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Efficiency of Banking on Non-Banking Finance Companies in India using New Technologies

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Abstract:

NBFCs form an integral part of the Indian Financial System. There has been greater recognition of the role of NBFCs in financing India's growth in the recent past, even as global debates on systemic risks arising from non-banks have travelled to Indian shores and led to somewhat fundamental shifts in the policy environment governing NBFCs. Non-banking financial and investment companies operate as an important adjunct to the banking sector in financial intermediation. They provide support to the capital market through investment holding, share trading and merchant banking activities, to the credit market through short and medium-term loans and also help in acquiring long-term assets through lease and hire purchase activities. In this paper we will study the regulators, market participants, Government departments, to gain a better understanding on NBFCs role in promoting 'Financial Inclusion' for our country .

Key words: NBFCs (Non-Banking Financial companies), Capital market, Banking sector.

1. INTRODUCTION

The financial system facilitates transfer of funds, through financial institutions, financial markets, financial instruments and services. Financial institutions act as mobilizes and depositories of savings, and as purveyors of credit or finance. They also provide various financial services to the community. They act as intermediaries between savers and investors. All banks and many non-banking institutions also act as intermediaries, and are called as non-banking financial intermediaries (NBFI). Financial institutions are divided into the banking and non-banking ones. The distinction between the two has been highlighted by characterizing the former as "creators" of credit, and the latter as mere "purveyors" of credit.1 The banking system in India comprises the commercial banks and co-operative banks. The examples of non-banking financial institutions are Life Insurance Corporation (LIC), Unit Trust of India (UTI), and Industrial Development Bank of India (IDBI). Financial markets provide facilities for buying and selling of financial claims and services. The participants on the demand and supply sides of these markets are financial institutions, agents, brokers, dealers, borrowers, lenders, savers, and others who are inter-linked by the laws, contracts, covenants, and communication networks of the land.

Financial markets are sometimes classified as primary (direct) and secondary (indirect) markets. The primary markets deal in new financial claims or new securities and, therefore, they are also known as New Issue Markets. On the other hand, secondary markets deal in securities already issued or existing or outstanding. The primary markets mobilize savings and they supply fresh or additional capital to business units. The secondary markets do not contribute directly to the supply of additional capital; they do so indirectly by rendering securities issued on the primary markets liquid. Stock markets have both the primary and secondary market segments.

2. ANALYZING THE REVISED REGULATORY FRAMEWORK FOR NBFCs

The roller coaster liquidity ride post the global financial crisis witnessed Indian NBFCs facing a predicament. Many of them had a favorable business opportunity to convert the available liquidity into short-term, profitable assets as the banking system and infrastructure-focused NBFCs dealt with asset quality issues. On the other hand, global regulatory attention on shadow banks brought the spotlight on their operations, governance, liquidity management and most of all, linkages with the banking system. NBFC regulation had evolved in phases. Some phases were marked with great benevolence, such as the registration of all entities with minimum capital and priority sector benefits to portfolio origination for banks. In contrast, some were marked with adverse business impact, such as restricting the flow of funds from banks to NBFCs and expression of displeasure with 'high growth' and concerns of systemic risks.

In the process, they have played a meaningful role in shaping borrower behavior, collecting credit related data and deepening the footprints of finance where data and information can be accessed by regulators and policymakers as well as other market participants. NBFC Regulation, on the other hand, deriving broadly from the banking framework, has been tweaked over time to ensure as good a fit as possible. The other pressure on the regulatory approach has been the desire to conform to global standards, even when the Indian economy and the demands of the services led, diverse, informal economy have been very different from the global counterparts. This tension, between a highly differentiated sector and the natural tendency of regulation to drive to standards goes to the core of the challenge of NBFC regulation in India. In what can be described as an optimal outcome, the final guidelines have addressed many fault lines without running into legal wrangles or creating widespread pain to participants.

3. VARIOUS TECHNOLOGY-BASED INITIATIVES UNDERTAKEN BY NON-BANKING FINANCE COMPANIES INDIAN BANKS

A lot has still to be done as has been highlighted in a recent RBI report on customer service, NBFCs have also been quick to impose penalties and fees while getting away with apologies for gross negligence in some cases. This has been one of the hurdles in driving customer adoption of new facilities offered by some banks. This is a critical point banks need to consider for accelerating adoption of technologies. The revised regulatory framework is applicable to all NBFCs except to NBFCs registered as primary dealers. With respect to Microfinance NBFCs and CICs, their extant regulations shall prevail wherever they are in conflict with the revised regulations.

