

A review on impact of financial sector reforms on non-banking financial corporation

¹Dr. Vivekanandan K, ²Dr. Mohan N

¹ Director, Gnanamani Institute of Management Studies, NH-7, Samuthiram A.K. Pachal (Po), Namakkal, Tamil Nadu, India.

² Pofessor & Head, Gnanamani Institute of Management Studies, NH-7, A.K. Samuthiram, Pachal (Po), Namakkal, Tamil Nadu, India.

Abstract

Non-banking financial corporations, or NBFCs, are financial institutions that provide banking services, but do not hold a banking license they fulfil financial requirements of business and society. They provide variety of financial instruments such as leasing finance hire purchase, mortgage, chit funds, loan against gold etc. A lot of the studies were already made and published to explore the impact of Reforms on NBFCs, role of NBFCs in economy, their development & growth, evaluation of NBFCs in India and future challenges etc. In present study an attempt is made through review of literature to find out the research gap in the impact of financial reforms on non- banking financial sector.

Keywords: Non-banking financial corporations NBFCs, impact of financial sector reforms, leasing finance hire purchase, mortgage, chit funds, loan against gold

1. Introduction

The financial sector reforms measure has impact on the overall efficiency and stability of the Non-Banking Financial Corporation's in India. With the commencement of New Economic Policy, the whole banking concept changed in India. It was measured fairly mature financial services practices in India particularly in Non-Banking Financial Corporation's (NBFCs) in terms of services offered by this sector. NBFCs have turned out to be engines of growth and are essential part of the Indian financial system, enhancing competition and diversification in the financial sector, scattering risks particularly at times of financial distress and have been increasingly recognized as complementary of banking system at competitive prices. Non-Banking Financial Corporation's in India represent a varied group of privately-owned, medium & small-sized financial intermediaries which offers a variety of services including equipment leasing, hire purchase, loans, investments and chit fund activities, loan against gold etc. These companies play an important role in providing credit to the unorganized sector and to the small borrowers at the local level. The Banking sector has always been highly regulated, however simplified sanction procedures, flexibility and timeliness in meeting the credit needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding. The research on the NBFCs is going in different parts of the world to review the policies and functions of the NBFCs in the world. To look into the changes and developments in the structure, functions, regulations, progress, etc. many of the studies were already made and a few latest studies are reviewed as under.

2. NBFCs: Review of Literature

Sagir Ahmad Ansari Writes on "Financial Reforms in India". The book examine constituents of the Indian financial system in detail. It highlight strengths and weaknesses of Indian financial system before 1991, making a strong case of understanding a comprehensive financial sector reforms in India to achieve high and sustained economic growth. It describes in detail the different types of reforms measures

under taken after 1991, in financial sector. The book also critically analyse the impact of reforms on commercial banks, cooperative banks, DFIs and NBFCs, Jafor Ali Akhan (2010) ^[5] writes on "Non-Banking Financial Companies (NBFCs) in India". The book discussed the financial system in India. It covers the financial intermediaries including commercial banks, regional rural banks, cooperative banks and Non-Banking Financial Companies in India. The book is good source in getting information on businesses, classification, management of assets, risk coverage, etc of the NBFCs in India.

K. Martina Rani (2008) ^[14] in her paper entitled "Impact of Financial Sector Reforms on Non-Banking Financial Companies" published in AIMS International Journal of Management, The number of reporting NBFCs and the growth rate of deposits continued to rise till the year 1997, but declined after 1998 as the regulatory framework 1998 which came as a source of excessive control to the real and genuine players in the market. The main source of NBFCs has always been the fixed deposits. The gross NPAs to the total advances were 11.4 per cent in March 1998 and it declined to 9.7 per cent in September 2002.

