ISSN NO.2395-0692

International Journal of
IJAHMS Arts, Humanities and Management Studies

# Comparison of Growth between Non-Banking Financial Companies and Banks & Their Contribution in the Indian Economy

**Sarojit Mondal**

*Official Assistant of Asansol Postal Divisional Office*
*Asansol, West Bengal, India.*

## ABSTRACT

*Though India has a bank dominated financial system but recently Non Banking Financial Companies are competing with the banks in providing financial services and has been playing a complementary role with other financial institutions in the Indian Economy. The study has made an attempt to compare the performance of growth of Non Banking Financial Companies with Banks and their contribution in the Indian economy. For this study, data have been collected from secondary sources and simple statistical tools, tables have been used. The results show that during the study period, i.e. from the year 2006 to 2013, total assets of Non-Banking Financial Companies have been increasing at higher rate than the Banking Sector in India and also contribution to GDP of NBFC sector has been increasing more steadily than that of banks.*

**Key Words:** *Non-Banking Financial Companies (NBFCs), Banks, Assets Growth, GDP, Return on Assets.*

## INTRODUCTION

India had a bank-dominated financial system, but the role of Non-Banking Financial Companies (NBFCs) is also considerable. NBFCs are largely involved in serving those classes of borrowers who are generally excluded from the formal banking sector. Total Assets' size of NBFCs is around 14 percent of that of scheduled commercial banks (other than RRBs) and the sector has been growing tremendously over the years in size. As per Reserve Bank of India Act, 1934, a 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. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company [Residuary non-banking company (RNBC)].

As per Section 45-1A of the Reserve Bank of India Act, 1934, no NBFC can commence business without obtaining certificate of registration from the Reserve Bank of India but certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration from the RBI, viz. Venture Capital Fund/Merchant banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, etc. There are different types of NBFCs registered with RBI, they are – a) Asset Finance Company (AFC), b) Investment Company (IC), c) Loan Company (LC), d) Infrastructure Finance Company (IFC), e) Systematically Important Core Investment Company (CIC-ND-SI), f) Infrastructure Debt Fund (IFD), g) Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI), h) Non-Banking Financial Company – Factors (NBFC-Factors).

NBFCs are involved in providing financial services such as offering of small ticket personal loans, financing of two/three wheelers, truck financing, farm equipment financing, loans for the purpose of used commercial vehicles/unsecured working capital financing etc. Further, NBFCs also often take lead role in providing innovative financial services to Micro, Small, and Medium Enterprises (MSME) most suitable to their business requirements. The characteristics of NBFCs financial services include simple process and procedures in sanction and disbursement of credit, timely friendly and flexible terms of repayment aligned to the unique features of its clients, albeit at a higher cost.

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

i) Bank can accept demand deposits but NBFC cannot accept demand deposits;
ii) NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself but banks are performing all of these;
iii) Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike that in the case of banks.

**REVIEW OF LITERATURE:**

1) 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 collected from RBI Bulletins regarding financial and Investment Companies. In this study various 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 behavior of some the parameters which go along with the category of NBFC.
2) Harikrishnan (2008) researched on the topic "Receivable Management in Non Banking Finance Companies with Special Reference to Vehicle Financing". The objective of the study was to identify the major issues and problems in managing the receivable in respect of vehicle financing of NBFCs. For this study, data have been collected from the primary and secondary sources for the period 1999-2007. Primary sources of data are NBFCs and

ISSN NO.2395-0692

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their channel partners i.e., the borrowers of NBFCs and intermediaries who are the dealers of the vehicles & various websites, Reports, Journals, and Publications etc. are the secondary sources. Quantitative and qualitative techniques have been adopted in this study at different stages and suggested that there should be more transparency in dealing with the borrowers and interest rate calculation, the mode of disposal of reprocessed vehicle needs to be totally decentralized to branches for getting better price, discontinue the practice of temporary registration of vehicles, healthy relationship between dealers and NBFCs should be improved, etc.