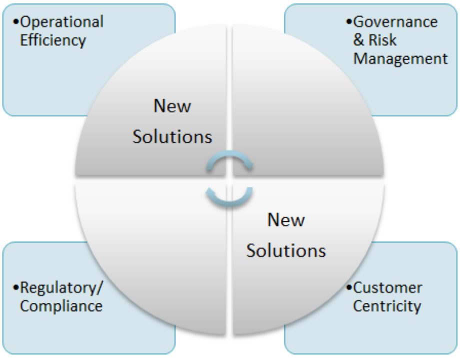

Figure 1. Technology-based initiatives

Operational Efficiency

- Straight-through-processing
- Transformation of Service Channels
- Collaborative Channel Management Strategy
- Branchless banking for Financial Inclusion
- Business Correspondents

Governance & Risk Management

- Enterprise risk management
- Real-time executive dashboards
- Real time Security management
- Risk based Authentication

New Solutions

- Mobile phone based banking application
- Social media support

Regulatory/ Compliance

- IFRS
- UID readiness
- Data flow Automation

Customer Centricity

- Customer analytics
- Efficient customer data management

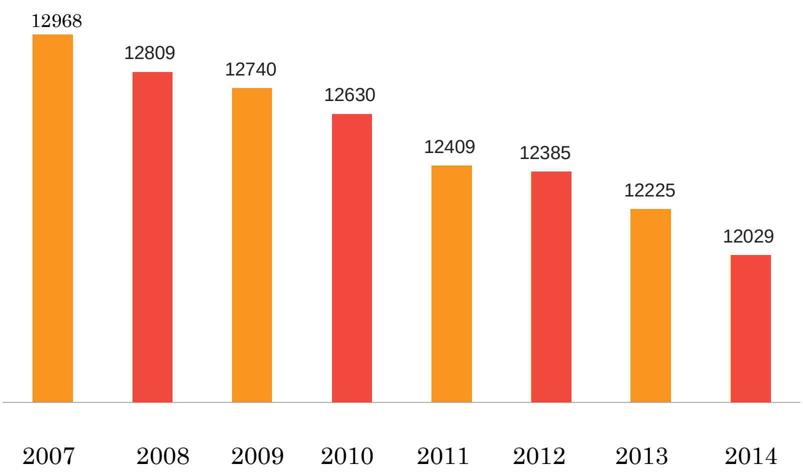

Figure 2: Number of NBFCs registered with RBI

A few niggling issues remain. The debate on whether a Core Investment Company (CIC) is or is not an NBFC rages on.

Interestingly, with no more credit concentration norms for non-deposit accepting NBFCs that are not systemically important (NBFCs-ND), group holding companies may have an incentive to continue as NBFCs and not get classified as CIC, given that the leverage cap is higher for such NBFCs compared to CICs (although defined differently under the two regulations).The Foreign Direct Investment (FDI) definition of an NBFC is still not alignTed with the RBI definition, causing pain to foreign investors in the sector specifically in terms of investment activity.This paper presents an analysis of the historical and current framework of NBFC regulations and examines some of the issues in detail. It also discusses the current business scenario and looks at some of the outstanding issues facing the sector. The discussion closes with a broad look at the way forward for NBFCs.

Banks and NBFCs – Inter-connectedness and inter-linkages

NBFCs have steadily grown in number and market share, indicating the success of their business models and the opportunities/potential in their target markets. The share of NBFCs has steadily grown from 10.7% of banking assets in 2009 to 14.3% of banking assets in 2014, thus gaining systemic importance. On the assets side, the share of NBFCs' assets as a proportion of Gross Domestic Product at current market prices has increased from 8.4% in 2006 to12% in 2013 The main reasons behind low penetration of banking have been as shown below:-

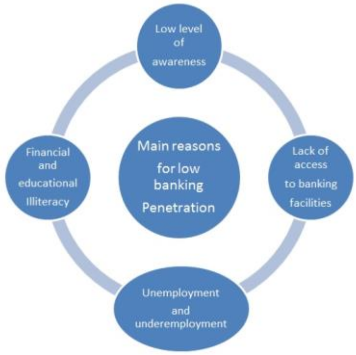

Figure 3. Low penetration of banking

CONCLUSION

The aftermath of the financial crisis highlighted the importance of increasing the scope of NBFC regulations to account for the risks that arise from regulatory gaps, arbitrage opportunities and from the linkages and inter-dependence of the NBFC sector with the rest of the financial system. There was a need to harmonize the entire framework so that the objectives of the RBI could be met in an efficient way, while ensuring that the impact on business and at the same time, the impact on business operations remained minimal or was phased over time. the regulators, market participants, Government departments, to gain a better understanding on NBFCs role in promoting 'Financial Inclusion' for our country.

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