Pawan Kumar Pandey ^[15] in his research report conclude that, since the financial reforms of 1991, there have been significant favourable changes in India's highly regulated sector. The financial reforms have had a moderately positive impact on reducing the concentration of financial sector (at the lower end) and improving performance. His empirical estimation shoed that regulation lowered the profitability and cost efficiency of public-sector banks at the initial stages of the reforms, but such negative impact disappeared once they adjusted to the new environment. Moreover, allowing banks to engage in non-traditional activities has contributed to improved profitability and cost and earnings efficiency of the whole financial sector, including public-sector. The response of the institutions to the reforms has been impressive. The financial institutions have been adjusting very well to the new environment.

Basu (1961) in his paper entitled “Non-Banking Financial Intermediaries and Monetary Policy” published in *The Banker* stated that a Non-Banking Financial Company (NBFC) is a company incorporated under the Companies Act, 1956 and conducting the financial business as its principal business. In India, the Non-Banking Financial Sector comprises of a multiplicity of institutions, which are defined under section 45 I(a) of the Reserve Bank of India Act, 1934. Its principal business is leasing and housing finance.

Thilakam and Saravanan (2014) ^[13] writes on “CAMEL Analysis of NBFCs in Tamil Nadu” in *International Journal of Business and Administration Research Review*. Financial intermediation is a crucial function of Banks, Non-Banking financial companies (NBFCs) and Development Financial Institutions (DFIs) the post reform period in India is characterized by phenomenal growth of NBFCs complementing the role of banks in mobilizing funds and making it available for investment purposes. During the last decade NBFCs have undergone wide volatility and change as an industry and have been witnessing considerable business upheaval over the last decade because of market dynamics, public sentiments and regulatory environment. To evaluate the soundness of NBFCs in Tamil Nadu over a decade, the authors made an attempt of CAMEL criteria for analysis of selected Companies. Based on findings the suggestions were offered to overcome the difficulties face by selected NBFCs in their development.

Shariq Nisar and Mohsin Aziz (2004) presented a paper entitled “Islamic Non-Banking Financial Institutions in India: Special Focus on Regulation”. Indian Muslims have always been trying to manage their economic affairs within the framework of Shariah. This paper aims to highlight the attempts made by Indian Muslims in this regard and how some of the later developments since mid-eighties affected their functioning. The paper focuses on how the period of late 1980s and early 1990s saw the proliferation of Non-Banking Finance Companies (NBFCs) in India and the subsequent failures of a large number of finance companies caused by the depressed economic scenario in early 1990s and the highly changing regulatory environment in the late 1990s. Some prominent Islamic NBFCs of India are taken for detailed case studies.

Shailendra Bhushan Sharma and Lokesh Goel (2012) ^[8] write on “Functioning and Reforms in Non-Banking Financial Companies in India”. Non-Banking Financial Companies do offer all sorts of banking services, such as loans and credit facilities, retirement planning, money markets, underwriting and merger activities. These companies play an important role in providing credit to the unorganized sector and to the small borrowers at the local level. Hire purchase finance is by far the largest activity of NBFCs. The rapid growth of NBFCs has led to a gradual blurring of dividing lines between banks and NBFCs, with the exception of the exclusive privilege that commercial banks exercise in the issuance of cheques. This paper provides an exhaustive account of the functioning of and recent reforms pertaining to NBFCs in India.

Xiaoqiang Cheng and Hans Degryse (2010) published a paper entitled “The Impact of Bank and Non-Bank Financial Institutions on Local Economic Growth in China” in *Journal of Financial Services Research*. The paper provides evidence on the relationship between finance and growth in a fast growing country, such as China. Employing data of 27

Chinese provinces over the period 1995-2003, the authors study whether the financial development of two different types of financial institutions- banks and non-banks- have a (significantly different) impact on local economic growth. The findings indicate that banking development shows a statistically significant and economically more pronounced impact on local economic growth.

Subina Syal and Menka Goswami (2012) ^[11] writes on “Financial Evaluation of Non-Banking Financial Institutions: An Insight in Indian Journal of Applied Research. The Indian financial system consists of the various financial institutions, financial instruments and the financial markets that facilitate and ensure effective channelization of payment and credit of funds from the potential investors of the economy. Non-banking financial institutions in India are one of the major stakeholders of financial system and cater to the diversified needs by providing specialized financial services like investment advisory, leasing, asset management, etc.

