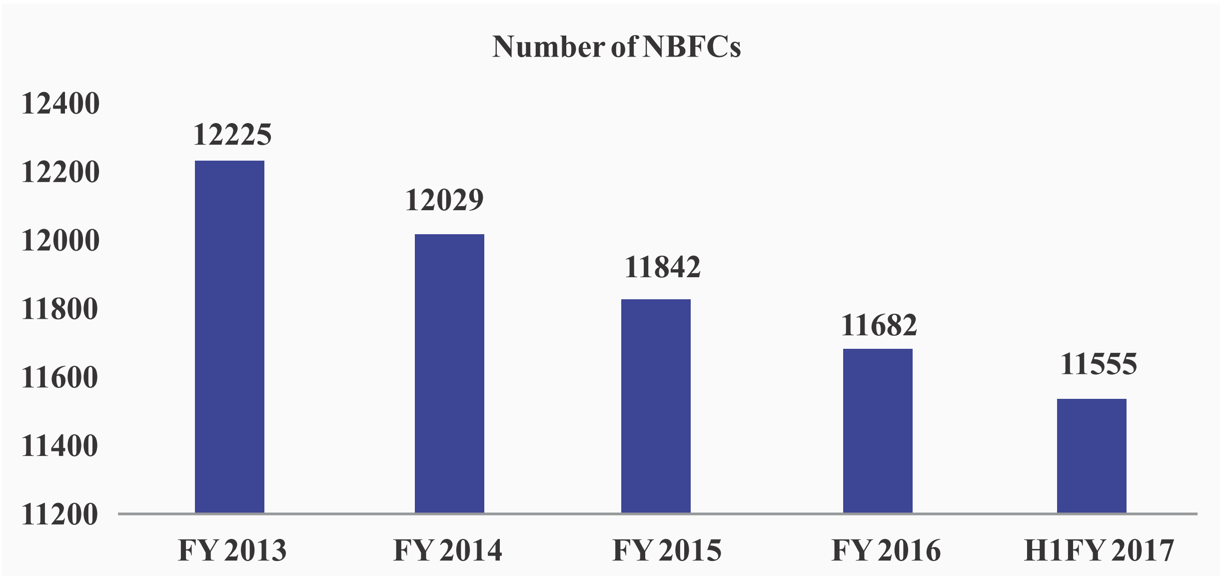


Figure 1: Number of NBFCs in India

Source: Money Life- News & Views

Exhibit 5

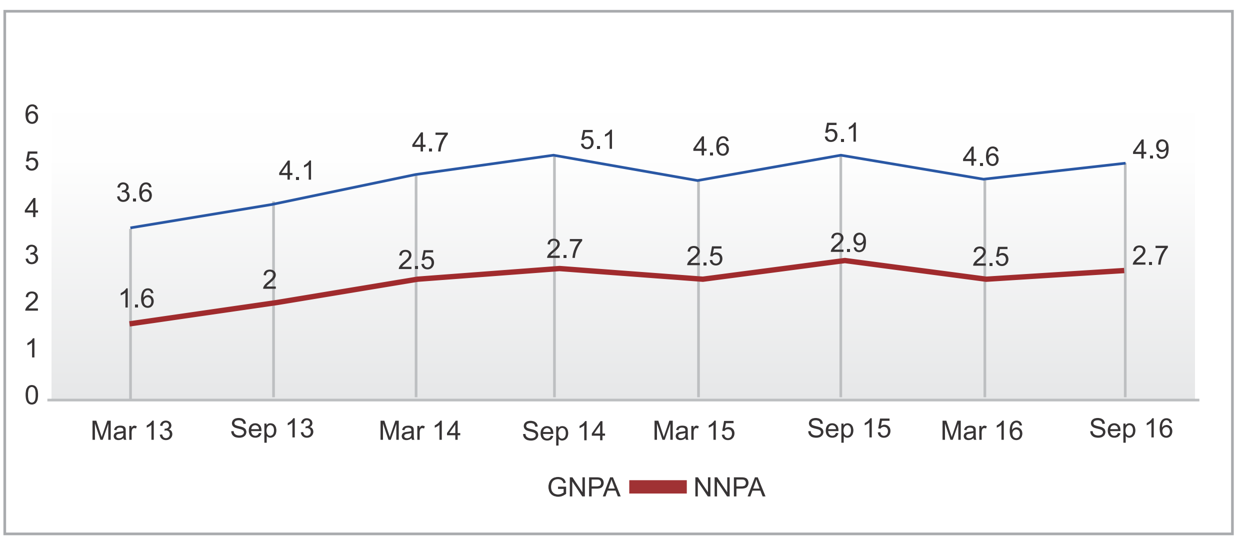


Figure 2 : Asset Quality of NBFCs

Source: Money Life- News & Views

Bibliography

1) "Non-Banking Finance Companies: The Changing Landscape", Retrieved from https://www.pwc.in/assets/pdfs/publications/2016/non-banking-finance-companies-the-changing-landscape.pdf

2) "As banks struggle, NBFCs improve their performance", Retrieved from http://www.livemint.com/Industry/4T8eyEJW2VsBCcGPxw7TqI/RBI-report-says-NBFCs-improving-on-performance-metrics.html

3) Kumar Sravan P, Reddy Dinesh K and Dhanunjaya A (2016). "Growth & Development of NBFC in India", Anveshana's International Journal of Research in Regional Studies, Law, Social Sciences, Journalism and Management Practices, Vol-1, November 2016, Retrieved from http://publications.anveshanaindia.com/wp-content/uploads/2016/10/GROWTH-DEVELOPNMENT-OF-NBFC-IN-INDIA-1.pdf

4) "Financial Stability Report. Reserve Bank of India, Issue No. 13, Retrieved from https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR2316BB76DB39BF964542B9D1EBE2CBC273E7.PDF

5) Dr.Kaushal H.R. (2016). "Impact of Non-Banking Financial Companies (NBFCs) in Indian Economic Growth", EPRA International Journal of Economic and Business Review, Vol-4, March 2016, Retrieved from http://epratrust.com/articles/upload/13.Dr.%20H.R%20Kaushal.pdf

6) "Enormous Potential in Non-Bank Finance and Ways to Make it Happen", Retrieved from https://media-publications.bcg.com/india/NBFC-2.pdf

7) "Hundred of NBFCs face closure threat on tighter rating norms", http://economictimes.indiatimes.com/markets/stocks/news/hundreds-of-nbfcs-face-closure-threat-on-tighter-rating-norms/articleshow/55042512.cms

