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CHAPTER II

REVIEW OF RELATED LITERATURE

2.1 Evolution and Growth of Non-Banking Finance Companies

The concept of lease financing, hire-purchase and instalment payment systems, is not new to Indian Financial System. The practice of leasing agricultural land called pattedari, can be traced long-back in our history. Even hire-purchase, which is a variant of instalment-sale, has been in extensive use since the advent of industrialisation. However, these were accepted as business practices of late.

In India, the conventional methods of financing used in acquisition of capital goods, such as term loans, deferred payments, and equity capital have not been adequate and are far from satisfactory. Lease financing and hire purchase are the non-conventional innovative techniques evolved to meet the growing financial needs of the business.

Though the business of leasing and hire-purchase has been of recent origin in India, it has now become an important source of medium-term finance
and is becoming progressively significant in terms of volume of business and also in terms of varieties of transactions.

**Origin and Growth – World Wide Scenario**

Researchers have traced back the origin of leasing as early as 5000 years ago to the advanced cultures of the Middle East in the form of granting other people the right to use their land. The rentals were received by the land owners in the form of a certain pre-agreed part of the harvest. Further evidences have been found which confirm that leasing of land was prevalent in Babylonia around 1800 B.C. Leasing developed further in the form of ship leases and animal leases. Later leasing grew in the form of mine lease.

During the 19th century the leased assets included of furniture, carriages and few other goods. The enactment of Limited Liabilities legislation 1855 enabled the corporate sector's entry into the wagon leasing industry. In the early 20th century several types of equipment leases became popular in U.K. Such leases included weaving looms, telephone systems, electricity and gas meters, vehicles, etc.
Leasing in United States developed in the early 20th century though evidences show the Bell Telephone Company commenced renting telephones in U.S.A. in the year 1877. The second world war gave fillip to leasing business in view of scarce capital available and urgent need for reconstructing devasted economies. Most of the Government contracts were executed on the strength of leased equipments. A number of other factors namely rapid industrialisation, advances in technology, improvement in the standard of living, gave further boost to the development of leasing during 1950’s. Manufacturers of capital goods considered leasing as a marketing device. In fact in U.S.A., leasing industry has become a part and parcel of the economic system. On realising the importance of leasing the banks in U.S.A. were permitted to enter leasing business on a direct basis in 1963.

The developing countries of Asia, Africa and South America also welcomed modern leasing in the 1970’s. The concept has been accepted by Islamic countries. By 1980’s the volume of business had been expanded all over the world. Today, US has the largest leasing industry in the world. Leasing
accounts for nearly 15% of the total private capital investment. About one third of the automobiles sold in the US are through lease financing.

**Development Lease Financing in India**

In the modern sense leasing business is of recent origin in India. Despite, existence of wide scope it is still in a preliminary stage. “First Leasing Company of India Ltd.,” was setup in the year 1973 as a lease finance company. The First Leasing Company had a monopoly till 1980, when the 20th Century Leasing Company was set up at Bombay. During 1980’s a new leasing company was incorporated in India almost every week. In 1984, the figure of leasing firms in India was around 150, in 1986 it rose to 500 and today it is estimated to be around 1500. During the same time some of the financial institutions like ICICI, IFCI and IRBI also entered the field of leasing. By considering the success of these financial institutions a number of state level development financial institutions also joined the race.

The Banking Laws Amendment Bill passed in 1982 permitted the Indian banks to setup subsidiaries for taking up leasing and hire purchase business which was then a forbidden area for them. Subsequently, a number of banks
floated their subsidiaries. Another interesting development was the permission granted to some foreign banks operating in India, to invest in some leasing and finance companies in India. The standard Chartered Bank was permitted to invest in Cholamandalam Investment and Finance Company and American Express was allowed to invest in Tata Industrial Finance Company Ltd.

A number of industrial houses also entered the fray by setting up in-house leasing companies. The main purpose, of course, behind such move was using one company as tax shelter for another. However, in a number of cases the motive was to boost the sale of products of group companies by using leasing as a "Sales-aid".

Today, leasing is emerging as an important supplementary source of finance. Lease financing has gained prominence due to a sudden surge of entrepreneurs. Lease financing is helpful for the establishment of small and medium sized units which generally face financial constraints. Banks and public sector units have diversified into leasing.

The leasing industry got a major boost when the government allowed leasing companies to raise public deposits and debentures equal to ten
times of their net worth ensuring that their cost of capital is low. Since then shares of leasing, hire purchase and finance companies have become popular among the Indian investors.

2.2 Non-Banking Financial Companies

The meaning of Non-Banking Financial Companies is to be understood in the wider perspective as they render financial services not only to members of society but to the business community catering their needs for investible funds. NBFCs render both fund based and non-fund based services. For fund based services they expect return on capital employed and for non-fund based services they get remuneration in the form of fees. Both types of services rendered by NBFCs are generally recognised as financial services.

It is difficult to trace the origin of non-banking finance activities or services rendered by them but it is stated in economic literature that Europe is the mother land of these services which developed as Kith and Kin to merchant banking services.