3) Gumparthi and Manickavasagam (2010) examined on the topic "Risk Assessment Model for Assessing NBFCs' (Asset Financing) Customers". The objective of the paper was to build Risk Assessment Model for NBFCs' based on market forces and found 28 parameters to measure the risk associated with the customer identified out of which 12 parameters are the more important ones.
4) Khalil and Group (2011) observed on the topic "Financial Performance of Non Banking Finance Companies in Pakistan" to analyze the financial performance of those non-bank finance companies (NBFCs) which are providing the services of investment advisory (IAS), asset management (AMS), leasing and investment finance (IF) for two year from 2008 to 2009. Ratio analysis method has been used to analyze the financial performance of non-bank financial institutions. The study concludes that the financial performance of NBFCs was better in 2008 as compared to the overall decline in 2009 caused by many factors.
5) Vadde (2011) investigated on the topic "Performance of Non-Banking Financial Companies in India – An Evaluation" after analyzing 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 have been collected from various 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.
6) Samal and Pande (2012) examined on the topic "A Study on Technology Implications in NBFCs: Strategic Measures on Customer Retention and Satisfaction" by using primary and secondary data & using both descriptive and analytical Research design. The authors concluded that technology on services and technology care for beneficiary have more influencing potentiality in increasing beneficiary satisfaction. But NBFCs must look to all other factors to increase its potentiality in technology, as new beneficiary are more accustomed with new technology to save their time and energy.
7) Sornaganesh and Navis Soris (2013) investigated on the topic "A Fundamental Analysis of NBFC in India" to analyze the profitability position of 5 sample NBFC companies, like 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 the Balance Sheets of the sample companies. The study reveals that SF has performed better in terms of Earnings Per share (EPS) followed by STF, BF, CF & M&MF but STF and M&MF are far better than other in NPM (Net Profit Margin).

8) Perumal and Satheskumar (2013) studied on the topic "Non Banking Financial Companies" analyzing the Balance Sheets and income statements of two sample companies, viz., Sundaram Finance Limited and Lakshmi General Finance Limited for the period 2007-2012 using primary and secondary data. The study was performed using various statistical techniques such as 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 a effective manner.
9) 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 endeavour to search for new products and services in order to survive and grow constantly.
10) Khan and Fozia (2013) have researched on the topic "Growth and Development in Indian Banking Sector Introduction" based on the secondary data. The purpose of the study was to show the growth and technological development in Indian Banking sector. Statistical tables and charts have been used by the researcher and concluded that banks need to optimally leverage technology to increase penetration, improve the productivity and efficiency, better customer service and contribute to the overall growth and development of the country.
11) 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'.
12) 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, enhancing competition and diversification in financial sector, spreading risks specifically at times of financial distress and have been increasingly recognized as complementary of banking system at competitive prices.

**RESEARCH GAP:**

None of the studies have been made regarding comparison of growth of Non-Banking Financial Companies (NBFCs) and Banks and their contribution in the Indian Economy and so the present study has been undertaken.

**OBJECTIVES OF THE STUDY:**

1) To observe the similarity and differences of NBFCs and Banks in India;
2) To compare the growth of NBFC sector and Banking Sector in India;
3) To observe the contribution of NBFCs and Banks to the GDP of India.

**HISTORICAL BACKGROUND OF NBFCS AND BANKS:**

The Indian economy has been witnessing high rates of growth in the last few years. Financing requirements have also risen commensurately and will continue to increase in order to support and sustain the tremendous economic growth. NBFCs have been playing a complementary role to the other financial institutions including banks in meeting the funding needs of the economy. They help fill the gaps in the availability of financial services that otherwise occur in bank-dominated financial systems. The gaps are in regards the product as well customer and geographical segments. NBFCs over the years have played a very vital role in the economy. They have been at the forefront of catering to the financial needs and creating livelihood sources of the so-called un-bankable masses in the rural and semi-urban areas. Through strong linkage at the grassroots level, they have created a medium of reach and communication and are very effectively serving this segment. Thus, NBFCs have all the key characteristics to enable the government and regulator to achieve the mission of financial inclusion in the given time.

