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Post-Recession Performance Evaluation of Non-Banking Finance Companies

[1]Manjeet Singh, [2]Dr. R.K.Godha
[1]Research Scholar MDS University, Ajmer
[2]Department of Economic Affairs & Financial Management. Govt. College Ajmer

Abstract: Non -Banking Financial Institutions (NBFIs) play an important role in the Indian financial system given their unique position of providing complementarity and competitiveness to banks. On account of intensification of the global financial crises in September 2008, some impact was experienced in the sector; thereby creating liquidity constraints for NBFIs. In response, the Reserve bank introduced special fixed term rate Repo under liquidity adjustment facility (LAF) to banks exclusively for the purpose of meeting the finding requirements of Non-BankingFinancial Companies (NBFCs). Besides, certain precautionary measures were taken by the Reserve Bank since October 2008 to enhance the availability of liquidity to NBFCs. Regulation of NBFIs in India was being progressively strengthened well before the onset of the global financial crises. The Reserve Bank undertook regulatory and supervisory policy initiatives in terms of capital to risk weighted asset ratio (CRAR), exposure norms and classification of assets.
Keywords: Banking Companies, Post Recession Period, NBCs, CRAR.

Introduction

In the wake of recent global financial crisis and its fall out on the financial institutions (Pis), the Reserve bank took a number of measures to preserve financial stability and arrest the modernization in the growth momentum. The Reserve Bank took policy initiatives for NBFCs also. As a measure aimed at expanding rupee liquidity, the Reserve Bank provided a special repo window under the LAF for NBFCs. In addition, an existing special purpose vehicle (SPV) was used as platform to provide liquidity support to NBFCs. In December 2008, systemically important non-deposit taking NBFCs (NBFCs-ND-SI) were permitted, as a temporary measure, to raise foreign currency short-term borrowing under the approval routesubject to certain conditions.

The NBFCS in the Indian financial system continued to be resilient as the Reserve Bank had taken various measures to minimize the adverse effects of the ongoing financial crises on NBFCS have been competing with and complementing the services of commercial banks for a long time. The NBFCS as a whole account for 9.1 per cent of assets of the total financial system. The Committee on Financial Sector Assessment (CESA) observed that NBFCS are largely compliant in areas relating to licensing, permissible activities capital adequacy, risk management process, credit risk, problem assets large exposures, supervisory approach, supervisory techniques and supervisory reporting.

Importance of the study

Non-banking Finance Companies (NBFCS) arc a set of financial services companies that are quite unique to India in terms of their size and the range of services provided by them theservices provided by NBFCS range from retail service such as loans, leasing and hire purchase financing, brokerage and distribution services to bill discounting and syndication services to corporate customers. The important fund-based activities of NBFCS are equipment leasing loans/investments, venture capital, housing finance, factoring. Non-Banking Financial Companies (NBFCS), have earned respectable place by providing quick and tailor-made solutions to the financial requirements of different segments of the borrowers. This study focuses on the growth and performance of NBFCS in India.

Objectives of the study

- To evaluate the performance of the NBFCS after great meltdown.
- To identify the reasons for the prevailing trend in the sector
- To identify the possible strategic options for NBFCS to survive and grow

Various parameters like business profile, distribution of public deposits, regulatory and supervisory initiatives, distribution of total assets, distribution of net owned funds, maturity patterns. Financial performance and other monetary aggregates etc. were studied to test the objectives. To procced with the study further, a general 'hypothesis had been assumed that there is a sharp decline in the performance of the NBFCS during the period.

Review of Literature

Review of Literature in this field has been performed and a paper on "Financial Performance of Non-Banking Finance Companies in India" published by AnithaS.Kantawala and "The Performance Evaluation of Non-Banking Financial Companies" by Dr. D. Raghunatha Reddy and K. Sudha Rani has been taken as basis of this study. The studies reveals that there exists a significant difference various category of NBFCS. When two categories examined against each other, then the more number of ratios are not statistically different from each other in majority of the cases.

The other study on the Indian banking sector-"The Indian banking Sector- On the Road to Progress"-G.H. Deolalkar (Former Managing Director of State Bank of India) discussed about the fragility of the NBICS and necessity of the regulatory Framework by RBI as well as advantages and disadvantages of NBFCS. The study also focused on the asset liability management of NBFCS credit rating, capital adequacy, statutory and registration norms with RBI.

Though the earlier studies have done remarkable research on NBFCS but still there is a need to throw light on post-recession performance of NBFCS, hence the need for the present study.

Data base and period of Study

The data source for the study is primarily the secondary data. The yearly publications of RBI, articles published in various business newspapers, journals and books on financial services are the secondary sources from which the data has been collected. The data collected for the study consists for two years from April 2007 to March 2008.

The sample for the study is taken from the population consisting of NBFCS reporting to RBI accepting the public probability representation basis. The number of reporting companies to RBI stood at 401 in the year 2007 and 364 in 2008 have been considered for the present study to draw the inferences and to arrive at conclusions.