Today, the services rendered by the non-banking finance companies are extremely dynamic and challenging to meet the diverse need of corporate
enterprises. They are grossly involved in the development and promotion of commerce and industry at home and across the borders.

2.3 Concept of Non-Banking Finance Company

Non-Banking Finance Company is a business entity whether incorporated under the companies act, 1956 or not which devotes its resources in providing to the society the financial services of various descriptions which are distinct from and uncomprared to normal banking services.

Non-Banking Finance Company has been defined vide clause (c) of section 45-I of Chapter III B of Reserve Bank of India Act, 1934 as “Non-Banking Institution” which carries on its business or part of its business any of the following activities, namely :-

i. the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

ii. the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
iii. letting or delivering of any goods to a hirer under a hire-purchase
agreement as defined in clause (l) of section 2 of the Hire Purchase Act,
1972 (26 of 1972);

iv. the carrying on of any class of insurance business;

v. managing, conducting or supervising, as foreman, agent in any other
capacity, of chits or kuries as defined in any law which is for the time being
in force in any State, or any business, which is similar thereto;

vi. collecting, for any purpose or under any scheme or arrangement by
whatever name called, monies in lumpsum or otherwise, by way of
subscriptions or by sale of units, or other instruments or in any other
manner and awarding prizes or gifts, whether in cash or kind, or disbursing
monies in any other way, to persons from whom monies are collected or to
to any other person.

But does not include any institution, which, -

i. is an industrial concern as defined in clause (c) of section 2 of the Industrial
Development Bank of India Act, 1964 (18 of 1964), or

ii. carries on as its principal business, -
a. agricultural operations; or

b. the purchase or sale of any goods (other than securities) or the providing of any services; or

c. the purchase construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

d. "firm" means a firm as defined in the Indian Partnership Act, 1932 (9 of 1932);

e. "Non-Banking Institution" means a company, corporation or cooperative society.

2.4 Definition of Non-Banking Finance Company

Non-Banking Finance Company has been defined under clause (l) of paragraph 2 (1) of Non-Banking Financial Companies (Reserve Bank) Directions, 1977 as under:
"Non-Banking Financial Company" means any hire-purchase finance, investment, loan or mutual benefit financial company and an equipment leasing company (but does not include an insurance company or a stock exchange or stock-broking company; [2 (1) (l)]

2.5 Nature of Non-Banking Financial Company’s Services

Non-Banking Finance Companies have been providing services which are compared to banks. Non-banking finance companies provide opportunities to savers of funds to deploy them to earn handsome return thereon and meet the requirements for investible funds of different sectors of the business community. Their activities therefore, do affect the monetary and credit objects of the policies of the Central Banks as well as the Central Government.

Besides, the non-banking finance companies are currently engaged in number of financial activities like equipment leasing, hire-purchase, instalment credit, suppliers credit, buyers credit, overseas or cross border leasing, housing finance besides mobilisation of deposits from the public and the deployment of such deposits into productive investible channels.
Thus, non-banking finance companies play an important role in the economy if a country and industry in mobilisation of resources to cater the needs of growing economy and meet the economic aspirations of the society.

The following table shows the deposits with the Non-Banking Corporate Sector.

Table No. 2.1
Table showing Deposits with the Non-Banking Corporate Sector

(Rs. In Crores)

<table>
<thead>
<tr>
<th>Category</th>
<th>1990-91</th>
<th></th>
<th>1991-92</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of reporting companies</td>
<td>Regulated Deposits Rs.</td>
<td>Exempted Deposits Rs.</td>
<td>Total Rs.</td>
</tr>
<tr>
<td>Aggregate deposits of which held by</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Non-Financial Companies</td>
<td>2367</td>
<td>4618</td>
<td>21829</td>
<td>26447</td>
</tr>
<tr>
<td>(23.3)</td>
<td>(58.4)</td>
<td>(58.4)</td>
<td>(58.4)</td>
<td>(18.7)</td>
</tr>
<tr>
<td>ii. Financial Companies</td>
<td>6663</td>
<td>2013</td>
<td>14589</td>
<td>16602</td>
</tr>
<tr>
<td>(65.5)</td>
<td>(25.5)</td>
<td>(39.1)</td>
<td>(36.7)</td>
<td>(67.5)</td>
</tr>
<tr>
<td>iii. Miscellaneous Non-Banking Companies and Residuary Non-Banking Companies</td>
<td>1136</td>
<td>1276</td>
<td>936</td>
<td>2212</td>
</tr>
<tr>
<td>(11.2)</td>
<td>(16.1)</td>
<td>(2.5)</td>
<td>(4.9)</td>
<td>(13.8)</td>
</tr>
</tbody>
</table>
It is explained from the above table that during 1991-92, the aggregate deposits of reporting non-banking finance companies registered an increase of Rs. 8,298 crore (18.3 per cent) from Rs. 45,261 crore held by 10,166 companies in 1991 to Rs. 53,559 crore held by 12,817 companies in 1992. The total regulated deposits of the reporting companies went up by Rs. 1,362 crore, while the exempted one by Rs. 6,936 crore. Non-financial Companies accounted for 52.8 per cent of aggregate deposits while financial companies accounted for 41.5 per cent. The regulated deposits held by the non-banking sector was equivalent to 4.0 per cent of the aggregate deposits of all scheduled commercial banks as on March 20, 1992.
materials planning and purchase, has been stressed by A. Wahi. (Lok Udyog - August - 1980).