The first bank was established by the British raj in Calcutta in the year 1770, named Bank of Hindustan. Then 1786 General Bank of India was set up. Three presidency banks were set up by the British East India Company viz., Bank of Calcutta, Bank of Bombay and the Bank of Madras. They worked as quasi central banks in India for many years. In 1921 these three banks merged with each other and formed Imperial Bank of India. In 1955 it renamed as State Bank of India. As per Reserve Bank of India Act' 1934, RBI was set up in the year 1935. In India the process of Bank nationalization was started in the year 1969 and then by 1980 and various reform measures has been started by the Government of India since the year 1991. Now there are various types of banks in India like – Commercial bank, Land bank, Scheduled bank, Non-scheduled bank, Private sector bank, foreign banks etc.

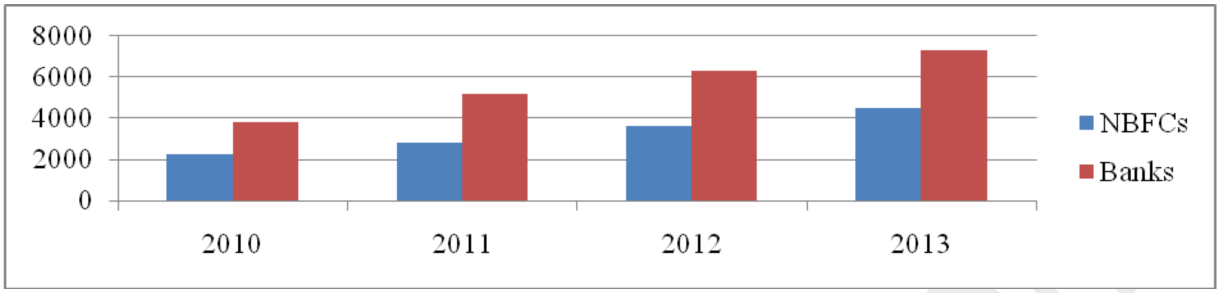
**METHODOLOGY OF THE STUDY:**

The data have been collected from the website of Reserve Bank of India. So the data are secondary in nature and the time period is taken from the year 2006 to 2014 for this analysis. Statistical table, column chart and line chart has been used for this analysis. The data collected from the website are presented below:

ISSN NO.2395-0692

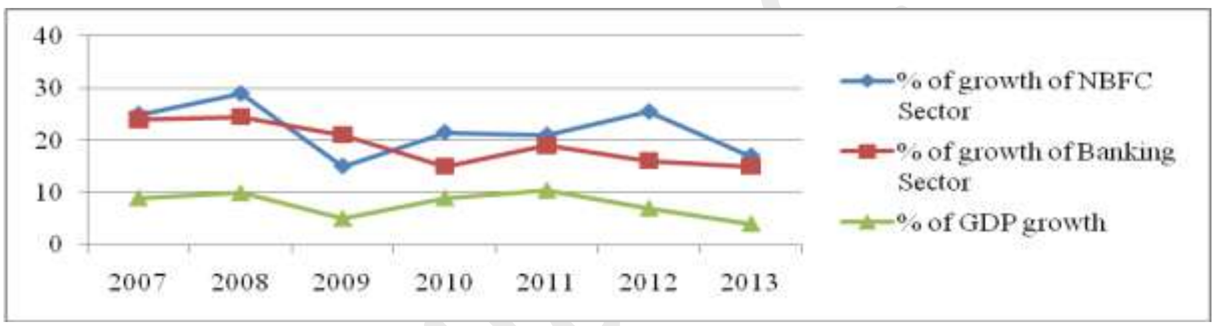
IJAHMS International Journal of Arts, Humanities and Management Studies