8) "Report on Trend and Progress of Banking in India 2015-16 and Financial Stability Report December 2016", Retrieved from https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=39074

9) "Financial Statements of Power Finance Corporation", Retrieved from http://www.moneycontrol.com/financials/powerfinancecorporation/capital-structure/PFC02#PFC02

10) GhoshAbhirup (2017). “NBFCs fail to perform in FY15-16, first half FY16-17, Retrieved from http://www.moneylife.in/article/nbfcs-fail-to-perform-in-fy15-16-first-half-fy16-17/49379.html

11) “Indian Retail Non-Banking Finance Market”- Q1FY2017 Performance Update and Industry Outlook, Retrieved from http://www.icra.in/Files/ticker/NBFC%20Note%20-%20Oct%202016-FINAL-SUMMARY.pdf

12) “PE funds face touch challenge from NBFCs in realty sector”, Retrieved from http://www.livemint.com/Companies/Y8iYFFLtu2UXhwODtLR6SJ/PE-funds-face-tough-challenge-from-NBFCs-in-realty-sector.html

13) “Financial Statements of Reliance Capital”, Retrieved from http://www.moneycontrol.com/financials/reliancecapital/balance-sheet/RC

14) “Financial Statements of IDFC”, Retrieved from http://www.moneycontrol.com/financials/idfc/balance-sheet/IDF

15) “Financial Statements of LIC Housing Finance Limited”, Retrieved from http://www.moneycontrol.com/financials/lichousingfinance/balance-sheet/LIC

16) “Sharma Nandini (2016). “Non-Banking Financial Corporations (Challenges and Opportunities)”, Retrieved from www.eurekajournals.com

Motto

"सत्यं वद। धर्मं चर।

speak the truth. abide by the law."

Vision

"To be a global leader in promoting good corporate governance"

Mission

"To develop high calibre professionals facilitating good corporate governance"

THE INSTITUTE OF
Company Secretaries of India

IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

Headquarters

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

tel 011-45341000, 4150 4444 **fax** +91-11-2462 6727

email info@icsi.edu **website** www.icsi.edu