Attention has been drawn to the rather neglected area of material handling in Lt. Gen. Banga’s ‘Importance of Material Handling in Corporate System’ (Log Udyog - September 1980), wherein he identifies material handling as a key result area and discusses its potential.

Dr. Parkash has argued that the case for Credit Squeeze vis-a-vis ‘Unused Inventories in Central Government Enterprises’ (Lok Udyog - December 1978 and January 1979). Asserting that under effective management, inventories should move in square root relationship with sales/usage. Dr. Parkash contends that if management efforts over the decade had been successful in controlling the inventories at a level determined by square-root relationship, under ‘Laboratory controlled’ Conditions of 1966, the public enterprises would have had nearly 64 per cent of less total inventories in the terminal year (1976) without having any adverse impact on production. This observation is of major important to keen researchers.
Dr. Vijayasaradhi and Rajeswar Rao have enquired into the 'Management of Advances of Public Enterprises in India' (Lok Udyog - January 1980) and suggested measures to contain their levels. It is revealing that as much as 50 to 100 per cent of cash credit and working capital loan from Government constitute advances, which in many cases are typical instance of high cost acquisition and low cost disposal of funds. The same authors have also made out a strong case for decentralised 'Cash Management in a Multi-Division Enterprise' (Lok Udyog - October 1980), spelling out the sizable benefits accruing therefrom.

Dr. Verma in his study "Management of working capital in Iron and Steel Industry in India" has compared the public sector units like steel authority of India Ltd., (SAIL) and its constituent plants, namely, Rourkela Steel Plant (RSP), Bhilai Steel Plant (BSP), Durgapur Steel Plant (DSP), Indian Iron and Steel Company (IISCO) with the only private sector, Tata Iron and Steel Company Limited (TISCO).

In his study, "Management of Working Capital" Mr. Praveen Kumar Jain has analysed the working capital management of seven paper companies which includes two public sector companies viz., National Newsprint and Paper

Mr. Ramamorthy in his 'Working Capital Management' has compared the working capital management of 16 Industries ranging from Tea Plantations to Cement Industry.

All these are related to the working capital management of specific companies or in general. To regularise the use of bank credit in industries, Government of India has constituted three committees namely Dahejia Committee, Tandon Committee and Chore Committee.

An attempt to regulate Non-Banking Finance Companies was started in the sixties. Regulations of these institutions was found necessary for the following three reasons, viz., (i) ensuring efficacy of credit and monetary policy, (ii) safeguarding depositor's interest and (iii) ensuring healthy growth of Non-Banking Finance Institutions. Thus, the Banking Laws (Miscellaneous Provisions) Act, 1963 was introduced to regulate the Non Banking Financial
Institutions. Subsequently, to enable the regulatory authorities to frame suitable policy measures, several committees were appointed from time to time to conduct in-depth study of these institutions and make suitable recommendations for their healthy growth within a given regulatory framework. Each committee has made recommendations considering the contemporary financial scenario. Their suggestions have become the basis for the formulation of policy measures by the regulatory authorities.

The examination of the role and operations of Non Banking Financial Institutions constituted a part of the Terms of Reference of the Banking Commission (1970), which in turn appointed a sub-group under the chairmanship of Dr. Bhabatosh Datta for the study of this particular segment of the system. The group observed that Non Banking Financial Institutions are usefully supplemented by the activities of banks in the fields of both deposit mobilisation and lending and that they are capable of playing a dynamic role in the economy. The group also observed that despite the miniscule size of their operations as compared to that of the banking sector, there was a need to regulate the activities of Non Banking Financial Institutions for ensuring the safety of depositors' funds and...
efficacy of the credit policy on one hand and encouraging their orderly growth on the other.

In the year 1974, another study group was constituted under the chairmanship of Shri James S. Raj for the purpose of reviewing the provisions of the RBI Act relating to Non Banking Finance Companies, the directions issued there under and for examining the adequacy thereof, in the light of the recommendations of the Banking Commission. After assuming the performance of Non Banking Finance Companies the study group recommended that the situation prevailing at that time called for regulation and not prohibition of deposit acceptance by these companies.

Chakravarthy Committee (1987) attributed the emergence and growth of Non Banking Finance companies to the need for provision of finance to activities which were not served by the organised banking system. The committee was of the view that Non-Banking Finance companies had a role to play in the economic development of the country. Therefore, regulations aiming at Non-Banking Finance companies should curb that part of their activity which was not in conformity with the credit policy but not that which genuinely helped
activity was allowed to grow without adequate control. JPC has recommended amendments to existing laws or a separate legislation to control the deployment of funds by non-banking financial companies.