*Figure 1: Lending to Infrastructure Sector-NBFCs vis-à-vis Banks (Rs. Billion)*



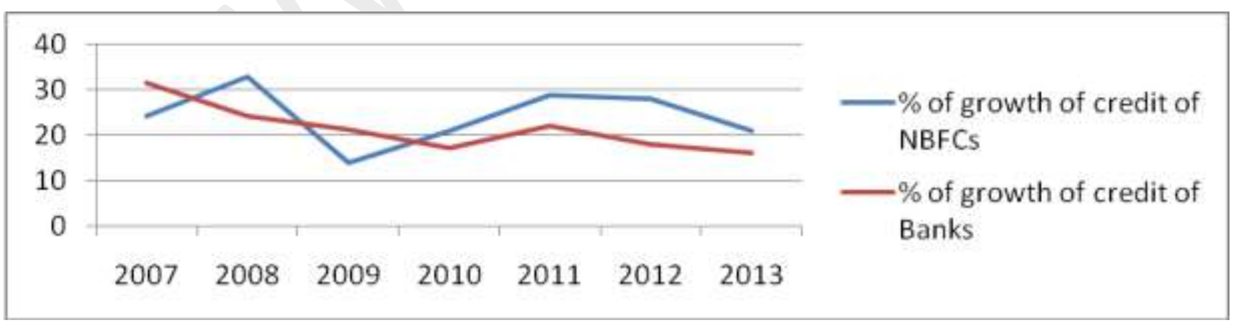

**Source**: COSMOS Database for NBFC-IFCs and Hand Book of Statistics on Indian Economy for Banks, 2012-13.

*Figure 2: Balance Sheet Growth at the end of Financial Year of– NBFCs vis-à-vis Banks*




Source: Reports on Trend and Progress of Banking in India 2007-2013 and Hand Book of Statistics on Indian Economy 2012-13.

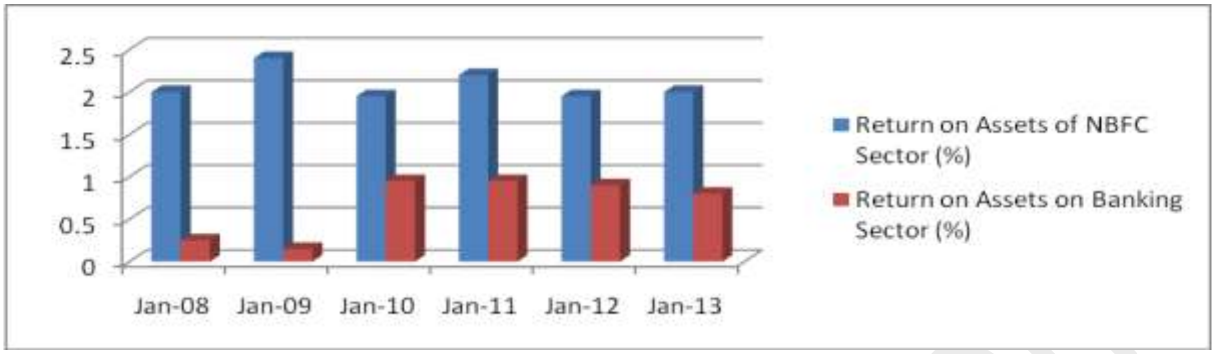
*Figure 3: Growth in Credit at the end of Financial Year of – NBFCs vis-à-vis Banks*