Non-banking financial sector in India has been a considerable growth in the recent years. The aim of the present study is to analyze the financial performance and growth of non-banking financial institutions in India in the last 5 years. The study is helpful for the potential investors to get the knowledge about the financial performance of the non-banking financial institutions and be helpful in taking effective long-term investment decisions.

Taxmann’s (2013) ^[12] published “Statutory Guide for Non-Banking Financial Companies” is published by Taxmann’s Publications, New Delhi. The book listed the laws relating to Non-Banking Financial Companies. The rules and laws governing the kinds of businesses undertaken by different types of NBFCs are also discussed.

Amit Kumar and Anshika Agarwal (2014) ^[2] published a paper entitled Latest Trends in Non-banking Financial Institutions in *Academicia: An International Multidisciplinary Research Journal*. In Indian Economy, there are two major Financial Institutions, one is banking and other is Non-Banking. The Non-Banking Financial Institutions plays an important role in our economy as they provide financial services on wide range, they also work to offer enhanced equity and risk-based products, along with this they also provide short to long term finance to different sectors of the economy, and many other functions. This paper examines the latest trends in Non-Banking Financial Institutions. This paper analyzes the growth and enhanced prosperity of financial institutions in India.

Naresh Makhijani (2014) ^[6] writes on “Non-Banking Finance Companies: Time to Introspect” in *Analytique*. Over the last few years the Non-Banking Finance Companies (NBFC) sector has gained significant advantages over the banking system in supplying credit under-served and unbanked areas given their reach and niche business model. However, off late the Reserve Bank of India has introduced and suggested various changes in the existing regulatory norms governing NBFCs with a view to bring NBFCs regulations at par with the banks. The ongoing and proposed regulatory changes for the NBFCs in terms of increased capital adequacy, tougher provision norms, removal from priority sector status and changes in securitization guidelines could bring down the profitability and growth of the NBFC sector. NBFCs will need to introspect and rethink their business models as they will now not only have to combat stringent regulatory norms but

also have to face the challenge of rising cost of funds, scare capital and direct competition from banks.

Shail Shakya (2014) [9] published a working paper entitled "Regulation of Non-banking Financial Companies in India: Some Visions & Revisions". Non-Banking Financial Companies are pioneer in their cash deployment, accessibility to the markets and others to count. NBFCs are known for their higher risk taking capacity than the banks. Despite being an institution of attraction for the investors, NBFCs have played a significant role in the financial system. Many specialized services such as factoring, venture capital finance, and financing road transport were championed by these institutions. NBFC sector has more significantly seen a fair degree of consolidation, leading to the emergence of large companies with diversified activities. However, the recent financial crisis has highlighted the importance of widening the focus of NBFC regulations to take particular account of risks arising from the regulatory gaps, from arbitrage opportunities and from inter-connectedness of various activities and entities associated with the financial system. The regulatory regime is lighter and different than the banks. The steady increase in bank credit to NBFCs over the recent year's means that the possibility of risks being transferred from more lightly regulated NBFC sector to the banking sector in India can't be ruled out.

3. Conclusion

The NBFCs are playing noteworthy role in meeting financial needs of the medium sized and small sized industries and growth of Indian economy in a roundabout way. On the other side of the paper the policies of NBFCs are also providing investment safety measures for the investors. It tinted that due to the regulations of the RBI, still the NBFCs are not extending more credit. It is suggested to the NBFC credit policy to reduce rate of interests, which helps to small institutions to get loans for their different capital needs. The review made above shows that the research in NBFCs is not so accelerating & progressive towards economic development as many of the published research papers shows only fundamentals and basics of the NBFCs and still it is crucial to study the impact of financial sector reforms on the performance of NBFCs in India and also the role in development of Indian Economy.

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