Regulatory and Supervisory Initiatives

Regulation of NBFCS is being progressively strengthened and the process has started before the onset of the global financial crisis. Non-Deposit taking NBFCS with asset size of Rs. 100 crore and above were defined as systematically important and an elaborate prudential framework was put in place. NBFCS-ND-SI (NBFCS-ND) with asset size of Rs. 100 crore and above) are subject to CRAR and exposure norms prescribed by the Reserve Bank. Reclassification of NBFCS was affected in December 2006, in terms of which companies Financing real/physical assets for productive/economic activities would be classified as Asset Finance Companies (AFCS). The other two categories of NBFCS would be Loan Companies (LCs) and Investment Companies (ICs).

Monitoring of Frauds in NBFCS

In July 2008, the Reserve bank revised the approach towards monitoring of frauds in NBFCS issued in March 2008. Accordingly, NBFCS were advised to report frauds in their subsidiaries and affiliates/joint ventures.

Rating of NBFCS

Guidelines on Capital Adequacy, Liquidity and Disclosure Norms for NBFCS-ND-SI

The Reserve Bank reviewed the extant guidelines regarding NBFCS-ND-SI and the final guidelines were issued on August 1, 2007. In terms of these guidelines, the minimum CRAR for each NBFC-ND-SI was raised from the existing 10 per cent to 12 per cent to be reached by March 31, 2008. In view of the economic downturn and based on several requests received, this requirement was postponed for one year.

Introduction of Interest rate future-NBFCS

To hedge the underlying exposure directions were focused covering the framework for trading of Interest Rate Futures by NBFCS in exchange in India recognised by SEBI subject to RBI/SEBI guidelines in the matter.

Profile of NBFCS

Total number of NBFCS registered with the Reserve Bank, consisting of NBFCS-D (deposit-taking NBFCS), RNBCS, mutual benefit companies (MBCS), miscellaneous non- banking companies (MNBCS) and Nidhi companies, declined from 12,968 at end-June 2007. (Table 1.1) Table 1.1 Number of NBFCS registered with the Reserve Bank of India

End June	Number of Registered NBFC's	Number of NBFCs-D
1999	7,855	624
2000	8,451	670
2001	13,815	776
2002	14,077	784
2003	13,849	710
2004	13,764	604
2005	13,261	507
2006	13,014	428
2007	12,968	401
2008	12,809	364

Table 1.2
Profile of NBFCs(Amount in Rs. Crore)

Item	As at end-March			
	2007		2008	
	NBFCs	of which RNBCs	NBFCs	of which RNBCs
1	2	3	4	5
Total Assets	99,014	24,452 (24.7)	95,727	20,211 (21.1)
Public Deposits	24,400	22,358 (91.6)	21,548	19,607 (91.0)
Net Owned Funds	11,921	1,718 (14.4)	13,458	1,870 (13.9)

Source: Annual Returns
Note Figures in parenthesis are percentage to respective total of NBFCs.

Total assets of NBFCs declined to Rs. 95,727 crores during 2007-08 from Rs. 99,014 croresin previous year. Public deposits also recorded a decline to Rs. 21,548 crores at end-March 2008 from Rs.24,400 crore at end-March 2008.Net owned funds (NOF) witnessed a growth of S.S per cent and stood at Rs. 13,458 crores as on end-March 2008.

The ratio of deposits of reporting NBFCs to the aggregate deposits of scheduled commercial banks dropped to 0.53 per cent at end-March 2008 from 0.73 per cent at end-March 2007 mainly due to the decline in deposits of reporting NBFCs.

Total assets/liabilities of NBFCs (excluding RNBCs) expanded at the rate of 1.3 per cent during 2005-08 as compared with 53.6 per cent during 2007-08.

The increase in assets/liabilities of AF Cs was mainly on account of reclassification of NM: Cs, which was initiated in December 2006 and the process of which is still continuing. The relative significance of various NBFC groups reflected largely the pattern of their borrowings as deposits constituted a small share (2.6 percent) of their totalliabilities.

Interest Rates on Public Deposits with NBFCS

Conclusion

The recent financial crisis has posed the problem to NBFIs in terms of accessing low-costfunds leading them to recourse to unsecured loans for funding their asset base. CFSA 2008 has advised that given the limited access to low-cost funding of NBFCs, there is a need to develop alternative funding source like an active corporate bond market. Alternative funding source will facilitate in their asset base growth as well as in asset diversification. In the present scenario, NBFCs-ND is a growth driver of NBI'Cs, however, there is a need for an appropriate structure for regulation and supervision to bridge up the gap in areas relating to transfer of significant ownership, major acquisition, risk management, internal control and home host relationship for systematically important NBFCs-ND.

The right strategic choice for NBFCs is the configuration of entire value chain of the company through a different set of activities to deliver unique value to customers. If NBFCs arc able to deliver superior value to customers through unique positioning and value chain configuration, then it can attain a sustainable competitive advantage against other players in its chosen product market segment.

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