**Source**: Reports on Trend and Progress of Banking in India 2007-2013.

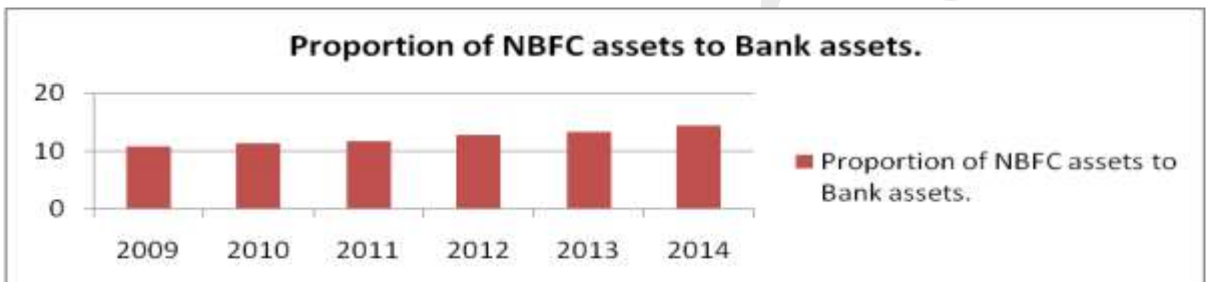
ISSN NO.2395-0692
IJAHMS International Journal of Arts, Humanities and Management Studies

*Figure 4: Trends in Return on Assets – NBFCs vs. Banks*




**Source:** Speech delivered by Sri P. Vijaya Bhaskar, Executive Director, Reserve Bank of India, at the national Summit on 'Non Banking Financial Companies – Game changers' on January 23, 2014 at ASSOCHEM in New Delhi.

**Figure 5: Proportion of NBFC Assets to Bank Assets**




**Source:** *CARE Rating Report on NBFC Sector* dated 5th December 2014.

*Table A: Assets of NBFC and Banking (SCBs) Sector as a percentage to GDP*

| Ratio | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|
| NBFC Assets to GDP (%) | 8.4 | 9.1 | 10.1 | 10.3 | 10.8 | 10.9 | 11.9 | 12.5 |
| Banks Assets to GDP (%) | 75.4 | 80.6 | 86.8 | 93.0 | 93.0 | 92.2 | 92.7 | 95.5 |

Source: Reports on Trend and Progress of Banking in India 2006-2013 and Hand Book of Statistics on Indian Economy 2012-13.
Note: Assets of NBFC sector include assets of all deposit Taking NBFCs and Non-Deposit Taking NBFCs having assets size Rs. 100 cr. and above (NBFCs-ND-SI).

## ANALYSIS AND INTERPRETATION

Holding on an average almost 13% of total assets (Figure-5), NBFC sector has been granting loan almost 58% to the infrastructure sector in comparison to the volume of credit granting by the banks, i.e. NBFCs have granted major portion of fund as a loan to infrastructure sector in comparison to banking sector (Figure-1). From Figure-2 it is seen that there is a positive relationship between the GDP growth rate and banking and NBFCs growth rate but in most of the years, Balance Sheet growth of NBFC sector grew at faster rate than that of banking sector. Similarly credit of NBFC sector grew more rapidly as compared with banking sector (Figure-3). Return on Assets of NBFCs has shown stability with figure ranging around 2 percent since 2008 (Figure 4). The return on assets of NBFCs is typically higher than that of banks. Return on Assets in Banking Sector is 0.67 percent per year on an average. The share of NBFCs' assets has grown from 10.70 percent of banking assets in 2009 to 14.3 percent of banking assets in 2014 (Figure 5). From Table A it is also seen that percentage of NBFCs assets to GDP has grown to 12.5 in the year 2013 from 8.4 of the year 2006 so rate of increase is almost 50% but percentage of banks assets to GDP has been increased all most 27% in the same period. So the overall performance of growth of NBFC sector is better than that of banking sector during the study period.

## CONCLUDING REMARKS

During the study period the proportion of NBFCs' assets to Banks' assets has been increasing steadily and the Returns on Assets are better than that of banking sector. So the NBFCs have been growing at a steady rate and its growth rate is far better than that of banking sector. Proportion of credit provided by the NBFCs to infrastructure sector is far better than that of banks during the study period. Hence the contribution of NBFC sector to capital formation as well as overall economic growth has been increasing at a higher rate than that of banks.

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